

Advanced Charitable Brainteasers: Common Problems and Uncommon Solutions

Bryan Clontz, CFP®
Charitable Solutions, LLC

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Agenda

EIGHT ADVANCED CHARITABLE CASE STUDIES

1. Life-Changing Baseball Coach: Commodities for College
2. Artwork to Ireland: Thankfully People Buy Modern Art
3. Corporate Real Estate Give-Back: Employees Retrained
4. Doctors' With a Good Investment: Believe It or Not!
5. Religious Conversion: Stabilizing a Family Foundation
6. Asset Compression and Anonymity: Lesson Learned
7. Pledge Fulfilled With Leveraged Dollars: Saving Face
8. S-Corporations and Roach Motels: Tax Arbitrage is a Beautiful Thing

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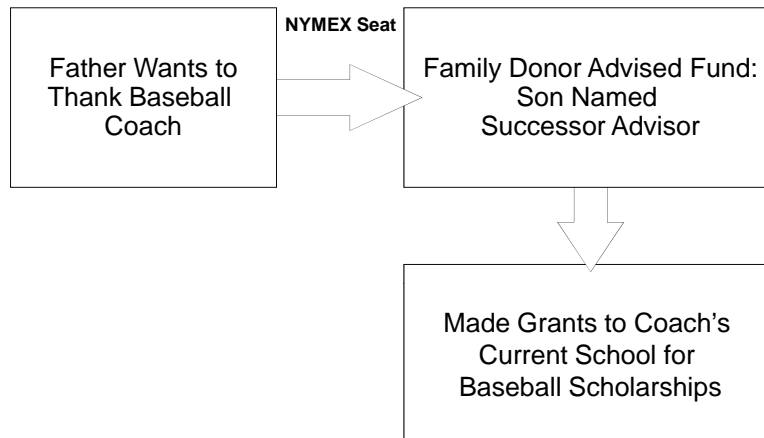
Charitable Brainteaser #1 – Situation

LIFE-CHANGING BASEBALL COACH:
COMMODITIES FOR COLLEGE

- ▶ Client's son barely graduated high school
- ▶ Went to small Midwestern university on baseball scholarship
- ▶ Immediately, coach positively changed son's life
- ▶ Son is 27, graduated from Princeton and is VP in father's Commodity Trading Business
- ▶ Father wants to create a Scholarship Fund to honor coach
- ▶ Doesn't want Fund if coach leaves or retires
- ▶ Father's assets are limited except for three seats on the NYMEX

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Charitable Brainteaser #1 – Solution



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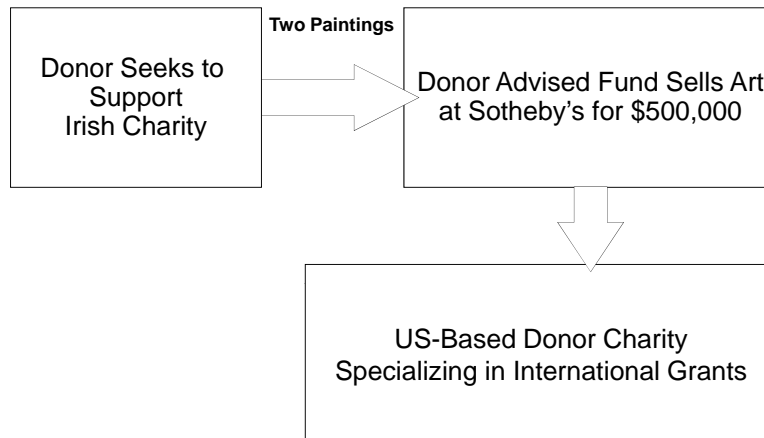
Charitable Brainteaser #2 – Situation

ARTWORK TO IRELAND:
THANKFULLY PEOPLE BUY MODERN ART

- ▶ New York client owns multiple pieces of inherited art currently in storage
- ▶ Originally intended to bequeath art to local church
- ▶ Now he wants to make a \$500,000 donation to an Irish charity's endowment with no US-affiliate

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Charitable Brainteaser #2 – Solution



