Handling Charitable Bequests and Charitable Trusts

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I. [11.1] INTRODUCTION

More people are extending their lifetime charitable and philanthropic interests into their estate plans. Many involve their children in such plans. The estate or trust gift to charity is motivated by charitable goals and the desire to include the children in their goals. Sometimes the inclusion of a charity as a beneficiary is recognized as something that enhances income or estate tax planning. In some circumstances, the estate charitable gift is designed to pass control of future charitable giving to one’s natural children — a charitable inheritance. For example, one may look at an individual retirement arrangement (IRA) as being heavily burdened by estate and income tax and choose to give the retirement account to a private family foundation that can be managed by the children or a donor-advised fund that can be directed by the children. By establishing and funding this foundation, the patriarch or matriarch has avoided heavy taxation and also given to his or her children the opportunity to manage the foundation. Estate gifts to charity are becoming more frequent, and the practitioner will encounter more of them in the administration of estates and trusts. Unfortunately, it is not unusual to have testamentary charitable gifts that do not qualify for the estate tax charitable deduction or are otherwise not tax efficient.

Dealing with a charity beneficiary is different because the charity is an entity and not a person. The charity beneficiary is most often a corporate entity that is governed by a board of directors and its officers. Sometimes the charity beneficiary is a trust. The ultimate beneficial interest of a charity beneficiary is a public interest and not an identifiable person.

A charity beneficiary is an organization qualifying for income tax exemption under §501 of the Internal Revenue Code (Code) and is accountable to the Attorney General of the state in which it is organized and conducts business activities.

NOTE: For the purposes of this chapter, the use of the term “charity beneficiary” presumes that the charity qualifies as a charitable organization within the meaning of Code §2055(a) and the receipt of its property interest qualifies the decedent’s estate for an estate tax charitable deduction.

This chapter covers the unique requirements of handling a testamentary gift to a charitable organization, including

a. confirming (1) the identity of the entity as the one intended by the donor, (2) the type and good standing of the charitable organization’s entity, (3) who within the organization is empowered to act on its behalf, and (4) its status as an organization qualifying for the estate tax charitable deduction;

b. identifying what estate property interest is the subject of the charitable gift and the opportunities or problems associated with that type of property interest;

c. confirming that the nature of the estate gift to the charity beneficiary qualifies the estate for an estate tax charitable deduction under Code §2055 and whether the gift wholly or partially qualifies for the estate tax charitable deduction;
d. determining what administration expenses or death taxes may be charged against the charitable gift that may affect the estate tax charitable deduction;

e. considering income tax consequences unique to handling an estate or trust that contains a charitable deduction asset;

f. registering the charitable estate or trust gift interest with the Illinois Attorney General;

g. conceptualizing available opportunities to enhance the effects of the charitable gift; and

h. during the initial phase of estate administration, identifying the not-so-obvious traps that may affect the charitable gift.

II. INITIAL CONFIRMATIONS

A. [11.2] Reviewing All Documents

It is not condescending to emphasize that a thorough review of all of the estate documents is essential to the proper handling of the beneficiaries and their interests. We know how important it is to determine early whether a disclaimer may be appropriate. Similarly, the sooner you have identified that there exists a gift to a charitable organization and its nature, the better you will be able to handle its unique considerations. The documents to acquire and review immediately for clues to charity beneficiaries include recent income tax returns, gift tax returns, the will and codicils, revocable living trusts, irrevocable trusts, beneficiary designations, payable-on-death (POD) and transfer-on-death (TOD) designations, annuities and gift agreements, and charitable pledge agreements. You cannot assume that charity beneficiaries can be identified only by looking at the will and living trust. Frequently, the estate charitable gift is made outside of the will and any living trust.

B. [11.3] Confirming Identity, Type, and Good Standing of Charitable Entity

You start the administration process by identifying and confirming the identity of the charity beneficiary. Just as a natural person may change his or her name and address (e.g., through marriage), a charitable entity can change its name, move, merge, or cease existence. Too often the person creating the gift document was not precise enough in identifying the charity beneficiary. Unlike a natural relationship, a testamentary donor’s intention towards a charity beneficiary may be much more remote than his or her lifetime activities and interests would indicate.

Just as you would confirm that a natural beneficiary is living and competent, you need to confirm the nature of the charity beneficiary’s entity status. Is it a trust, corporation, association, or governmental agency? What evidence do you have of its existence? Is the entity in good standing to conduct its affairs?

The charity beneficiary is a public interest in the form of a trust, corporation, association, or governmental agency. You should determine who is empowered to interact with the estate and sign the appropriate estate documents. You may need to review the charity beneficiary’s trust provisions, its bylaws, directors’ minutes, and other governing documents and obtain necessary certifications from its officers or governing body. The sooner you know who can legally act for the charity beneficiary, the smoother the estate administration will go.

For estate tax purposes, if an inappropriate person receives the gifted property, the charitable deduction may be disallowed. For example, a priest under a vow of poverty in a religious order does not himself qualify for a qualified charitable gift. The gift must be to the religious order, although the priest might be able to accept it on behalf of the religious order. Rev.Rul. 68-459, 1968-2 Cum.Bull. 411.

D. [11.5] Confirming Organization’s Status as Qualifying for Estate Tax Charitable Deduction

Whether the charity beneficiary is defined as an organization in Code §2055(a) and is already determined by the IRS as being so will have significant impact on estate tax considerations in administering the estate. Estate tax is payable nine months from the decedent’s death. Do not assume that a “charitable” beneficiary automatically qualifies the estate for an estate tax charitable deduction.

Except for a religious association (church, temple, etc.) or a form of government, the charity beneficiary should be able to provide you with a copy of the IRS letter that determined its qualification as a tax-exempt entity and for which deductions it qualifies. You should obtain a copy of this letter.

The IRS maintains a list of organizations it has qualified as tax-exempt and the nature of deductions for which each organization qualifies. This list is contained in its Publication 78, Cumulative List of Organizations, which is available online at www.irs.gov/charities/article/0,,id=96136,00.html. Note that the estate tax charitable deduction is governed by Code §2055 and not §501 or §170, so your inquiry as to qualification for tax-exempt status is in reference to §2055.

If you are dealing with a private foundation, greater care is necessary to ascertain whether it has been operating in accordance with requirements for a private foundation.

III. [11.6] Identifying What Estate Property Interest Is Subject of Charitable Gift

Sections 11.2 – 11.5 above focus on identifying whether there is a gift to a charity beneficiary, who is the charity beneficiary, and whether the charitable organization actually qualifies the estate for an estate tax charitable deduction. Sections 11.7 – 11.10 below identify gifted property and consider the nature of the gifted property.
§11.7

I. Quality of Charitable Gift

What is the charity beneficiary actually going to receive? What is its quality? The question is not whether the gift is valuable but whether it is of specific, identifiable property (e.g., an account, a stock, or a parcel of real estate), a specified amount of money (a pecuniary gift), or a percentage of a specified asset or of the residue of the estate. The answers may have implications for how the asset is managed during administration and what the net economic effect is to the estate and all the beneficiaries, both charitable and non-charitable.

1. Specific Property

A gift of specific property to a charity beneficiary most often will be through a beneficiary or a payable-on-death designation. The charity will receive the particular property interest and any income, and its tax characteristics will flow to the charity. This beneficiary designation vests the property in the charity beneficiary as a nonprobate asset. Even though the property is not subject to probate, the nature of the charity and the property may have significant effects on the estate, the other beneficiaries, and the taxes ultimately due. For example, an individual retirement arrangement that is paid to a charity beneficiary should reduce estate taxes by reason of the estate tax charitable deduction and also avoid income tax by reason of the realization of income by the tax-exempt nature of the charity. A charity named as the death beneficiary of an IRA or qualified retirement plan is a qualifying charitable transfer. Pvt.Ltr.Rul. 199939039 (June 30, 1999).

If the will or trust gives a specific item of property, then the executor or trustee has hands-on control of the gifted property until it is delivered to the charity beneficiary. If the charitable gift does not pass through the will or trust, the estate’s executor (whether the probate executor or the executor as defined for Internal Revenue Code purposes) will nevertheless have responsibilities for payment of taxes, equitable apportionment, and tax elections relating to the charitable gift.

2. Pecuniary and Percentage Gifts and Income in Respect of a Decedent

A specified dollar amount is the simplest kind of gift. However, what property actually is used to pay the gift has an impact on the estate and its beneficiaries. Similarly, a gift of a percentage or fraction of a specified property or residue needs more handling and consideration. For each of these types of gifts, the use of the income in respect of a decedent (IRD) income tax class of property has important implications.

It is important to identify an IRD income tax class of asset under Code §691 early in the administration of an estate or trust to evaluate traps or opportunities pertaining to this kind of property. See §§11.52—11.54 below.

B. Wholly Charitable or Split-Interest Gift

Most often a gift to a charity beneficiary simply says that the charitable organization receives its property interest outright. Sometimes, however, the interest is layered along with a non-charity beneficiary’s interest in the same property.
If the gift property is given wholly outright to the charity, then its administration should be straightforward and the tax implications more readily determined. When it’s done, it’s done.

If the gift is layered or blended with an interest of a non-charity beneficiary, then further review is necessary to determine what, if any, of the gift to the charity beneficiary will qualify the decedent’s estate for an estate tax charitable deduction. If a gift is of a wholly charitable interest, then you probably need not look further than Code §2055 for qualification for the estate tax charitable deduction. If a gift is other than a wholly charitable interest (i.e., a split-interest gift), then you also need to explore whether the gift qualifies under Code §664 and what portion of the gift is deemed qualified for charitable purposes.

Only that portion of a split-interest gift that qualifies as charitable under Code §664 will qualify as an estate tax charitable deduction under Code §2055. These qualified split-interest charitable gifts are commonly referred to as charitable remainder trusts, charitable lead trusts, and pooled income funds. You also need to be on the lookout for other gift interests, such as gift annuities, qualified life estates, conservation easements, and copyrights separate from works of art. See Ch. 10, Administration of Charitable Trusts, TRUST ADMINISTRATION (IICLE, 2008), for a full discussion of split-interest charitable gifts.

For example, if a trust is established whereby a non-charity beneficiary has a lifetime beneficial interest based on a discretionary spray provision with the remainder going to a qualified charity beneficiary, none of the trust actually passing to the remainder charity beneficiary will qualify for a tax deduction because it is not qualified under both Code §§664 and 2055.

IV. [11.11] ESTATE TAX CHARITABLE DEDUCTION — CODE §2055

An important part of administering an estate that has a charity beneficiary is to confirm the extent to which the estate qualifies for an estate tax charitable deduction under Code §2055.


Like the marital deduction, the charitable deduction is unlimited to the extent that the charitable gift is qualified under Code §2055. There is no distinction for the estate tax charitable deduction as to whether the charity beneficiary is a private foundation or a public charity. The income tax limitations for a charitable deduction (commonly referred to as the 50-percent, 30-percent, and 20-percent limitations) are not relevant for estate tax charitable deduction purposes. Treas.Reg. §20.2055-1(a).

B. [11.13] Qualified Charity

One of the criteria for an estate to be entitled to the charitable estate tax deduction is that the recipient must be an eligible charity under Code §2055(a). For example, in Estate of Starkey v. United States, 223 F.3d 694, 697 (7th Cir. 2000), the taxpayer ultimately prevailed, but the IRS fought that the class of beneficiaries included persons who might not be qualified charities — “missionaries preaching the Gospel of Christ.”
Code §2055(a) sets forth five classes of qualified charitable organizations:

1. the United State government and its political subdivisions, including any state, any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

2. any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), and 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), that is not disqualified for tax exemption under Code §501(c)(3) by reason of attempting to influence legislation and that does not participate or intervene in (including the publishing or distributing of statements) any political campaign on behalf of or in opposition to any candidate for public office;

3. a trustee or trustees or a fraternal society, order, or association operating under the lodge system, but only if the contributions or gifts are to be used by the beneficiary exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals, if the beneficiary would not be disqualified for tax exemption under Code §501(c)(3) by reason of attempting to influence legislation and if the beneficiary does not participate or intervene in (including the publishing or distributing of statements) any political campaign on behalf of or in opposition to any candidate for public office;

4. any veterans’ organization incorporated by act of Congress or local chapters or posts of a veterans’ organization, no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

5. an employee stock ownership plan (ESOP) if the transfer qualifies as a qualified gratuitous transfer of qualified employer securities within the meaning of Code §664(g).

