Northwest Planned Giving Roundtable

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GOVERNMENT RELATIONS REPORT
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Federal Activity

Perhaps this introduction will help put things in perspective. Members of the gift planning community have as their priorities:

- Preserving the charitable deduction.
- Extending the charitable IRA rollover and enhancing it to include the ability to contribute retirement plan assets to life income gift plans.
- Less regulation of charitable activities – including the simplification of gift annuity regulations in the regulated states – Washington, California, New York, and New Jersey especially.
- Solving the estate tax dilemma.
- Increasing the charitable gifts and life income plans established to support charities.

The administration and Congress have other priorities and they may not be the same. And the issues and interests vary among the Republicans and Democrats, as well as factions within the parties:

- Health care reform legislation – the key goal of the Obama administration.
- Dealing with the economy – lowering unemployment across the country.
- Raising revenue – the stimulus activity and the war in Afghanistan continue to add to the federal deficit.
- Immigration reform - in whatever form that may take.

Key questions: where on the list of the priorities of the parties in Washington are the matters of importance to the charitable community? Where is estate tax legislation on this list?

Some thoughts on the topics being discussed in the press and meetings I have attended.

Tax Rates

The January special election in Oregon saw the approval of higher income tax rates and new taxes on businesses operating in Oregon. Oregon for the first time has a sales tax. It is called the gross receipts tax that was placed on business. Businesses are now being taxed on their gross sales, rather their income. A business can lose money and still pay tax on their gross sales.

Activity on the federal level is being driven by the need to raise revenue. Because of the economic crisis in 2008, the United States will incur a $3 trillion cumulative deficit during 2008-2010.

The Bush tax cuts are being allowed to pass into the sunset. Increases in the federal income tax rates are coming. The President's budget proposal for 2010 calls for an increase in the top two federal income tax brackets from 33% to 36% and from 35% to 39.6%. Capital gains taxes are expected to increase from 15% to 20% (this will make the combined Oregon capital gains tax rate roughly 28%). Any final outcome on the health care legislation being considered will likely include increased taxes for the highest-earning taxpayers (translation – charity's biggest donors).

Limits Proposed on Itemized Deductions
The Obama budget proposal includes limits on itemized deductions for taxpayers in the highest tax brackets at a 28% rate beginning in 2011. In effect, if a donor had a charitable deduction of $1,000, instead of deducting it against her full 39.6% rate, she could deduct it only against 28%.

Federal Estate Tax
It was expected that the issue of the federal estate tax would have been resolved before the year 2010 arrived. Remember that the unified credit amount had been increasing from 2001 to 2009 when it reached $3.5 million.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (ECGRRA) reduced the estate tax gradually. In 2010 the estate tax was reduced to zero. One of the most notable characteristics of EGTRRA is that its provisions are designed to *sunset*, or revert to the provisions that were in effect before it was passed. EGTRRA will sunset on January 1, 2011 unless further legislation is enacted to make its changes permanent

Under the provisions of the 2001 tax act, in 2011 the estate tax will be readjusted and return to the rates in effect before the legislation. This would mean that in 2011 the unified credit (exemption amount) would be $ one million and the estate tax rate would be 55%.

Because of the repeal of the estate tax in 2010, complicated new "carry-over basis" provisions were enacted which would increase the income tax on capital gains realized by some estates and heirs. (Under pre-EGTRRA law, property that is subject to estate tax gets a new income tax basis equal to fair market value, eliminating any capital gain on lifetime appreciation.)

It was/is expected that legislation will be passed to retain the estate tax with a 45% top bracket and a $3.5 million exemption. It has not happened yet, so when?

Factors that will affect how the estate tax law is changed:

1. Ongoing budget battle – tension between those who want to limit spending by depriving the federal government of revenue (more politically palatable than actually opposing spending) and those who want to do things with the revenue will continue.

   Surpluses were projected because economic growth was projected to continue at, more or less, 3.1% annually adjusted for inflation, but if that had dropped to 2.7% the projections would change to substantial deficit. Of course, an economic downturn, rebuilding after September 11, and the war against terrorism have pushed surpluses off or an undetermined number of years.

2. Control of Congress and the Presidency over the next decade.
3. Other problems that will take the focus off of the estate tax such as the AMT.
4. Predilections of early and mid-generation baby boomers. On the one hand, retirees want Social Security on a sound footing. On the other hand, some of those boomers will be looking to an elderly surviving parent and the amount they receive by inheritance will depend directly on the operation of the estate tax. If Social Security and Medicare are “fixed” (that is a big if), then estate tax reduction may have an appeal again.