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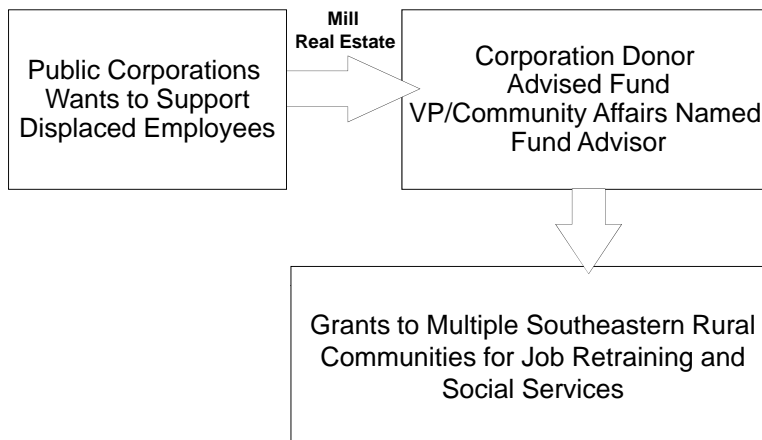
Charitable Brainteaser #3 – Situation

CORPORATE REAL ESTATE GIVE-BACK: EMPLOYEES
RETRAINED

- ▶ Fortune 500 corporation shut down domestic textile mill production and outsourced jobs
- ▶ Goal was to create a foundation to provide job-retraining and social service grants to effected employees
- ▶ Critically important to maximize tax savings and minimize administrative burden
- ▶ Would consider funding with cash or shuttered mill property

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Charitable Brainteaser #3 – Solution



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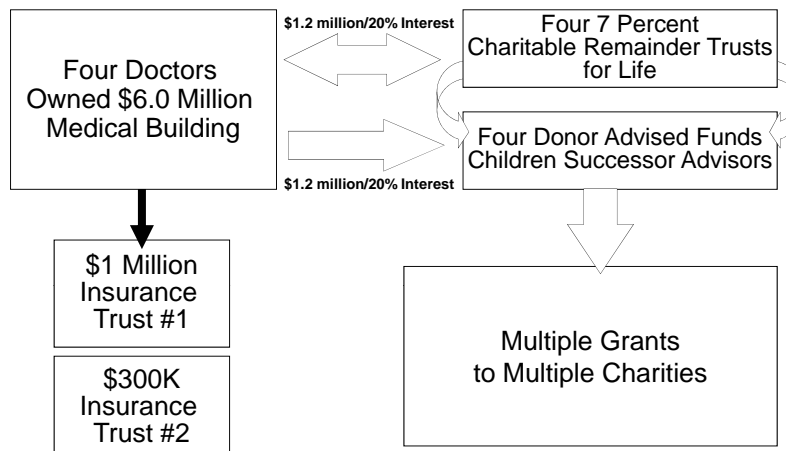
Charitable Brainteaser #4 – Situation

DOCTORS WITH A GOOD INVESTMENT: BELIEVE IT OR NOT!

- ▶ Four doctors owned their medical building with virtually zero cost-basis
- ▶ A regional REIT offered to purchase it every year
- ▶ Doctors wanted to retire and sell practice to six junior doctors
- ▶ Junior doctors wanted long-term lease
- ▶ Each doctor was charitably-inclined but wanted to maximize tax savings and receive a life income
- ▶ Two were particularly concerned about disinheritting children/grandchildren with donations

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Charitable Brainteaser #4 – Solution