There is no requirement that the charity beneficiary be in existence at the time of the decedent’s death. Estate of Smith v. Commissioner, 20 T.C.M. (CCH) 1268 (1961); Buder v. United States, 7 F.3d 1382 (8th Cir. 1993). Therefore, a gift to a testamentary foundation should qualify for the charitable deduction. What is necessary for an estate tax charitable deduction is a valid and effective transfer of property, before or at death, to or for a qualified recipient or purpose. Treas.Reg. §20.2055-1(a).

**PRACTICE POINTERS**

✓ Look for a fail-safe provision in the governing documents that essentially expresses, “I give the following sums to such of the following beneficiaries as are described in §§170(c) and 2055(a) of the Internal Revenue Code of 1986, as amended: . . . .”
Ascertain the qualifying status of each charitable organization. Two common ways to ascertain the tax status of a charity are (1) asking the organization for proof of its tax classification by the IRS and (2) checking IRS Publication 78, Cumulative List of Organizations, which is available on the Internet at www.irs.gov/charities/article/0,,id=96136,00.html.


Only gifts of property that are included in the gross estate of the deceased donor qualify for a charitable estate tax deduction. Consequently, the charitable tax deduction will not be greater than the value of the property that is included the gross estate. Code §2055(d); Treas.Reg. §20.2055-1(a); Rev.Rul. 54-90, 1954-1 Cum.Bull. 194. Therefore, an estate tax charitable deduction will not be allowed if the gift to the charity beneficiary is funded from (1) an irrevocable life insurance trust, (2) a “B” or “family” or credit shelter trust, or (3) an exercise of a testamentary special power of appointment. These funding sources are not a part of the donor-decedent’s gross estate and therefore do not qualify for an estate tax charitable deduction.

Property included in the decedent’s gross estate by reason of the decedent holding a general power of appointment that is received by a charity beneficiary through its appointment or lapse of appointment (a taker-in-default) is considered a gift by the decedent holding the power. Code §2055(b); Treas.Reg. §20.2055-1(b); Code §2041; Rev.Rul. 54-90, 1954-1 Cum.Bull. 194; Estate of Flanigan v. Commissioner, 743 F.2d 1526 (11th Cir. 1984); Estate of Hall v. Commissioner, 63 T.C.M. (CCH) 1951 (1992); Estate of Miller v. Commissioner, 400 F.2d 407 (3d Cir. 1968); Estate of Lande v. Commissioner, 21 T.C. 977 (1954). See §§11.25 and 11.26 below for qualifying qualified terminable interest property and qualified domestic trusts for both the marital deduction and the charitable deduction.


Only a gift by the decedent, but not his or her beneficiaries, qualifies for an estate tax charitable deduction. Estate of Kirkwood v. Commissioner, 23 B.T.A. 955 (1931); McFarland v. Campbell, 213 F.2d 855 (5th Cir. 1954).

An estate is not entitled to a charitable deduction when the bequest is to a non-charity beneficiary who predeceased the decedent (and yet still takes from the decedent) and the deceased beneficiary left all of his or her property to charity, thereby resulting in an indirect bequest to charity by the decedent. Estate of Pickard v. Commissioner, 60 T.C. 618 (1973), aff’d, 503 F.2d 1404 (6th Cir. 1974). The decedent must articulate charitable intentions in the testamentary instrument.

A charitable deduction is allowed when a contingent charity beneficiary receives a testamentary gift that takes effect if a primary beneficiary does not survive the decedent. Sullivan v. United States, 113 F.Supp. 749 (D.Mass. 1953), aff’d, 213 F.2d 765 (1st Cir. 1954).
A charitable gift as a result of a qualified disclaimer is treated as passing directly from the
decedent (not from the disclaimant) to the charity. Code §2518; Treas.Reg. §25.2518-1(b).

E. [11.16] Insufficient Estate

If the funds in the estate are insufficient to permit payment of a charitable bequest, no
deduction is allowed even if assets are advanced by an inter vivos trust and the charity beneficiary
is actually paid. Estate of Dorsey v. Commissioner, 19 T.C. 493 (1952); Estate of Hohensee v.
Commissioner, 25 T.C. 1258 (1956); Estate of Bob v. Commissioner, 4 T.C.M. (CCH) 592
(1945). There must be funds available for payment of the charitable bequest to receive the
charitable tax deduction.

PRACTICE POINTER

✓ There should be a review of the funding sources for the charitable gift to make certain
that funds will be available for payment of the charitable gift; otherwise, the charitable
tax deduction will be lost, resulting in no charitable gift or a gift reduced by taxes.


The available charitable tax deduction is subject to reduction (increasing estate tax) if the
charitable gift is reduced by taxes or expenses. Code §2055(c); Treas.Reg. §20.2055-3; Harrison
v. Northern Trust Co., 317 U.S. 476, 87 L.Ed. 407, 63 S.Ct. 361 (1943); Alston v. United States,
349 F.2d 87 (5th Cir. 1965); Estate of Horne v. Commissioner, 91 T.C. 100 (1988); Estate of
McKay v. Commissioner, 68 T.C.M. (CCH) 279 (1994); Estate of Bradford v. Commissioner,
84 T.C.M. (CCH) 337 (2002). In other words, the estate can deduct only the amount that the charity
actually receives or the amount actually available for charitable uses.

1. [11.18] Charging Estate Tax and Administration Expenses

If estate or inheritance taxes are wholly or partly payable out of the bequests, legacies, or
devises otherwise deductible under Code §2055, then the deduction is the sum of the bequests,
be reduced by administration expenses chargeable against the residue. Code §2055(c); Treas.Reg.
§20.2055-3; Rogan v. Taylor, 136 F.2d 598 (9th Cir. 1943); Rev.Rul. 73-98, 1973-1 Cum.Bull.

This results in a circular estate tax calculation. The payment of taxes or expenses from a
charitable bequest reduces the bequest, thus reducing the charitable deduction, thus increasing the
tax, thus reducing the charitable bequest, etc., thus going around and around in a complicated
circular calculation of estate taxes. There are computer programs that make this complicated
calculation. The computation of the deduction needs to be disclosed on the estate tax return.
Treas.Reg. §20.2055-3(a).
PRACTICE POINTER

✓ If the gift to the charity beneficiary would, in the typical handling of the estate, be charged with taxes and administration expenses (e.g., the charity beneficiary is a residuary beneficiary), look for a provision in the will or trust that essentially expresses, “I direct that no death taxes of any description due because of my death (or any interest or penalties thereon) or expenses of administering my estate shall be payable from these [charitable] gifts.” Such language should save the estate from the circular estate tax calculation.

However, if the residuary charitable bequest is not reduced because interest on estate taxes is paid from postmortem income, then the full charitable deduction can remain. *Estate of Street v. Commissioner*, 974 F.2d 723 (6th Cir. 1992), aff’d *in part*, rev’d *in part* 56 T.C.M. (CCH) 774 (1988). Treas.Reg. §20.2055-3(b) (effective for estates of decedents dying on or after December 3, 1999) provides that the estate management expenses attributable to, and payable from, the property interest passing to the charity do not reduce the value of the property interest. However, the allocable amount of the charitable deduction is reduced by the amount of these management expenses if they are deducted on the federal estate tax return.


Although administration expenses are chargeable to the estate, the executor has the option of electing the expenses as a deduction from either income or estate tax. Code §642. A decision to declare administration expenses as an income tax deduction may disadvantage the estate by increasing its estate tax liability. *Republic National Bank v. Commissioner*, 334 F.2d 348 (5th Cir. 1964); *Estate of Luehrmann v. Commissioner*, 287 F.2d 10 (8th Cir. 1961). See §§11.48 and 11.49 below, relating to the effects of the executor’s election under Code §642(g) and Treas.Reg. §20.2056(b)-4.


There may be assets that by their nature are valued differently for inclusion in the gross estate than for purposes of the charitable deduction. This may result in an unanticipated estate tax because the charity receives an asset valued less than its value as included in the gross estate.

Consider circumstances in which voting and nonvoting stock are valued as a block for purposes of determining the gross estate but only the nonvoting stock is actually received by the charity. A lesser value may be assigned to the nonvoting stock for purposes of the charitable deduction. So the value of the assets for estate tax inclusion purposes can be different from the value for charitable deduction purposes. *Estate of Curry v. United States*, 706 F.2d 1424 (7th Cir. 1983); *Ahmanson Foundation v. United States*, 674 F.2d 761 (9th Cir. 1981); *Estate of Schwan v. Commissioner*, 82 T.C.M. (CCH) 168 (2001). This could also hold true when stock is valued for estate tax purposes at a greater value than the value provided for by the terms of a stock repurchase agreement (in situations in which the IRS can ignore the stock repurchase agreement).

A gift to an eligible charity for non-charitable purposes may lose its deduction. Code §§2055(a)(2), 2055(a)(3); Treas.Reg. §20.2055-1. For example, the IRS disallowed a charitable deduction for a scholarship fund that was limited to recipients with the same surname as the decedent. Tech.Adv.Mem. 9631004 (Apr. 30, 1996). See also Griffin v. United States, 400 F.2d 612 (6th Cir. 1968). A bequest that is benevolent, but not for a charitable purpose, does not qualify for the estate tax charitable deduction, such as a gift to a class of students at a school without specific educational purpose. Rev.Rul. 57-449, 1957-2 Cum.Bull. 622.

PRACTICE POINTERS

✓ Caution must be exercised for gifts to a charity earmarked for creative uses that may go beyond a charitable purpose, are restricted from the charity’s tax-exempt purpose, or may provide some private inurement.

✓ Look for a fail-safe provision in the governing document that essentially expresses, “I give the following sums to such of the following beneficiaries as are described in §§170(c) and 2055(a) of the Internal Revenue Code of 1986, as amended, or their current counterparts at the time of my death . . . to be used for their general charitable purposes.”

H. [11.22] Power To Choose Charitable Beneficiaries

If a third person (such as an executor or trustee) is given the power to select charity beneficiaries from the class that qualifies for the charitable deduction and the amount of the charitable gift is ascertainable at the time of decedent’s death, the third party can give amounts or portions to various charity beneficiaries, and the gifts will qualify for the charitable deduction. Rev.Rul. 69-285, 1969-1 Cum.Bull. 222; Rev.Rul. 81-20, 1981-1 Cum.Bull. 471; Marine Midland Trust Company of Southern New York v. McGowan, 223 F.2d 408 (2d Cir. 1955); Dulles v. Johnson, 273 F.2d 362 (2d Cir. 1959), cert. denied, 81 S.Ct. 54 (1960); Pvt.Ltr.Rul. 9331015 (May 6, 1993). It does not matter whether the charitable gift is an amount, a specific asset, a portion of an asset, or a portion of the residuary estate. What is necessary is that the class from which the charity beneficiaries may be selected is restricted to those that qualify for a deduction under Code §2055(a) and that the amount of the charitable gift is otherwise ascertainable at the time of the decedent’s death.

PRACTICE POINTERS

✓ Note that charities are defined somewhat differently for income tax purposes (Code §170) and estate tax purposes (Code §2055(a)). Code §2055(a) lists employee stock ownership plans as qualified organizations. The listings of qualified organizations under §2055(a) allow contributions to foreign governments and political subdivisions if the use is restricted exclusively for charitable purposes. Rev.Rul. 74-523, 1974-2 Cum.Bull. 304.

Look for a fail-safe provision in the governing document that essentially expresses, “I direct my executor to distribute the sum of $__________ to and among such one or more organizations and in such proportions as my executor selects to carry out my general charitable intent, provided each such organization shall be described in §§170(c) and 2055(a) of the Internal Revenue Code of 1986, as amended, or their counterparts at the time of my death. I further direct that no death taxes of any description due because of my death (or any interest or penalties thereon) or expenses of administrating my estate shall be payable from these gifts.”