Turney Berry, Comments on Estate Tax Repeal

Senator Max Baucus (D-MT), Chairman of the Senate Finance Committee, said he expects to draft estate tax legislation that will re-impose the 2009 estate tax retroactively to the start of 2010 but that timing for such legislation remains uncertain.

However, speakers at the Estate Planning Conference in Portland in January noted that the pressure for revenue along with the ticking calendar may provide a rationale for doing nothing. These “national authorities” are now expecting the estate tax rate to revert to 55% with a $1 million exemption. In their views, if Congress has not done anything by the summer recess, it may be too late and too easy to just let the old rates return.

Because of the difficulties experienced in 1976 and the outcries that will be coming from the accounting community, no matter what happens to the estate tax issue, I still see the step-up basis for appreciated assets to be returned through some corrective legislation. The "carry-over basis" rules are too much of a nightmare.

Summary of Estate Tax Rates

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

Expansion of Charitable IRA Rollover
The ability to make charitable gifts from IRA funds has been in effect for four years, but it has expired. Legislation to extend the provision has been proposed and may still pass. It has passed the House but needs to be considered by the Senate.

However, there appears to be little likelihood that the charitable IRA rollover provisions will be expanded to include gifts from those under 70 ½ and the transfer of IRA funds into life income plans. Remember – the need to raise revenue will be become even more important.

Result
Any increase in income taxes tends to favor charitable giving, as each dollar given to charity will save the donor more in taxes. A permanent resolution of the estate tax issue (whatever it is) will enable donors and their advisors to be more confident in their estate and charitable planning. If capital gains tax rates increase, charitable remainder trusts may become more popular. Charitable lead trusts will continue to draw increased interest (especially with the estate exemption amount at $1 million).

Since most of the changes being proposed would apparently begin in 2011, 2010 may be the best year for giving – from a tax planning standpoint. It might be well for donors to consider bunching future annual gifts into 2010, or making donor advised fund gifts in 2010 and "advising" distributions to charities after 2010.

Legislative activity in Washington and the uncertainty or unsettledness of the tax structure are discouraging some charitable planning. The other significant factor is the state of the US economy. It was not too long ago that the credit markets were frozen, the stock market was in free fall, unemployment rates were skyrocketing, and donors were nervous.

The U.S. economy is sluggish and recovery is expected to remain slow-paced for some time. Even with the downturn, the U.S. still has the most vibrant, diversified and dynamic economy on the planet. The panic is gone. But are donors confident enough to resume their previous giving patterns? Probably not – they are more cautious; they are still uncertain of their financial standing; and they don't feel that they are in a position where they can make large gifts. They issue is perception – has the donor's perception returned to a point of confidence?

Sources:

- PG Calc Looks in to the Crystal Ball for 2010, January 2010.
- New Decade Predictions, Gift Law
- Federal Income Tax Proposals & 2010 Charitable Gift Planning, Gift Planning Tips, R&R Newkirk Company, January.
- Berry, Turney. Comments on Estate Tax Repeal. Paper presented at Estate Planning Council of Portland annual conference.

- Zaritsky, Howard. Through a Dark and Murky Crystal Ball. Paper presented at Estate Planning Council of Portland annual conference.

IRS, Court Cases, & Regulatory Matters

Cash Contributions for Haiti Relief Now Deductible for 2009
President Obama has signed Public Law 111-126, which will allow taxpayers to make cash contributions to Haiti relief programs until March 1, 2010, and claim those contributions on their 2009 income tax return. The new law also specifies that contributions made via text message can be deducted and filers can show a telephone bill to prove the deduction.

Trust May Make Gift When not Intended by the Donor/Settlor
In Notice 2010-19 the IRS has stated that transfers made after 2009 to a grantor trust that is not wholly owned by the donor or the donor's spouse is treated as a gift of the entire interest in the property under section 2511(c).

This issue has special interest for those involved with charitable remainder trusts.