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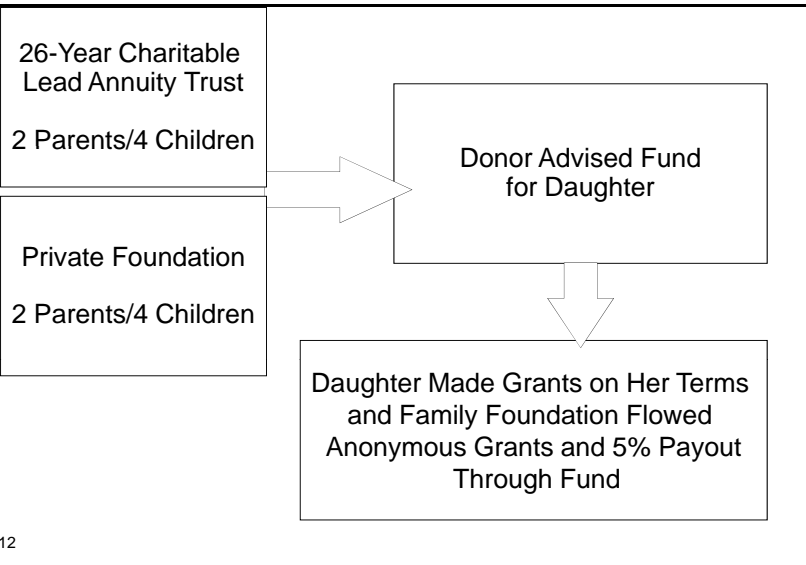
Charitable Brainteaser #5 – Situation

RELIGIOUS CONVERSION:
STABILIZING A FAMILY FOUNDATION

- ▶ 5 years ago, grandfather wanted a 100% charitable estate tax deduction without irrevocably giving the assets to charity
- ▶ Now, two children and four grandchildren are on also on the family foundation's board – one grandchild married outside of faith and upset her brother
- ▶ She feels ostracized and can't make grants to new church
- ▶ Family foundation had not met 5% payout requirement and also wanted to grant to an environmental charity but application expressly excluded environmental groups

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Charitable Brainteaser #5 – Solution



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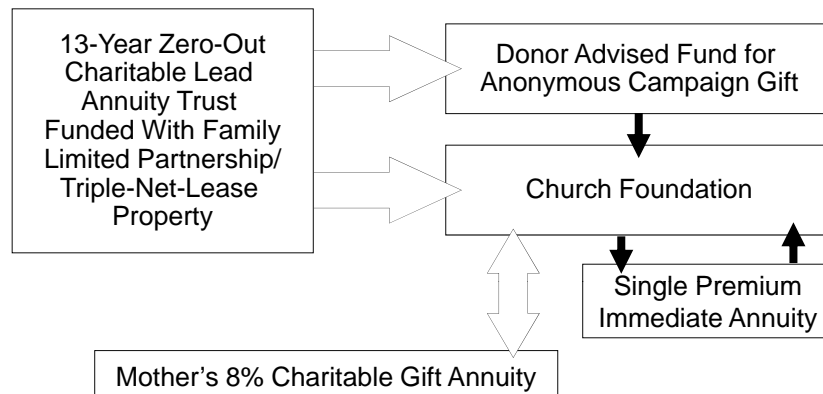
Charitable Brainteaser #6 – Situation

ASSET COMPRESSION AND ANONYMITY:
LESSON LEARNED

- ▶ An overly optimistic client was named capital campaign chair for church – promised completion in 24 months
- ▶ As a warehouse developer, he held a number of triple-net lease properties which he wanted to tax-effectively transfer to his children
- ▶ 23.9 months into the campaign, he called to say the campaign was \$300,000 short and he needed some solutions
- ▶ Also, his 80-year-old mother planned to contribute \$500,000 to the church campaign for a charitable gift annuity (income for life) but was concerned about default risk

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Charitable Brainteaser #6 – Solution



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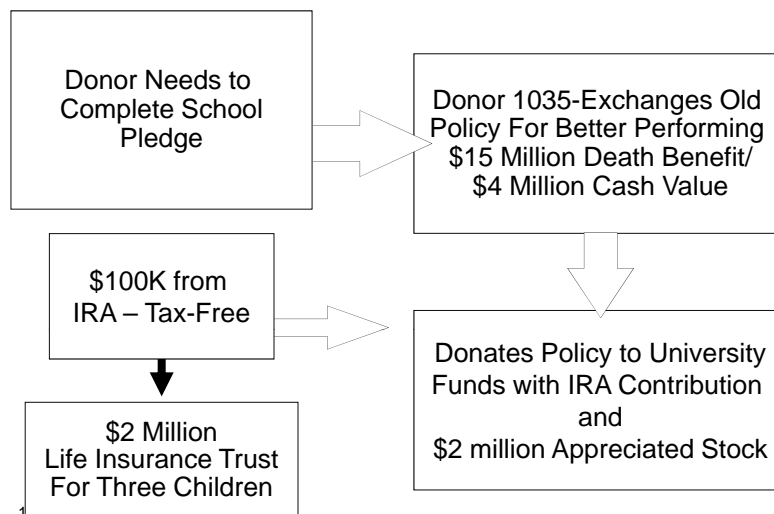
Charitable Brainteaser #7 – Situation