I. [11.23] Indefinite or Discretionary Testamentary Gifts

If an executor is granted discretionary authority to make charitable gifts, that mere authority is insufficient to support a charitable deduction. Delbridge v. United States, 89 F.Supp. 845 (E.D.Mich. 1950). Further, a mandate to make charitable gifts that does not specify the amount or the charity will not qualify for the charitable deduction. Rev.Rul. 55-335, 1955-1 Cum.Bull. 455. If the executor or trust has the discretion to give to other than a qualified charity organization, then to that extent, there will be no charitable deduction allowed even if charitable organizations actually receive the estate assets.

Estate of Marine v. Commissioner, 990 F.2d 136 (4th Cir. 1993), aff’g 97 T.C. 368 (1991), is a fascinating study of how easy it is to inadvertently miss the target in its entirety. Mr. Marine had an estate worth approximately $2.1 million, of which he bequeathed one half to Princeton University and one half to Johns Hopkins University, both qualified charitable organizations. Mr. Marine asked his attorney to prepare a codicil that would give the executor the power to recognize the efforts of a few special people who were caring for him in his final days. Mr. Marine amended his will, providing:

I empower my Personal Representatives, in their sole and absolute discretion, to compensate persons who have contributed to my well-being or who have been otherwise helpful to me during my lifetime by allocating to each of them such items of tangible personal property, or by transferring securities, or by giving them cash, or any combination of tangible personal property, securities or cash, as my Personal Representatives determine is a fair bequest for services rendered. My Personal Representatives shall take into account the length and nature of such services and the spirit in which such services were rendered on my behalf throughout the period of such contribution to my well-being. No single bequest, however, shall exceed one percent (1%) of my gross probate estate, but may be considerably less. The decision of my Personal Representatives as to both the amount of a bequest and what it shall consist of shall be final. 990 F.2d at 137.
After Mr. Marine’s death, the personal representatives exercised their discretion and gave $10,000 to the housekeeper and $15,000 to a companion. The remaining estate of approximately $2.1 million was actually given to the charity beneficiaries.

The court ruled that there was no estate tax charitable deduction! Why? Because the personal representative had authority to give away 100 one-percent shares, the entire estate could have been given to non-charity beneficiaries. Because of this discretion to give (the amount of the charitable gift was not ascertainable as of Mr. Marine’s date of death) and because the qualified charities were not guaranteed a legacy, the charitable deduction was denied although qualified charities in fact received the remaining estate.

If the intent of a charitable purpose is clear and the amount is ascertainable at death, the executor or trustee may be given discretion for the actual purpose and application of the gift — again, as long as the discretion is constrained within an articulated charitable purpose. *Estate of Boyles v. Commissioner*, 4 T.C. 1092 (1945); Rev.Rul. 54-220, 1954-1 Cum.Bull. 65; *Markle v. Commissioner*, 28 B.T.A. 201 (1933).


A charitable deduction may be lost if there is a possibility that the property will not pass to the charity or may not be kept by the charity. *Commissioner v. Estate of Sternberger*, 348 U.S. 187, 99 L.Ed. 246, 75 S.Ct. 229 (1955); *United States v. Dean*, 224 F.2d 26 (1st Cir. 1955); *Estate of Moffett v. Commissioner*, 269 F.2d 738 (4th Cir. 1959). The charitable deduction is in jeopardy unless the possibility that the charitable gift will fail is so remote as to be negligible. Treas.Reg. §20.2055-2(b); Pvt.Ltr.Rul. 199903001 (Oct. 19, 1998). See Tech.Adv.Mem. 9443001 (Apr. 14, 1993), in which a gift of property to any governmental agency could be declared void by the executor if not accepted within nine months from the decedent’s death and thus was denied a charitable deduction.

K. Split-Interest Testamentary Gifts


The first decedent’s spouse gift in trust for the benefit of the surviving spouse often qualifies for the full marital deduction. Upon the surviving spouse’s death, the trust’s remainder charitable interest established by the first deceased spouse that passes to charity qualifies the second deceased spouse’s estate for the full charitable deduction. Marital deduction trusts followed by a gift to a charity beneficiary that qualify for full marital deduction and full charitable deduction include the following:

a. a marital trust with general power of appointment (Code §2055(b); Treas.Reg. §20.2055-1(b));

b. a qualified terminable interest property (QTIP) marital trust (Code §§2056(b)(7), 2044(b)); and

c. a qualified domestic trust (QDT) followed by a wholly charitable gift (Code §§2056(d)(2), 2056A(b)(10)).
2. **[11.26] Charitable Remainder Trusts and Pooled Income Funds**

Charitable remainder trusts and pooled income funds will qualify the estate for an estate tax charitable deduction to the extent that the charity beneficiaries are entitled to the present value of the remainder interest. Code §2055(e)(2); Treas.Reg. §20.2055-2(e)(2)(v). The charitable remainder trusts must be qualified under Code §664(d), and the pooled income funds must be qualified under Code §642(c)(5).

   a. **[11.27] Spouse with Lead Interest in Charitable Remainder Trust**

      A marital deduction for the value of the surviving spouse’s interest in a charitable remainder trust is allowed under Code §2056(b)(8) if the surviving spouse is the only non-charitable beneficiary of a qualified charitable remainder trust (being one defined as a “charitable remainder annuity trust” or “charitable remainder unitrust” in Code §664). Code §2056(b)(8)(B)(iii).

      The effect is that the entire value is deductible for estate tax purposes, part as a marital deduction and part as a charitable deduction. Nothing will be included in the estate of the surviving spouse under this kind of arrangement because the surviving spouse will not have transferred anything at death.

   b. **[11.28] Non-Spouse with Lead Interest**

      The rules governing split-interest bequests with a non-spouse are essentially the same as those governing similar lifetime gifts. Code §§2055(e)(2), 664, 642(c)(5).


      A successive life interest beneficiary of a split-interest trust will not qualify for the charitable deduction unless the trust instrument requires that the second life estate takes effect only if the non-charity beneficiary supplies the funds for payment of any death taxes that may be payable by reason of the decedent-donor’s death. Rev.Rul. 82-128, 1982-2 Cum.Bull. 71. This rule applies to trusts created after October 3, 1982. If the decedent-donor’s will apportions the death taxes from the split-interest trust, then the successive non-charity beneficiary is relieved of the actual tax liability.

3. **[11.29] Other Split-Interest Arrangements**

   The following may also be the subject of a split-interest arrangement that qualifies for the estate tax charitable deduction:

   a. a personal residence (Treas.Reg. §20.2055-2(e)(2)(ii));

   b. a farm (Treas.Reg. §20.2055-2(e)(2)(iii)); and

   c. an undivided portion of an entire interest in property (Treas.Reg. §20.2055-2(e)(2)(i)).
Works of art and their copyrights under federal law may be treated as separate property for the estate tax charitable deduction. Code §2055(e)(4).

Certain limited interests in real property given to appropriate organizations for purposes of recreation or scenic enjoyment, historical preservation, or environmental protection may qualify for the estate tax charitable deduction, separate from the real estate. Code §2055(f).

The court in *Harbison v. United States*, No. 1:98-CV-1675-BBM, 2001 U.S.Dist. LEXIS 5344 (N.D.Ga. 2001), held that notwithstanding the death of a non-charitable income beneficiary before the filing of a timely estate tax return, no charitable deduction was allowable for a defective split-interest trust because there was an actual invasion of principal for the benefit of the non-charitable beneficiary.

4. [11.30] Inadvertent Non-Qualified Split-Interest Arrangements

Being creative or imprecise with split-interest rules with a testamentary devise to a charity can inadvertently create a split-interest arrangement that will not qualify for a charitable deduction. *Galloway v. United States*, 492 F.3d 219 (3d Cir. 2007), involved a testamentary gift from the decedent’s revocable trust. Upon Mr. Galloway’s death in 1998, the trust terms identified the trust’s beneficiaries as four equal shares, two of which were charity and two of which were natural persons. The trust directed a distribution of one half of each equal trust share in 2006 and the remainder in 2016. However, the trust property remained single and undivided until the two distributions in 2006 and 2016. The executor took an estate tax charitable deduction for two charitable trust shares. On audit, the IRS denied the deduction, asserting the trust arrangements did not meet the split interest trust requirements under Code §2055(e)(2). The district court affirmed the denial, noting that the trust was created from one document and one set of property and was held for both individual and charitable beneficiaries. The Third Circuit Court of Appeals agreed, stating that the language of Code §2055(e)(2) clearly disallows any charitable deduction when an interest in the same property passes to both charitable and non-charitable beneficiaries.

L. Void or Voidable Testamentary Gifts


If local law holds a testamentary gift void, then no deduction is allowable. *Selig v. United States*, 73 F.Supp. 886 (E.D.Pa. 1947), aff’d, 166 F.2d 299 (3d Cir. 1948); *Estate of Riddle v. Commissioner*, 21 T.C. 1109 (1954). It does not matter if there is no objection to the void gift by the other beneficiaries. The gift then is deemed to pass from those who should have received it and not from the decedent. *Estate of Carey v. Commissioner*, 9 T.C. 1047 (1947), aff’d per curiam, 168 F.2d 400 (3d Cir. 1948).


If a testamentary gift is only voidable (rather than void) and there is no objection to the gift by the other beneficiaries, a deduction will be allowed for the expressed gift that is received by
the charity beneficiary. *Humphrey v. Millard*, 79 F.2d 107 (2d Cir. 1935); *Dimock v. Corwin*, 99 F.2d 799 (2d Cir. 1938); *Estate of Varick v. Commissioner*, 10 T.C. 318 (1948), acq., 1948-2 Cum.Bull. 4. In *Estate of Casey v. Commissioner*, 948 F.2d 895 (4th Cir. 1991), the court found a lifetime gift voidable because there was no specific grant of the power to gift and included the gift property in the gross estate pursuant to Code §2038, thus negating the annual gifting tax exclusions.

M. [11.33] Pledges

A lifetime pledge that is enforceable under local law is not deductible as an estate tax charitable contribution but is deductible under Code §2053 as a claim against the estate. To obtain the deduction, the pledge (1) otherwise must qualify for a charitable deduction if it had been fashioned as a testamentary gift and (2) must be enforceable under local law. Code §2053(c)(1)(A); Treas.Reg. §§20.2053-4, 20.2053-5; Pvt.Ltr.Rul. 9718031 (Feb. 4, 1997); *Estate of Sochalski v. Commissioner*, 14 T.C.M. (CCH) 72 (1955).

N. [11.34] Settlement Agreements and Estate Contests

There may be a charitable deduction if a settlement agreement is reached in situations in which (1) there was a bona fide dispute; (2) the charity beneficiary actually receives an estate distribution (the charitable deduction being limited to the amount received by the charity beneficiary); and (3) the distribution is not greater than the value the charity beneficiary would have received if there had been no dispute. “Value” in this context includes the monetary value, the nature of the property, and its characteristics for tax purposes. Treas.Reg. §20.2055-2(d); Rev.Rul. 77-491, 1977-2 Cum.Bull. 332; *Thompson’s Estate v. Commissioner*, 123 F.2d 816 (2d Cir. 1941); *Bach v. McGinnes*, 333 F.2d 979 (3d Cir. 1964); *Estate of Toulmin v. United States*, 462 F.2d 978 (6th Cir. 1972), aff’g 326 F.Supp. 1028 (S.D. Ohio 1971); *Ahmanson Foundation v. United States*, 674 F.2d 761 (9th Cir. 1981); *Estate of Brandon v. Commissioner*, 828 F.2d 493 (8th Cir. 1987); *Estate of Burdick v. Commissioner*, 96 T.C. 168 (1991); *Estate of Hubert v. Commissioner*, 101 T.C. 314 (1993), aff’d, 117 S.Ct. 1124 (1997).