Section 2511(a) generally provides that the gift tax shall apply to transfers in trust or otherwise whether direct or indirect. Under the Gift Tax Regulations, a gift is complete when the donor parts with sufficient dominion and control as to leave in the donor no power to change its disposition. Section 2511(c) provides that, notwithstanding any other provision of section 2511 and except as provided in regulations, a transfer in trust shall be treated as a transfer of property gift unless the trust is treated as wholly owned by the donor or the donor's spouse. The Joint Committee on Taxation's explanation of section 25112(c) provides that certain transfers in trust are treated as transfers of property by gift even though such transfers would have been regarded as incomplete gifts, or would not have been treated as transfers under the gift tax provisions in effect prior to 2010.

What's the big deal of all this technical language? Up until this time, a charitable trust may have been written for a term of years to provide distributions to husband and wife, and then following their death to a child for the balance of the term of the trust. A provision would have been included granting the settler the right, exercisable only by will, to revoke the child's successor interest. This right is reserved to avoid a gift to the child for gift tax purposes.

Conrad Teitell has noted in an appeal to the IRS on behalf of the American Council on Gift Annuities that a literal reading of 2511(c) could result in the settler making a gift to the child (successor beneficiary) even when there is absolutely no income shifting. The donor is taxable on the CRT's payments during her life. The successor beneficiary will receive the trust payments (and be taxable on the payments according to IRC section 664) only if the child survives the immediate beneficiary of the trust and the settler has not exercised his/her testamentary right to terminate the successor beneficiary's survivorship interest.

A literal reading of section 2511(c), it could be said that the entire amount transferred is a gift and subject to gift tax.

"For the charities that depend on charitable remainder trusts to enable them to carry out their missions, the shadow cast by section 2511(c) is comparable to an automobile manufacturer having vehicles with accelerators that stick and brakes that fail." Conrad Teitell

It will be interesting to see how the IRS responds. This is a radical departure from use and practice.

DNA Testing Not Always Conclusive or as Intended
DNA tests have become important in the legal world. People convicted of crimes have been set free as a result of DNA testing. DNA tests can determine if a person was present at a crime scene or if someone is related to a person of interest.

Question: Is a daughter a daughter for trust purposes, even though she never was adopted and is not a genetic descendant? This question arises from a recently decided Florida case of Doe v. Doe, 2009 WL 2841190 (Fla. App. 2nd Dist. September 4, 2009).

For space reasons I have summarized the case details.

In 1988, Chester Jr. and his wife, Eleanor, executed mutual, revocable trusts. The trusts were amended several times, but in the end the trust was to be divided into subtrusts with one share for each then living grandchild.

Chester III had married Catherine's mother in July 1966. Catherine was born six months later, and her birth certificate listed Chester III as her father. They divorced in 1971 and executed a marital settlement agreement reciting that Catherine was their child and providing for Chester III's visitation and payment of child support.

In 1999 when Catherine was 32 years old, Chester submitted samples for himself and Catherine to two separate labs for DNA testing. The test results conclusively excluded Chester III as Catherine's father.

In 2006, the trustees initiated an action against Catherine and the settlers three other grandchildren seeking an order determining whether Catherine was a beneficiary of the trust. The court ordered Catherine to submit to DNA testing. The testing confirmed the 1999 results that Chester III was not Catherine's biological father. The court granted the trustees' motion and held that Catherine was not a descendant by blood of Chester Jr. and Eleanor and therefore had no beneficial interest in the trusts. Catherine appealed.

The appellate court began its opinion by stating that Catherine is indisputably the legitimate child of Chester III because she was born while Chester III was married to her mother and because Chester III acknowledged paternity during the divorce proceedings.

The trusts clearly contained a limitation of gifts to "only children and descendants by blood." The court focused on the fact that such language has been used since long before genetic testing became available to prevent adopted children from inheriting. The reading of the trusts' restriction to "descendants by blood" as requiring genetic testing ignores the lessons of legal history. **The phrase "descendants by blood" is a legal term of art, not a scientific one, so, as a legitimate child of one of the settlors' issue, Catherine qualifies as a descendant by blood.**

Finally, the court noted that there was no evidence that the settlers intended to exclude Catherine as a beneficiary. In the original trusts and subsequent amendments, they consistently referred to Catherine as their grandchild.

This ruling comes as a bit of a jolt to those of us used to DNA testing being the last unassailable word. A child may not really be a child (blood relative), but may still be a child of mother and father and may still benefit as a direct descendant. And you thought we could tell who was a direct descendent by some little test that everyone would support. More battles will follow on this issue.

Trusts & Estates, November 2009.

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That's it for issue #12. Please feel free to comment, send tips, or provide questions.