TAM 201004022 (1/29/2010) concluded that property passing to charity as the result of a settlement agreement or lower court judgment will be treated as passing from the decedent to charity only if it is based on an enforceable right of the charity under state law, correctly interpreted. In this matter the charity interest arose because the charity was named in a previous will, the subsequent will was defective by having no residuary clause causing the estate to pass by intestacy law, and a settlement agreement with the intestacy legatee gave money to the charity but the actual receipt was not legally enforceable by reason of the will.

For greater discussion, see Ch. 17, *Family Settlement Agreements*, LITIGATING DISPUTED ESTATES, TRUSTS, GUARDIANSHIPS, AND CHARITABLE BEQUESTS (IICLE, 2009).

O. Notices of Termination of Tax-Exempt Status, Self-Dealing, Political Activities, and Other Disqualifications


No charitable deduction is allowed for the following transfers:
a. a transfer to or for the use of an organization or trust (either being a private foundation) described in Code §508(d) or §4948(c)(4) (Code §2055(e)(1));

b. a gift or bequest by any person after a Code §507(a) notification with respect to tax-exempt status termination by the organization to the Secretary or by the Secretary’s notice to the organization (Code §508(d)(1)(A));
c. a gift or bequest by a substantial contributor in the year the organization takes any action that culminates in imposition of Code §507(c) tax (Code §508(d)(1)(B)); and

d. a gift or bequest if the donee private foundation’s governing instruments do not have provisions that require income to be distributed each year (Code §4942) and prohibit (1) self-dealing (Code §4941(d)), (2) retaining excess business holdings (Code §4943(c)), (3) making speculative or jeopardy investments (Code §4944), and (4) making taxable expenditures (Code §4945(d)) (Code §508(e)).

2. [11.36] Tax-Exempt Status Has Not Been Recognized and Notice Is Given to Secretary That Tax-Exempt Status Is Being Sought

There is no charitable deduction when there is a gift or bequest to an organization not treated as an organization described in Code §501(c)(3) by reason of not giving timely notice to the Secretary that it is applying for recognition of tax-exempt status. Code §§508(d)(2)(B), 508(a). The notice must be filed within 27 months from the end of the month in which the organization was organized. The notice requirement is satisfied by filing IRS Form 1023 or Form 1024. Treas.Reg. §1.508-1(a)(2)(i). If timely notice is given, the Secretary’s granting of tax-exempt status relates back to the organization’s date of organization. If timely notice is not given, then the charitable deduction will be denied for gifts or bequests during the period of time that there is no appropriate notice.


There is no charitable deduction for a gift or bequest to a foreign organization (one that receives substantially all of its support from sources outside the United States) after the Secretary publishes notice that the Secretary has notified the organization that it has engaged in a prohibited transaction and that the organization is not tax-exempt under Code §501(a) by reason of engaging in a prohibited transaction. Code §4948(c)(4). Code §501(a) provides that an organization described in Code §501(c), §501(d), or §401(a) is exempt from taxation unless the exemption is denied under Code §502 or §503.

4. [11.38] Political Activity

No charitable deduction is allowed if the organization engages in activity that would cause it to be classified as an “action” organization under Treas.Reg. §1.501(c)(3)-1. These activities are generally recognized as attempts to influence legislation and to intervene in political campaigns.

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**PRACTICE POINTER**

Yes There should be confirmation that the charity beneficiary is one described in Code §2055(a) by obtaining its qualification letter and checking IRS Publication 78 (see the IRS website at www.irs.gov/charities/article/0,,id=96136,00.html). Also, consider soliciting from the charity beneficiary an affirmative statement that it is not one described in Code §508(d), Code §4948(c)(4), or Treas.Reg. §1.501(c)(3)-1.
P. [11.39] Evidence To Be Filed with Federal Estate Tax Return

In establishing the right of the estate to the charitable deduction, the executor should submit the following with the return:

1. a copy of any written instrument by which the decedent made a transfer of property in his or her lifetime, the value of which is required to be included in the gross estate, for which a charitable deduction is claimed (if the instrument is of record, the copy should be certified, and if not of record, the copy should be verified); and

2. a written statement by the executor containing a declaration that it is made under penalties of perjury and stating whether any action has been instituted to construe or to contest the decedent’s will or any provision thereof affecting the charitable deduction claimed and whether, according to the executor’s information and belief, any such action is designed or contemplated. Treas.Reg. §20.2055-1(c).

V. [11.40] Determining Charges or Allocations of Administrative Expenses and Death Taxes

As discussed in §11.18 above, if a gift to charity is reduced by tax and administration expense charges, the estate tax charitable deduction will be reduced to the amount that the charity beneficiary actually receives. Therefore, it is important to determine if administration expenses or estate taxes may be charged against the charitable gift. Know sooner rather than later, and avoid the surprise of higher than expected estate taxes due by a subsequent IRS notice of deficiency.


If the testator expresses his or her intentions with respect to who pays taxes and expenses, such intention controls. If no such intention is expressed, then equitable apportionment and rights of reimbursement takes place pursuant to state law and federal tax law. Generally, state law controls apportionment over federal law. Federal and Illinois taxes are handled the same. Except as provided in §§11.48 (the Code §642(g) election) and 11.49 (the application of Treas.Reg. §20.2055-3(b)) below with respect to those two federal tax apportionment exceptions, administration expenses are generally handled the same as estate taxes.

B. [11.42] Equitable Apportionment

“Equitable apportionment” is the term used to describe the process of distributing the burden of certain estate expenses and death taxes among the beneficiaries in the same proportion as they respectively cause the expenses to be incurred. Illinois does not have an equitable apportionment statute.

Leading equitable apportionment Illinois (common-law) cases are Roe v. Estate of Farrell, 69 Ill.2d 525, 372 N.E.2d 662, 14 Ill.Dec. 466 (1978) (regarding intestate estates and affirming

For greater discussion, see Ch. 15, *Apportionment and Statutory Rights of Recovery, LITIGATING DISPUTED ESTATES, TRUSTS, GUARDIANSHIPS, AND CHARITABLE BEQUESTS* (IICLE, 2009).


Illinois equitable apportionment common law gives the benefits of the marital deduction to the surviving spouse, but the charity beneficiary does not receive the benefit of the charitable deduction. *Haberl v. County of Monroe*, 142 Ill.App.3d 152, 491 N.E.2d 909, 96 Ill.Dec. 630 (5th Dist. 1986); *In re Estate of Maddux*, 93 Ill.App.3d 435, 417 N.E.2d 266, 48 Ill.Dec. 864 (5th Dist. 1981). This means that if a charity is a remainder beneficiary, even though its interest does not create estate taxes (because its share qualifies for a charitable deduction), it will be charged with estate taxes and expenses of administration as will the non-charity beneficiaries. For Illinois equitable apportionment purposes, like Cinderella, the charitable deduction is treated unfairly in relation to its stepsister, the marital deduction.

See also Ch. 15, *Apportionment and Statutory Rights of Recovery, LITIGATING DISPUTED ESTATES, TRUSTS, GUARDIANSHIPS, AND CHARITABLE BEQUESTS* (IICLE, 2009).

These charges against the charity beneficiary’s share will reduce the charitable deduction and result in a circular estate tax calculation as discussed in §11.18 above.


Illinois’ equitable apportionment rules apply only when the testator has not otherwise expressed an apportionment intention. The rules of equitable apportionment are as follows:

1. Equitable apportionment occurs between probate and nonprobate assets (“outside” or “external” apportionment) on a pro rata basis.

2. The residuary probate estate bears the burden of taxes and expenses for all of the probate estate (the “burden on the residue rule”). Residuary beneficiaries share on a pro rata basis.

3. If the residuary estate is insufficient to fully pay taxes and expenses, then the non-residuary legatees must contribute. Under §24-3 of the Probate Act of 1975, 755 ILCS 5/1-1, *et seq.*, the rules of abatement prefer specific legacies over general legacies. 755 ILCS 5/24-3(b). Abatement is discussed in §11.46 below.

There is no “inside” or “internal” equitable apportionment between the separate tiers of beneficiaries, residuary, specific, or general legatees.
As mentioned in §11.43 above, under the rules of equitable apportionment, the spouse receives the benefits of the marital deduction, but charity beneficiaries do not receive the benefit of the charitable deduction.


The federal tax apportionment statutes apply when state law and the decedent’s will do not apportion taxes. However, Code §§2206 and 2207 have supremacy of federal recovery rights over Illinois common law. In re Estate of Lyons, 98 Ill.App.3d 995, 425 N.E.2d 19, 54 Ill.Dec. 507 (2d Dist. 1981). The federal tax apportionment rules include:

1. Code §2205, regarding the estate’s burden to pay taxes and reimbursement rights;
2. Code §2206, regarding the liability of life insurance beneficiaries (note that the right of reimbursement ignores charitable deduction benefits);
3. Code §2207, regarding recipients of general power of appointment property (note that the right of reimbursement ignores charitable deduction benefits);
4. Code §2207A, regarding rights of recovery for qualified terminable interest property (QTIP) (note that the right of reimbursement ignores charitable deduction benefits); and
5. Code §2207B, regarding rights of recovery for Code §2036 (transfers with retained interests) property (other than a charitable remainder trust (Code §2207B(d))).

PRACTICE POINTER

✓ Look for a will or trust provision that states in effect, “I direct that no death taxes of any description due because of my death (or any interest or penalties thereon) or expenses of my estate administration shall be payable from these [charitable] gifts.” This provision keeps intact the whole estate tax charitable deduction and avoids the need for the circular estate tax deduction.


Unless otherwise expressly provided by the will, if the estate of a testator is insufficient to pay all legacies under the will, specific legacies will be satisfied pro rata before general legacies, and general legacies will be satisfied pro rata, without any priority in either case as between real and personal estate. The other way of saying this is that if the estate is insufficient to pay all legacies, general legacies abate pro rata to the extent necessary, and, if exhausted, specific legacies abate pro rata. 755 ILCS 5/24-3. The rules of construction prefer the preservation of specific bequests over that of general bequests and devises.

A “specific legacy” singles out a particular thing (or things) that the testator intends the donee to have without regard to its value, and a “general legacy” can be satisfied out of general assets, as the chief element of the gift is its value.
PRACTICE POINTER

✓ If it is likely that the assets of the estate will be insufficient to meet all the gifts, then look for a will or trust provision that specifies gift abatement (in which order of priority and in what portions).

A more complete presentation of apportionment and abatement can be found in Ch. 15, Apportionment and Statutory Rights of Recovery, LITIGATING DISPUTED ESTATES, TRUSTS, GUARDIANSHIPS, AND CHARITABLE BEQUESTS (ICLE, 2009). Note that the author of this chapter suggests for federal tax apportionment purposes that calculations be made to use the benefit of the charitable deduction as would be made to use the benefit of the marital deduction. He acknowledges that this is without federal statutory support but is a logical extension of the benefit of the marital deduction benefit.

PRACTICE POINTER

✓ It is important to review the will and trust to ascertain whether the decedent expressed an intention that taxes and expenses should not be charged against any charitable estate gift. This will affect the net gift to the charity and the amount of a charitable deduction that will be available to compute estate taxes.


Effective for decedents dying after December 31, 2004, pursuant to Code §2053(d) there is an elective deduction for state taxes on charitable transfers if either (1) the entire decrease in federal estate tax resulting from the deduction inures solely to the benefit of a charitable, etc., transferee described in Code §2055 or §2106(a)(2); or (2) the federal estate tax is equitably apportioned among all transferees of property included in the gross estate. Treas.Reg. §20.2053-9(b). However, a deduction is not allowable for state death tax on a charitable remainder trust interest because the increase in trust principal would also inure to the benefit of the life tenant through increased income. Watson v. McGinnes, 240 F.Supp. 833 (E.D.Pa. 1965). The election is made by written notice filed with the district director during the period of assessment of the tax. Treas.Reg. §20.2053-9(c).

VI. INCOME TAX CONSIDERATIONS

A. Estate Administration Expenses Affecting Estate Tax Charitable Deduction

1. [11.48] Code §642(g) Election

An election can be made under Code §642(g) to take certain federal estate tax return (IRS Form 706) deductible items instead on the fiduciary income tax return (IRS Form 1041). This can have the effect of reducing a residuary charity beneficiary’s bequest and increasing estate taxes. See Chapters 8 and 9 of this handbook.
2. [11.49] Treas.Reg. §20.2055-3(b) — The Hubert Regulations

Some administration expenses will reduce the amount of the charitable deduction. This is so even though the expenses are paid from estate corpus or income. Treas.Reg. §20.2055-3(b).

The Treasury Regulations divide administrative expenses into two defined groups: “estate transmission expenses” and “estate management expenses.” Treas.Reg. §20.2055-3(b)(1). The regulations provide that only estate transmission expenses will reduce the value of property for charitable deduction purposes. Treas.Reg. §20.2055-3(b)(2). See also Treas.Reg. §20.2056(b)-4(d)(2) for the same effect on the marital deduction.

The regulations define “estate transmission expenses” as all estate administration expenses that are not estate management expenses, specifically “expenses that would not have been incurred but for the decedent’s death and the consequent necessity of collecting the decedent’s assets, paying the decedent’s debts and death taxes, and distributing the decedent’s property to those who are entitled to receive it.” Treas.Reg. §20.2055-3(b)(1)(ii). “Estate management expenses” are those incurred in connection with the investment of the estate assets or with their preservation or maintenance during a reasonable period of administration, such as investment advisory fees, stock brokerage commissions, and custodial fees and interest. Treas.Reg. §20.2055-3(b)(1)(i).

See Chapter 9 of this handbook and Commissioner v. Estate of Hubert, 520 U.S. 93, 137 L.Ed.2d 235, 117 S.Ct. 1124 (1997).

B. [11.50] Income Tax Charitable Deduction — Code §642(c)

An income tax charity deduction is available to an estate or trust for the portion of the trust or estate that is paid to or set aside for a charity beneficiary. This avoids income tax on income and capital gain allocable to the charity beneficiary. Code §642(c).

The estate must satisfy specific requirements to establish entitlement to the deduction. The estate must pay or set aside an amount of its gross income pursuant to the terms of the will for a charitable purpose specified in Code §170(c). Code §642(c). The computation of the charitable deduction is made on IRS Form 1041-A, Trust Accumulation of Charitable Amounts.

The will’s provisions that specify the source of the charitable distribution are controlling. If the will’s provisions do not specify the source of funds, then the characterization is the same as the proportion of the various income items for the estate. Treas.Reg. §1.642(c)-3(b)(2). Tracing may be required to prove that the charitable distribution was actually made from gross income. Crestar Bank v. Internal Revenue Service, 47 F.Supp.2d 670 (E.D.Va. 1999); Van Buren v. Commissioner, 89 T.C. 1101 (1987). Tax-exempt interest that may be considered a part of gross income will reduce the available charitable deduction.

Private Letter Ruling 200906008 provided distribution of trust income to charity pursuant to a beneficiary’s power of appointment will qualify for a charitable contribution deduction. In this PLR, a trust instrument gave the primary beneficiary of the trust a limited power of appointment as follows: “[T]he Trustee shall distribute all or any portion of the trust state as [the beneficiary] may appoint, at any time and from time to time during the lifetime and upon the death of such
beneficiary to any one or more ‘charitable organizations’.” The IRS ruled that because the trust agreement specifically authorized the exercise of the power in favor of one or more charitable organizations, distributions of income pursuant to the exercise of that power would be paid “pursuant to the terms of the governing instrument” within the meaning of Code §642(c)(1). Therefore such distributions would qualify for a charitable contribution deduction.

For trusts and estates, there are no income tax charitable deduction limitations like there are for individual income tax returns (commonly referred to as the 20-percent, 30-percent, 50-percent limitations). Treas.Reg. §1.642(c)-1.
No distribution deduction is allowed for the amounts paid, used, or permanently set aside for a charitable purpose because amounts paid for a charitable purpose do not constitute distributable net income (DNI). Code §663(a)(2). See also Ch. 7, Income Taxation of Trusts, TRUST ADMINISTRATION (IICLE, 2008).

In June 2008, the Treasury Department issued proposed regulations that amend the regulations under Code §642(c) (specifically Treas.Reg. §1.642(c)-3(b)) and Code §643 (specifically Treas.Reg. §1.643(a)-5(b)), concerning the computation of the charitable contribution deduction and computing the amount of tax-exempt income includible in DNI. These proposed regulations, if and when made final, will affect the ordering rules for payment from a trust or estate to charitable beneficiaries. The proposed regulations provide (the introduction to the proposed regulations say “clarify”) that an ordering provision in a trust or a will or a provision of local law that specifically provides as to the source out of which amounts are to be paid, permanently set aside, or used for a purpose must have economic effect independent of income tax consequences in order to be respected for federal tax purposes. Otherwise, payments to a charity will consist of the same proportion of each class of the items of income of the trust as the total of each class bears to the total of all classes. The proposed regulations also similarly clarify the corresponding language in Treas.Reg. §1.643(a)-5(b) pertaining to tax exempt income. These proposed regulations have received criticism from the professional community, and, at the time of this writing, these proposed regulations have not been made final. The proposed amendment to the regulations would apply to trusts and estates for taxable years after the date final regulations are published in the Federal Register. The proposed regulations are published at 73 Fed.Reg. 34,670, as corrected at 73 Fed.Reg. 40,793 and 2008-33 Int.Rev.Bull. 391.

VII. [11.51] REGISTRATION WITH ILLINOIS ATTORNEY GENERAL

The Illinois Attorney General has the responsibility and jurisdiction of monitoring charitable interests on behalf of the people of the State of Illinois. The Attorney General even has standing to contest a will when there is a charitable interest or when a previous will contained a charitable interest. In re Estate of Stern, 240 Ill.App.3d 834, 608 N.E.2d 534, 181 Ill.Dec. 461 (1st Dist. 1992).

The Illinois Charitable Trust Act, 760 ILCS 55/1, et seq., requires a trustee who holds assets in excess of $4,000 for charitable purposes to register with the Illinois Attorney General. 760 ILCS 55/2, 55/5, 55/6. Under the Charitable Trust Act, “trustee” means any person, individual, group of individuals, association, corporation, not-for-profit corporation, estate representative, or other legal entity holding property for or solicited for any charitable purpose. 760 ILCS 55/3. Note that this definition includes decedents’ estates, testamentary trusts, and living trusts that become irrevocable on a decedent’s death.

Registration requirements are fully presented in Ch. 7, Government Regulation, NOT-FOR-PROFIT CORPORATIONS (IICLE, 2007). See also Ch. 10, Administration of Charitable Trusts, TRUST ADMINISTRATION (IICLE, 2008). Registration information and forms are available at the Attorney General’s website at www.illinoisattorneygeneral.gov/charities/index.html. A sample charitable organization registration form is available at www.illinoisattorneygeneral.gov/charities/co-1form.pdf.
The Office of the Attorney General released a Memorandum of Position and Guidance, dated March 1, 2003, pertaining to registration for decedents’ estates, trusts, and property interests. See §11.67 below. The Attorney General simply states that all estates and trusts that hold assets with a value in excess of $4,000 for charitable purposes, even though of a remainder interest, must register the estate or trust with the Attorney General’s office. However, the Attorney General prudently and pragmatically recognizes certain exceptions. Although the following is provided without citation to legal authority, the author previously reviewed this text with a ranking representative of the Office of the Illinois Attorney General, and that representative stated that this is an accurate representation of how the Attorney General views our real world.

The first class of exceptions from registration includes trusts for which the charitable interest can be wholly divested by someone not acting in a fiduciary capacity. The Attorney General generally will not require registration of a trust interest when the remainder charitable interest may be divested wholly by (a) a current beneficiary’s unlimited power to withdraw all of the trust assets, (b) a person’s non-fiduciary general or limited power of appointment over the whole trust, or (c) a trust protector’s non-fiduciary ability to terminate the trust in favor of a non-charity or change the charitable beneficiaries to non-charity beneficiaries.

A trustee’s fiduciary discretion to invade principal for the beneficiary (whether the distribution standard is discretionary or ascertainable or broad or narrow) does not create an exception from registration. This is so even though the trust may be distributed entirely to a non-charity, subject to the fiduciary discretion of the trustee. Further, it is not relevant whether the trustee is also a beneficiary. The key to this analysis is whether the invasion power is subject to fiduciary duties (registration required) or is not subject to fiduciary duties (registration not required). As long as the charitable interest can be divested only by exercise of fiduciary responsibilities, then an expectation of charitable benefit exists, and such charitable expectations are subject to monitoring by the peoples’ watchdog, the Attorney General.

In carving out the first class of exceptions, the Attorney General is simply being pragmatic in that it need not monitor an interest that may never come into existence and in which vesting is in the sole discretion of a non-fiduciary right or power.

The second class of exceptions from registration covers situations in which the custodian of the assets merely holds them for the charitable beneficiary and has no meaningful administrative and investment discretion or authority. The Attorney General generally will not require registration of matured testamentary interests that create a charitable interest by a death beneficiary designation of the following contracts, accounts, or specific asset interests: (a) individual retirement accounts; (b) qualified retirement trusts; (c) life insurance or annuity contracts; (d) payable-on-death designations; (e) transfer-on-death designations; (f) Totten trusts (In re Totten, 179 N.Y. 112, 71 N.E. 748 (1904)); and (g) land trusts (subject to analysis of a contrary power of direction).

In creating the second class of exceptions, the Attorney General recognizes that the value of the charitable interest is fixed at the decedent-donor’s death and that the custodian’s discretions (if any) in handling the funds are merely objective and ministerial in nature.
Neither of the above exceptions applies if a charitable interest is vested and someone has the discretion to select charity recipients or the timing and manner of distribution to a class that is restricted to charity. In these situations, the Attorney General continues to be interested and requires registration.

If the charitable interest is one of a future value, with an intermediate non-charity interest, how should it be valued today to determine if the gift is required to be registered for purposes of the $4,000 threshold? The author suggests that the practitioner use the same methodology of present value as is used to determine the present value of a charitable remainder interest for federal income tax purposes. The Illinois Attorney General is not bound by valuation methodologies used for federal income tax purposes. The Attorney General, however, is interested that an objective and unbiased valuation methodology be applied. The $4,000 valuation requirement represents a de minimis exception. In keeping with the spirit of de minimis, as long as a good-faith effort is made to determine the present value of the charity remainder interest with an objective and sound valuation methodology, the Attorney General (if ever involved) should be satisfied.

There are respected practitioners who may have been relaxed in suggesting an informal rule of not registering decedents’ estates and trusts with charitable interests when the estates and trusts were merely estates and trusts administratively in transition to the more permanent charitable distribution, noting that the executor and trustee acting within their fiduciary duty, counseled by a member of the bar, inherently deliver the charitable gift as required — in other words, “no harm, no foul.” However, it is apparent that the Illinois Attorney General takes its representation of the people’s interests seriously and seeks enhanced compliance with registration requirements under the Charitable Trust Act. The practitioner needs to consider the plain language of the Act and the present views of the Illinois Attorney General with respect to registration.

The author has found the Charitable Trust Bureau at the Attorney General’s office to be quite helpful and practical with assisting and giving direction to practitioners who are just trying to do a good job. If there are questions about the need to register, consider contacting our colleagues at the Charitable Trust Bureau of the Office of the Illinois Attorney General at 312/814-2595 or www.illinoisattorneygeneral.gov/charities/index.html.

VIII. OPPORTUNITIES TO ENHANCE EFFECTS OF CHARITABLE GIFT

A. [11.52] Effective Use of Income in Respect of a Decedent

Testamentary charitable gifts have the greatest economic benefit when they are funded with the income tax class of assets known as “income in respect of a decedent.” This class of assets is identified and governed by Code §691. Its key characteristic for this discussion is that it receives no “stepped-up” tax basis by reason of the decedent’s death. Code §1014(c). In other words, taxable income and capital gains continue to be a “built-in” characteristic of IRD, and the carryover tax basis is inherited by its recipient.
IRD property includes assets such as individual retirement arrangements, qualified retirement benefits, installment sale agreements, accounts receivable, accrued interest on bonds, unpaid salary, other deferred income, and the like.

Does a tax-exempt charity care whether it receives an asset that has taxable income or capital gain built into it? Consider a simple estate with two assets: $100,000 in stock (tax basis before death of $1,000) and $100,000 in an IRA (tax basis before and after death of $0). The stock receives a step-up in tax basis by reason of the decedent’s death, but the IRA does not receive a step-up in tax basis because it is classified as IRD. The decedent’s daughter is to receive one half of the estate, and a charity is to receive the other half. If the daughter receives one half of each asset, she will not effectively receive $100,000 because she has to pay income tax on the built-in taxable income of the IRA. If the estate is structured (or the executor or trustee is expressly directed to facilitate) so that the charity receives the IRA and the daughter receives the stock, each beneficiary receives $100,000 without reduction by any taxes. The daughter has in her hands stock with a tax basis of $100,000. The charity realizes $100,000 from the IRA because it is tax-exempt. This is a “win-win” situation.

Treas.Reg. §1.691(a)-4(b) provides that if the estate of a decedent or any person transmits the right to IRD to another who would be required by Code §691(a)(1) to include such income when received in his or her gross income, only the transferee will include such income when received in his or her gross income. In this situation, a transfer within the meaning of Code §691(a)(2) has not occurred. Treas.Reg. §1.691(a)-4(b)(2) provides that if a right to IRD is transferred by an estate to a specific or residuary legatee, only the specific or residuary legatee must include such income in gross income when received. Rev.Rul. 92-47, 1992-1 Cum.Bull. 198, holds that a distribution to the beneficiary of a decedent’s IRA that equals the amount of the balance in the IRA at the decedent’s death, less any nondeductible contributions, is IRD under Code §691(a)(1) that is includable in the gross income of the beneficiary for the tax year the distribution is received. See also Pvt.Ltr.Rul. 200803002 (Oct. 16, 2007); Pvt.Ltr.Rul. 200845029 (July 10, 2008); Pvt.Ltr.Rul. 200850004 (Sept. 8, 2008).

The best ways of facilitating the transmission of IRD characterized assets is by direct beneficiary designation (such as by an IRA beneficiary designation) or a specific devise of the IRD characterized asset.

See §11.49 above for information on receipts by charity of income includible in estate or trust distributable net income.

Commonly recognized IRD assets more specifically include the following:

1. compensation earned but not received before death, including vacation pay, sick pay, and similar allowance due at death; unpaid deferred compensation payable to the employee; qualified employee benefits; an employer’s voluntary payment to the deceased employee’s estate or family; a post-death bonus to which the employee has no legal right but will receive to a “substantial certainty”; receivables due for services (e.g., commissions and professional fees); statutory stock options; and fiduciary and director fees earned but not received;
2. partnership income attributable to a pre-death period (current distributive share);

3. post-death realization of partnership receivables;

4. investment income, including interest income accrued to the date of death, nonrecognized gain on U.S. savings bonds, dividends declared before death when death occurs after the record date but before payment, rental income accrued to the date of death, royalties attributable to a pre-death period, and nonrecognized income and gains from annuities;

5. sale proceeds, including installment obligations, executory contracts, and Code §736(a) payments; and

6. other assets, including alimony arrears, medical reimbursement rights, trust or estate income distributed to a beneficiary after the beneficiary’s death, and certain damage claims.

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**PRACTICE POINTERS**

✓ A Roth IRA is not IRD.

✓ IRD paid to a charity beneficiary that is entitled to an estate tax charitable deduction will not qualify the estate or its beneficiaries for a Code §691(c) deduction in respect of a decedent. Because there is no estate tax attributable to this asset (by reason of the charitable deduction), there is no §691(c) deduction.

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**B. [11.53] The Pecuniary Trap**

A pecuniary (dollar amount) legacy funded with income in respect of a decedent generally accelerates the recognition of income tax. Code §691(a)(1)(A); Treas.Reg. §1.691(a)-4; *Kenan v. Commissioner*, 114 F.2d 217 (2d Cir. 1940).

Note that *Kenan*, a case often cited in accelerating taxable income, is a case pertaining to appreciated property and not IRD property specifically. It does not mention Code § 691(a)(2) which is the governing provision over the transfer of a IRD, such as an inherited IRA.

The court in *Estate of Noel v. Commissioner*, 50 T.C. 702 (1968), and *Findlay v. Commissioner*, 332 F.2d 620 (2d Cir. 1964), held that a distribution by a decedent’s estate to a distributee not described in Code §691(a)(1)(C) is deemed a taxable transfer of the right to the IRD receivable under Code §691(a)(2). The distributee in such an event should be considered to have received his or her pecuniary bequest to which he or she is entitled without any incidence of income taxation.

**EXAMPLE:** An estate consists solely of a $500,000 individual retirement account that is payable to the estate. The decedent’s will gives $100,000 to a charity beneficiary and the remainder estate to non-charity legatees. The IRA is IRD. Although the charity’s gift actually is paid from the IRA proceeds, the taxable income of the IRA is not passed through to the charity beneficiary because
the charitable gift is a pecuniary amount. Therefore, the estate recognizes taxable income of $100,000 of the IRD because it is trapped in the estate.

Chief Counsel Memorandum 2006-44020 (November 2006) holds the opinion that the assign of an IRA (separate and segregated inherited IRA) in satisfaction of a pecuniary gift accelerates the taxable income (the income in respect of a decedent – IRD) to the trust and does not transfer its tax attributes to the transferee. Some commentators believe the Chief Counsel is correct is the situation of the fiduciary having discretion to choose between funding the pecuniary gift with either IRD or non-IRD assets. However, some commentators differentiate the result if (1) the governing instrument or law requires the use and transfer of IRD property to satisfy the pecuniary gift or (2) IRD property is the only property available to satisfy the pecuniary gift and such IRD property is thus transferred to satisfy the pecuniary gift – note each circumstance removing funding discretion from the fiduciary.

Conversely – Payment directly from an IRA to a pecuniary charitable beneficiary. If a charity is a direct beneficiary of an IRA and receives a pecuniary (dollar amount) gift within the IRA, rather than a fractional share, many commentators say that this pecuniary amount carries with it the taxable income to be recognized by the charity — there is no “trapping.” There is no fiduciary discretion in the use of IRD property.
PRACTICE POINTERS

✓ Beware of the potential adverse income tax consequences of an IRD asset funding a pecuniary gift.

✓ Look for a fail-safe provision in the governing documents that essentially expresses, “My executor shall first use and transfer any property, the receipt of which by the executor would constitute income in respect of a decedent for federal income tax purposes, in satisfying these [charitable] gifts.” If the fiduciary does not have discretion to choose which kind of property to use, then there should be the transmission of IRD through to the transferee.

 ✓ Many practitioners have accepted that if the death beneficiary designation of an individual retirement account is, in part, a pecuniary amount (e.g., $100,000 to XYZ Charity), the direct payment from the retirement account is not the kind of pecuniary gift that traps or accelerates taxable income. The charity in this case realizes the taxable income distribution from the IRA. This perspective is unique to the nature of an IRA and qualified retirement account that has a direct beneficiary designation.

C. [11.54] Fiduciary’s Discretionary Powers

The executor or trustee may have the power to effectively allocate income in respect of a decedent to a charity beneficiary and thus achieve the additional tax benefit of avoiding income tax.

In Rev.Rul. 81-20, 1981-1 Cum.Bull. 471, the IRS ruled that an executor may be given the power to determine which of the estate’s property to distribute to the charity and to the non-charitable beneficiaries.

In Pvt.Ltr.Rul. 200234019 (May 13, 2002), the IRS allowed an executor of an estate to assign the decedent’s IRA and Code §403(b) plans to charity beneficiaries in satisfaction of the estate’s remainder fractional bequests to such charities. The IRS held that the assignments did not cause either the estate or the non-charity remainder beneficiaries to have taxable income nor did they cause the amounts to be taken into account in the computation of the estate’s distributable net income for the taxable year of the assignment. It was the charity beneficiaries that realized the taxable income. In this situation, it is important to know that the decedent’s will provided that the executor had “the power to make distributions in cash or in kind (including non pro-rata distributions of undivided interests in property), at such values as the executor shall determine; to make any income tax elections concerning in-kind distributions; and in making such distributions . . . allocate assets to a particular beneficiary without regard to the basis of such assets.” Id.

The planning concept here is different than having the IRD tax characteristics carried out with DNI. This concept treats the IRD as a specific bequest, and the IRD goes with that specific bequest. However, if the IRD is recognized in the estate or trust, care must be taken not to have the recognition of IRD trapped in the estate or trust by reasons of the close of the tax year and it not being carried out as DNI.

A disclaimer is a powerful tool to achieve goals and effects that become apparent or are necessary after the decedent’s death.

EXAMPLE: A surviving spouse is given a fixed annuity interest for life in a trust, and the trustee also has the discretionary power to invade the principal for the spouse’s benefit. Because of the trustee’s power to invade the principal for a non-charity beneficiary, the trust will fail to qualify for a charitable deduction as a charitable remainder trust. The spouse can make a qualified disclaimer of the spouse’s interest to receive principal distributions. The trust now may qualify as a charitable remainder trust and permit the estate to claim an estate tax charitable deduction. Treas.Reg. §25.2518-3; Rev.Rul. 71-483, 1971-2 Cum.Bull. 337; Pvt.Ltr.Rul. 200052006 (Sept. 25, 2000); Pvt.Ltr.Rul. 200127007 (Mar. 30, 2001).

Code §2055(a) provides that a qualified disclaimer also includes the complete and timely termination of a power to consume, invade, or appropriate property for the benefit of an individual before such power has been exercised. This provision relaxes some of the stringent requirements of Code §2518.

Disclaimers are fully discussed in Chapter 16 of this handbook.


If split-interest gifts do not meet the technical requirements of a split-interest gift qualifying for the charitable deduction, a reformation of the governing instruments may be permitted, which would place the gift in compliance with those technical requirements and thus allow the charitable deduction. Code §2055(e)(3).

There are technical requirements by Code and Treasury Regulations that must be strictly adhered to in order to be a “qualified reformation” and effectively reform a charitable trust and obtain the expected tax benefits. Perhaps the most important technical requirement is the timeliness of commencing the judicial proceeding: not later than the 90th day after — (1) if an estate tax return is required to be filed, the last date (including extensions) for filing such return, or (2) if no estate tax return is required to be filed, the last date (including extensions) for filing the income tax return for the first taxable year for which such a return is required to be filed by the trust. Code §2055(e)(3)(C)(iii). Any judicial reformation must be completed within a reasonable time after it is commenced. A nonjudicial reformation (amendment, contribution, family settlement agreement) is permitted if effective under state law (all relevant parties are bound by the change), provided it is completed by the date on which a judicial reformation must be commenced. See Treas.Reg. §§20.2055-2(e)(3)(iii), 20.2055-2T(e)(3)(iii).

PRACTICE POINTER

✔ As soon as a charitable remainder trust is discovered in the estate, the trust should be carefully reviewed for qualification and tested for compliance with the Code’s mathematical rules.

The Charitable Trust Tax Law Conformance Act, 760 ILCS 60/0.01, et seq., provides that a trustee of a private foundation or split-interest trust may amend the terms of the governing instrument to the extent necessary to bring the trust into conformity with federal tax law requirements. 760 ILCS 60/1. The Illinois statutory authority is designed to be responsive to the requirements of Code §2055(e)(3) with respect to reformation of split-interest trusts. Note that the Illinois statute includes split-interest trusts in its scope and also private foundations.


There may be incidents in which it becomes apparent that the charitable gift may fail because the charity is no longer in existence or the intended implementation of the charitable gift is impracticable or impossible. In these incidents, the doctrine of cy pres should be examined for its applicability in order to carry out the general charitable intentions of the donor. *Burr v. Brooks*, 83 Ill.2d 488, 416 N.E.2d 231, 48 Ill.Dec. 200 (1981).

The doctrine of cy pres (meaning “as near”) is implemented by the court when

1. the specific implementation of the charitable gift has become impossible, impracticable, inexpedient, or illegal;

2. a general charitable purpose exists; and


If these conditions exist, the court, after recommendations or consent of the Illinois Attorney General and other appropriate parties as the court may recognize, may reform the charitable gift to one that is as close as possible to the donor’s original intention. The essence of the doctrine of cy pres is to find a logical way to best approximate the donor’s more specific intentions and not allow the donor’s general charitable intention to fail.

If the charitable gift specifically provides for an alternate gift over or lapse if the gift conditions cannot be met, then the doctrine of cy pres will not be applied.

The specific and expressed given power of an executor or trustee to name a charitable recipient is not the subject of cy pres. If this discretionary power is specifically granted to an executor or trustee, then the power can be exercised without court action. However, if there is no such specific power granted to the executor or trustee, then the application of the doctrine of cy pres is the domain of the court, and the executor or trustee should bring an action before the court. *Continental Illinois National Bank & Trust Company of Chicago v. Sever*, 393 Ill. 81, 65 N.E.2d 385 (1946); *In re Petition of Village of Mount Prospect*, 167 Ill.App.3d 1031, 522 N.E.2d 122, 118 Ill.Dec. 667 (1st Dist. 1988).
The doctrine of cy pres is more fully presented in Ch. 10, Administration of Charitable Trusts, TRUST ADMINISTRATION (IICLE, 2008), and Ch. 14, Charitable Litigation, LITIGATING DISPUTED ESTATES, TRUSTS, GUARDIANSHIPS, AND CHARITABLE BEQUESTS (IICLE, 2009).

H. [11.59] Equitable Deviation

The doctrine of equitable deviation may allow deviation from the terms of the trust if compliance with the trust is impossible or illegal or if, due to unknown circumstances, failure to deviate will defeat or substantially impair the accomplishment of the trust’s purpose. Burr v. Brooks, 83 Ill.2d 488, 416 N.E.2d 231, 48 Ill.Dec. 200 (1981); RESTATEMENT (SECOND) OF TRUSTS §381 (1959). The doctrine of equitable deviation is a lesser known (and in Illinois still developing) way to reform a trust. The doctrine is less strict than cy pres in that it may apply to circumstances in which the trust expresses an alternative provision in the event of a charitable gift that becomes impossible or impracticable to accomplish.

For further discussion, see Ch. 10, Administration of Charitable Trusts, TRUST ADMINISTRATION (IICLE, 2008), and Ch. 14, Charitable Litigation, LITIGATING DISPUTED ESTATES, TRUSTS, GUARDIANSHIPS, AND CHARITABLE BEQUESTS (IICLE, 2009).

I. [11.60] Early Termination of Charitable Trust by Authority of Charitable Trust Act

If a charitable trust becomes impractical because of its small size or because of changed circumstances that adversely affect the charitable purpose of the trust, the Charitable Trust Act allows the trustee to go through a process of terminating the trust without resorting to court action. 760 ILCS 55/15.5.

A “small” trust is one in which the annual expenses of administration, including the trustee’s fees, investment management and accounting fees, and excise taxes, would, if charged entirely against income, exceed 25 percent of the income of the trust. 760 ILCS 55/15.5(b).

The term “changed circumstances” means a condition in which the charitable purpose or purposes of the trust have, in the judgment of the trustee, become illegal, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community. 760 ILCS 55/15.5(b).

In order to terminate the small trust, the trustee must notify each named charitable organization for the benefit of which the trust was created and obtain the consent of the Attorney General. 760 ILCS 55/15.5(a). On termination, the trust asset must be transferred to a community foundation or similar publicly supported organization described in Code §170(b)(1)(A)(vi) to be used in accordance with the expressed general intent of the donor. 760 ILCS 55/15.5(c). If the terminated trust was created for the benefit of a named charitable organization that has established an endowment fund and the principal of the endowment fund is under its irrevocable terms no more expendable by the organization than is the principal of the terminated trust as provided by the terms of the terminated trust, the named charitable organization may direct the trustee to transfer the terminated trust assets to the endowment fund to be used for the purposes expressed by the terminated trust. 760 ILCS 55/15.5(d).
J. [11.61] Early Termination of Charitable Trust by Authority of Common Law

The Charitable Trust Act is not the exclusive remedy for the termination of a split-interest charitable trust (such as a charitable remainder trust). 760 ILCS 55/15.5(f). Common law provides authority for an agreement by all the beneficiaries to terminate a trust. The common-law authority should apply equally to charitable trusts. See David R. Hodgman et al., IRS Rulings Provide Guidance on Early Termination of CRUTs, 30 Est.Plan. No. 1, 3 (Jan. 2003), which explains that in certain circumstances, an early termination of a charitable trust may not be an act of self-dealing, may not need a court order, and may not need the Attorney General’s consent. See also §11.67 below for comments by the Office of the Illinois Attorney General.

The early termination of a charitable trust is more within the topic area of administering charitable trusts after a decedent’s estate is settled. However, during the administration of a decedent’s estate it may become apparent that a charitable trust that is to be created may be troubled immediately. The estate administrator will be better able to handle these circumstances with the charitable trust trustee by knowing the available options.

IX. UP FRONT: IDENTIFYING THE NOT-SO-OBVIOUS TRAPS THAT MAY AFFECT A CHARITABLE GIFT

A. [11.62] Income in Respect of a Decedent

Inadvertently accelerating the built-in taxable income to the estate or family is too common. Great care must be taken in handling the charitable estate gift of IRD assets. See §§11.52 – 11.54 above and also Chapter 8 of this handbook.


In the absence of a proper waiver, the entire amount will be distributed to the surviving spouse as a matter of law (even if the employee had designated the charity as the beneficiary on the form he or she filed with the employer) or will be paid to the surviving spouse as a part of a qualified joint and survivor annuity. Code §§401(a)(11)(B)(iii), 401(a)(11)(A).

PRACTICE POINTERS

✓ Confirm that the charitable estate gift of a qualified retirement plan benefit has the appropriate spousal consent. Without the appropriate consent, the charity’s gift may not exist. However, this may be remedied through a disclaimer by the spouse.
IRAs, simplified employee pensions (SEP), savings incentive match plans for employees (SIMPLE), and government retirement plans are not subject to the spousal consent and waiver requirement. Code §§401(a)(11)(B), 411(e)(1) (in conjunction with the last sentence of Code §401(a)); Treas.Reg. §1.401(a)-20, Q & A 3(d).

A prenuptial agreement cannot effectively act as a waiver of a spouse’s rights under REA. In order to waive these rights, one must be a spouse at the time of the waiver, and “prenuptial” by definition means “before marriage.”

C. [11.64] The Unique Qualified Plan

Qualified pension plans may have effects other than those under the Retirement Equity Act. A “paternal” type of pension plan might provide a benefit only to the decedent-participant and the participant’s spouse. A remainder benefit to someone other than the participant and the participant’s spouse may not be allowed. There may be a limited ability for beneficiary designations. There may be restrictions on payment options (e.g., lump sum, installment, life, etc). These types of plans may prove problematic to the expected charity beneficiary and an estate tax charitable deduction.

D. [11.65] Partial Gift of Pension or IRA Type Asset and Minimum Distribution Rules

A charity is not a “designated beneficiary” for Code §401(a)(9) minimum distribution rules that permit distribution options to natural persons, such as the ability to take a payout over the life expectancy of a beneficiary. A charity’s deemed life is zero for purposes of the minimum distribution rules. This zero life can cause problems when a portion of a retirement account is given to a charity beneficiary and the remaining portion is given to natural persons.

In order to avoid the taint of the charity as a partial beneficiary, the retirement account should be separated into accounts for the various beneficiaries by September 30 of the year following the year of the owner’s death. Treas.Reg. §1.401(a)(9)-4, Q & A 4(a). The charity beneficiary’s account interest should be separate and apart from those of the non-charity beneficiaries. This will permit the non-charity beneficiaries the option of using their own life expectancies for their planning purposes, and they will not be burdened with the charity’s deemed zero life expectancy.

X. [11.66] CONCLUSION

Discovering that a decedent’s estate has a charity beneficiary is not “business as usual.” Although it is not unusual to find a charitable interest in an estate, the considerations for a charity beneficiary are significantly different than for a non-charity.
For an estate that contains a charity beneficiary, the following questions should be addressed:

- Is the charity beneficiary sufficiently identified and settled as the one intended by the donor? What is the type of the charitable organization’s entity? Is it in good standing? Who within the organization is empowered to act on its behalf? Does its status as an organization qualify for the estate tax charitable deduction?

- What estate property interest is the subject of the charitable gift? Are there opportunities or problems associated with that type of property interest?

- Does the nature and purpose of the estate gift to the charity beneficiary qualify the estate for an estate tax charitable deduction? Does the charitable gift wholly or partially qualify for the estate tax charitable deduction?

- What administration expenses or death taxes may be charged against the charitable gift that may affect the estate tax charitable deduction? Are there any other circumstances that will reduce what the charity was entitled at the time of the decedent’s death and is later distributable?

- What income tax considerations are unique to administering this estate?

- What estate interests should be registered with the Illinois Attorney General?

- What are the available opportunities to enhance the effects of the charitable gift?

- What are the traps that may affect the charitable gift?
XI. APPENDIX


OFFICE OF THE ATTORNEY GENERAL
STATE OF ILLINOIS

Lisa Madigan
ATTORNEY GENERAL

Memorandum of Position and Guidance Issued for Use by IICLE

March 1, 2003

From: Floyd D. Perkins, Chief of the Charitable Trust Bureau, Illinois Attorney General’s Office
       Therese Harris, Senior Attorney, Deputy Chief Charitable Trusts Bureau
       Matthew Shapiro, Senior Attorney, Assistant Attorney General, Charitable Trusts Bureau

Re: Special Registration Rules Under the Charitable Trust Act For Probate Estates and Irrevocable Inter Vivos Charitable Trusts

Bar groups, IICLE, CPA firms and probate practitioners have requested that the Attorney General’s Charitable Trust Bureau give guidance as to the State’s requirement for registration as a charitable trustee by probate representatives and trustees of certain inter vivos trusts that have become irrevocable as a result of a death.

PROBATE

The Charitable Trust Act at 760 ILCS 55/3 provides that “trustee” means “...estate representative ... holding property for ... any charitable purpose.” Registration under the Charitable Trust Act is required of each and every representative of a probate estate where the will provides for charitable bequests in excess of $4,000.00.

The Act expressly requires estate representatives to register and account. The Act defines a charitable trustee to include estate representatives. An estate representative holds legal title to the estate property and when a charitable bequest is provided the representative holds the property for charitable purposes. The Act is intended to establish a full and complete registry of all persons holding funds and assets for charitable use, and to effect an accounting of such to the People. Estate administration can take years to complete and on occasion issues impacting or compromising the charitable gift are involved. The relationship is one traditionally deemed a fiduciary relationship, and registration is required.
Standing-
The right of the Illinois public as beneficiaries of charitable funds held in an estate has been affirmed by the Illinois courts. The People of the State of Illinois are collectively the *cestui que trust* or ultimate beneficiaries of public charities and their assets and endeavors. (See *In re Estate of Laas*, 171 Ill. App. 3d 916, 920-21 (1st Dist. 1988) (wherein the Court held that “[t]he Attorney General has been recognized judicially as the proper representative of the State, which is itself regarded as the ultimate *cestui que trust* to any charitable bequest, in all actions concerning the enforcement or administration of a charitable trust”); see also *In re Estate of Stern*, 240 Ill. App. 3d 834, 836 (1st Dist. 1992) (where the Appellate Court, reversing the dismissal for lack of standing of an action brought by the Attorney General to enforce a charitable trust, held that in matters involving charitable trusts the People of the State of Illinois are the real party in interest and the Attorney General is “the sole officer authorized to represent the People of this State” in such a litigation). As a matter of trust law the People of the State of Illinois hold a direct, immediate and substantial beneficial interest in the use and integrity of charitable trust funds (*In re Estate of Tomlinson*, 65 Ill. 2d 382 (1976)). In *Tomlinson*, the Illinois Supreme Court considered the standing of the Attorney General to participate in a probate estate involving a charitable bequest and expressly found the Attorney General had an interest and standing in the probate matter relative to protecting the charitable gifts involved.

Necessary Party-
If a probate estate contains a charitable bequest, and a charitable bequest involves the probate representative receiving himself; or solely determining the charitable use of the bequest; or determining the charitable entities to receive the bequest; or a charitable bequest is to be paid into a pour over trust or to a charitable entity where the probate representative is also a fiduciary of the recipient; or, the estate involves a will contest; or, the estate involves will or trust construction; or, a supplemental matter is initiated effecting issues of estate share distribution, the Attorney General contends that in such circumstances, in addition to registration, that as the common law representative of the People he is a necessary interested person, and that he should be included as a necessary party in the probate litigation, in addition to the registration of the probate representative under the Act.

Registration-
To effect registration, a registration statement must be signed and filed by the estate representative(s) and a $15 registration fee must be paid. (760 ILCS 55/5) A completed and signed registration statement and $15 filing fee must be accompanied by copies of: the will, letters of office, inventory, and related pour over trusts. A copy of the registration form and instructions are attached.

Annual Reporting-
Probate representatives registered under the Charitable Trust Act are required to file each year an annual financial report with the Attorney General accounting for the assets, receipts and disbursements of the probate estate. Each filed report must be accompanied by an annual filing fee of $15, and failure to timely file the report will result in a $100 late filing fee. 760 ILCS 55/7

The annual filing can be made using the regular court accountings. A copy of an account filed with the probate court, and noticed and approved by the probate court can serve as the annual report (760 ILCS 55/7).
55/7(c). The $15 filing fee must still be paid. If an account is not filed with the court, generally the form and format used by the court can be used to create and make an annual report that will be accepted by the Attorney General. If there are questions, calls are urged and should be made to the Attorney General’s Charitable Trust Bureau (312) 814-2595.

INTER VIVOS TRUSTS

The Charitable Trust Act at 760 ILCS 55/3 provides that “trustee” means any person... corporation ... holding property for ... any charitable purpose. Registration under the Charitable Trust Act is required of each and every trustee holding trust assets gifted to charitable use in excess of $4,000.00. The Act defines a charitable trustee to include trustees of living inter vivos trusts that become irrevocable and subject to distribution upon the death of the settlor and/or charitable remainder trusts even with existing non-charitable interests. The Act makes no provision or exception for a trustee that is merely involved in closing and winding down the testamentary aspects of a living trust. The test of registration is whether a trustee holds property for a charitable purpose, and, if so, generally the trustee must register. The use of an inter vivos trust to provide for a charitable gift places the charitable funds in the hands of a fiduciary holding them for a charitable purpose when events cause the gift to become irrevocable. A terminating inter vivos trust often is operated for years, and involves administrative matters and the handling of the trust estate assets in more than just a ministerial manner. The gift is subject to abatement, contest, administration fees and compromise, and such a trust is in fact a traditional fiduciary relationship.

To effect registration, a registration statement must be signed and filed by the trustee(s) and a $15 registration fee must be paid. (760 ILCS 55/5) A completed and signed registration statement and $15 filing fee, must be accompanied by copies of: the trust, including all amendments, trust inventory, and recent accounting. A copy of the registration form and instructions are attached.

IRA: PENSION BENEFICIARY: LIFE INSURANCE BENEFICIARY

We have been asked to comment upon the need for registration by a fiduciary holding: An IRA account listing a charitable beneficiary; a pension trust with a charitable beneficiary; and a life insurance policy with a charitable beneficiary. Upon the vesting of the beneficial interest in a specific charitable entity or entities the IRA account, the Pension trust account, and/or life insurance policy proceeds are fixed amounts determined by contract terms and are subject to only objective ministerial decisions by the holder, with the holder having little discretion in handling the funds due the charitable entities, such a holder is not generally required to register. However, if the holder of the account or insurance proceeds is empowered by the instruments involved to act to select the charitable recipients or charitable entities to receive the gift, then the holder has the attributes of a traditional fiduciary and is required to register as a trustee.

TERMINATING AN IRREVOCABLE TRUST

We have been asked to comment upon whether an irrevocable trust containing a charitable gift can be terminated by an extra-judicial agreement without the Attorney General when such is joined in by the settlor and all the beneficiaries including named charitable beneficiaries. Under the common law, terminating an
irrevocable trust requires exceptional facts to justify a voluntary termination to what is by law an irrevocable trust. Irrevocable gifts to charity are generally subject to the oversight and protection of the chancery courts of this state. We would suggest that fiduciaries of charitable organizations recognize that there are certain risks in proceeding without notice to the Attorney General and that including the Attorney General is an added safeguard to assure the equities of the modification. First, only the Attorney General represents contingent, unnamed, or unspecified charitable interests. Thus, if remote charitable gifts included in the trust are not parties, or if the charitable share is not specifically allocated to a party charity or to a named charity, but is to charity generally, as for example, where the trustee is to select charitable takers, then the Attorney General on behalf of the People is a beneficiary and a necessary party. (See: In Re The Estate of Laas, 171 Ill.App.3d 916, 525 N.E.2d 1089 (1st Dist., 1988)). Second, fiduciaries of a charitable organization that compromises a charitable gift with the settlor without the approval of the Attorney General are subject to the propriety of the transaction upon inquiry by the Attorney General. Third, while legal authors reference common law authority to compromise private trusts, they generally fail to consider the many cases that reference the special and unique authority courts of equity enjoy over charitable trusts. In First National Bank of Chicago v. King Edward’s Hospital Fund, 1 Ill. App. 2d 338, 361 (1st Dist. 1954), the court held:


Thus, the Attorney General believes it is appropriate and necessary in many instances to obtain a chancery court’s approval.

Finally, in the regular course of her duties the Illinois Attorney General is asked to compromise and agree to trust amendments regularly. A practical world approach is applied to each request. If the agreement is fair to charity and is a practical resolution to a demonstrated need to terminate, the parties should consider seeking the Attorney General’s agreement. The Attorney General will promptly respond to such requests and it is likely in many instances agreements fair to charity will result, which if necessary can then be presented to the court upon an agreed basis.

Submitted By:

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B. [11.68] Practitioner’s Charitable Gift Administration Checklist

PRACTITIONER’S CHARITABLE GIFT ADMINISTRATION CHECKLIST

___ Have all documents been collected to identify (charitable) gifts?

___ Recent income tax returns
___ Gift tax returns
___ Will and codicils
___ Revocable living trust
___ Irrevocable trusts
___ Death beneficiary designations
___ Payable-on-death designations
___ Transfer-on-death designations
___ Totten trust accounts
___ Annuities
___ Gift agreements
___ Pledge agreements

___ Has the identity and status of the charity beneficiary been confirmed?

___ Name
___ Address
___ Federal employer identification number
___ Type of entity
    ___ Corporation
    ___ Trust
    ___ Association
    ___ Governmental unit
Governing documents acquired

Trust agreement
Articles of incorporation
Bylaws
Minutes or certifications authorizing acceptance of gift and authorizing representative to act for charity beneficiary

Confirmation of tax-exempt status of organization

IRS tax-exemption letter acquired
IRS Publication 78 checked
Purpose of organization has been reviewed and it qualifies under

Code §2055(a)(1) — United States or governmental subdivision
Code §2055(a)(2) — Corporation
Code §2055(a)(3) — Trust or association (including foreign government)
Code §2055(a)(4) — Veterans’ organization
Code §2055(a)(5) — Employee stock ownership plan

Are there any issues with the charity as a successor to another charitable interest, such as a merged charity, or a charity not in existence to take the first named charity’s interest?

Has the charity beneficiary given or received a Code §507(a) notification of termination of tax-exempt status?

Has a substantial contributor taken any action that may culminate in imposition of Code §507(c) tax?

If a private foundation, do the governing documents prohibit

self-dealing (Code §4941(d))?
retaining excess business holdings (Code §4943(c))?
____ making speculative or jeopardy investments (Code §4944)?

____ taxable expenditures (Code §4945(d))?  

____ If the IRS has not yet granted tax-exempt status under Code §2055(a), has the charity beneficiary timely filed its notice for application of tax exemption?

____ Has the charity beneficiary engaged in activity that could cause it to be classified as an “action” organization under Treas.Reg. §1.501(c)(3)-1 by attempting to influence legislation and to intervene in political campaigns?

____ Is the charitable gift property

____ a specific asset? If so, identify the asset: ________________

____ a pecuniary amount?

____ a fraction of ________________?

____ Is the charitable gift property

____ wholly charitable?

____ a split-interest gift? If yes, is it

____ a marital deduction gift lead gift? If yes, is the marital gift a

____ general power of appointment marital trust?

____ qualified terminable interest property (QTIP) marital trust?

____ qualified domestic trust (QDT) marital trust?

____ property interest identified immediately below?

____ a charitable remainder trust (CRT) qualified under Code §664? If so,

____ does the trust prohibit the payment of the decedent’s debt, death taxes, and administration expenses?

____ does the trust make the successive life interest beneficiary responsible to pay any death taxes that are due because of inclusion of the CRT in the decedent’s gross estate?

____ a pooled income fund qualified under Code §642(c)(5)?
Is the nature of the charitable gift property or gift interest disqualified, in whole or part, for the estate tax charitable deduction because

____ the charity beneficiary is not qualified as reviewed above?

____ the gifted property is not included in the decedent’s gross estate?

____ the charity beneficiary will receive a gift less than the amount included in the gross estate because it is reduced by death taxes or administration expenses or the estate is otherwise insufficient?

____ the purposes of the gift are not sufficiently charitable?

____ the gift, as of the decedent’s date of death, is not sufficiently ascertainable

____ to a qualified charity beneficiary or class of qualified charities?

____ in amount?

____ the gift is too contingent or otherwise indefinite?

____ the gift is void under local law?

____ the gift is a legally enforceable pledge?

____ the gift’s compromise is not sufficient to meet requirements for estate contests or settlement agreements?
____ the gift is an inadvertent and unqualified split-interest gift in need of reformation pursuant to Code §2055(e)(3)?

____ Is the charitable gift going to be charged with any death taxes or administration expenses by the governing documents or principles of equitable apportionment?

____ Is the charitable gift going to be reduced by reason of the executor’s income tax elections or the nature of the administration expenses?

____ Can the estate take an income tax deduction for income and capital gains distributed to the charity beneficiary by reason of Code §642(c)?

____ Does the estate, trust, or trustee need to register with the Illinois Attorney General pursuant to the Charitable Trust Act?

____ Are there opportunities to fund the charitable gift with income in respect of a decedent?

____ Is there a possibility that IRD may fund a pecuniary gift and accelerate recognition of taxable income?

____ Are there opportunities to use a qualified disclaimer (or complete a timely termination of a power to consume, invade, or appropriate property) to enhance the net effect to beneficiaries?

____ Does any charitable gift or its purpose appear impracticable, impossible, inapproriate, illegal, or substantially impaired?

____ If the charitable gift is funded through a beneficiary designation of an employer’s retirement plan and the decedent has a surviving spouse, did the spouse execute a waiver and consent to the beneficiary designation as required by the Retirement Equity Act of 1984?

____ If the charitable gift is funded through a beneficiary designation of an employer’s retirement plan, do the provisions of the employer’s plan permit the charity as a beneficiary? If so,

____ does the trust pass the mathematical tests?

____ If the charitable gift is funded by proceeds from an employer’s retirement plan or an IRA and the charity shares the benefit or account with non-charity beneficiaries, have steps been taken to separate the benefit or account into a separate account on or before September 30 of the year following the year of the owner-participant’s death?

____ Has a certified or verified copy of the written gift instrument been attached to the federal estate tax return, IRS Form 706?
Has there been attached to the federal estate tax return, IRS Form 706, a writing by the executor declaring under penalties of perjury whether any action has been instituted to construe or to contest the decedent’s will or any provision thereof affecting the charitable deduction claimed and whether, according to information and belief, any such action is designed or contemplated?