PLEDGE FULFILLED WITH LEVERAGED DOLLARS:
SAVING FACE

- ▶ 65 entrepreneur pledged \$10 million to name a business school in 1999
- ▶ Company collapsed in 2006 and he had \$7 million remaining on the pledge
- ▶ School said either \$7 million now or \$15 million in an irrevocable estate gift
- ▶ Client had an \$4 million IRA, \$13 million stock portfolio and a \$5 million life insurance policy (\$2 million in cash) originally purchased in 1985 as a cross-purchase business buy-sell (underperforming) and about \$300K in cash
- ▶ Client does not want pledge fulfillment to negatively impact three children

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Charitable Brainteaser #7 – Solution



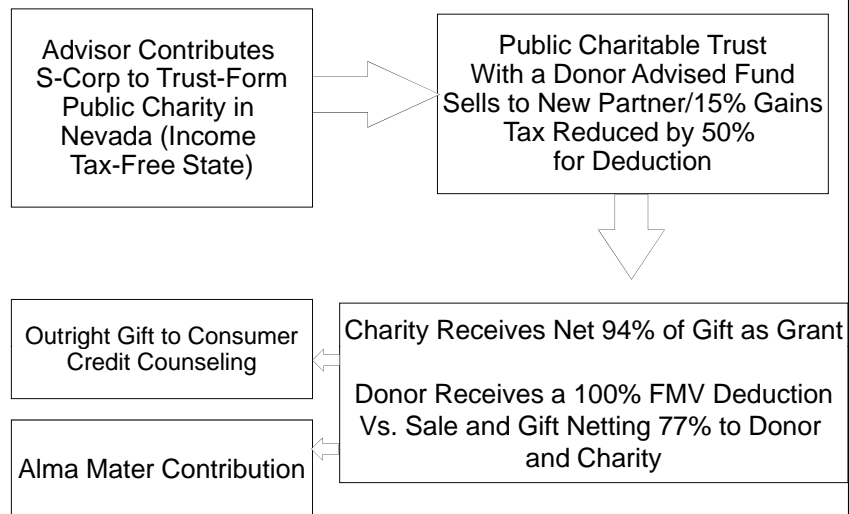
Charitable Brainteaser #8 – Situation

S-CORPORATIONS AND ROACH MOTELS:
TAX ARBITRAGE IS A BEAUTIFUL THING

- ▶ Investment advisor's firm is a S-Corp and he wants to sell \$500,000 to new partner
- ▶ State income tax rate is 8%
- ▶ Investment advisor is charitably-inclined
- ▶ Advisor wants to use the S-Corp stock if possible to make a contribution to consumer credit counseling and alma mater
- ▶ S-Corp has zero cost-basis and all gain is categorized as unrelated business taxable income to the charity (UBTI)

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Charitable Brainteaser #8 – Solution



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Advanced Charitable Brainteasers: Common Problems, Uncommon Solutions

Case Study Legal/Tax References Guide

Legal/Tax Issues in Case Study #1 – Commodities for College

Donor Advised Fund Grants to Scholarship Fund - Under the Pension Protection Act provisions, sponsoring organizations may make grants to natural persons from amounts not held in donor advised funds and may establish scholarship funds that are not donor advised funds. A donor may choose to make a contribution directly to such a scholarship fund (or advise that a donor advised fund make a distribution to such a scholarship fund).

Capital Gain vs. Ordinary Income Asset – IRC 170(b)(1)(A) as well as (a) and (e) related to deductibility limitations.

Legal/Tax Issues in Case Study #2 – Thankfully People Buy Modern Art

Tangible Personal Property Donated to a Non-Use Related Charity – Deduction is limited to adjusted cost basis – IRC 170(e)(1)(B)(i).

Collectibles Tax – IRC 170(e)(1)(B)(ii) states that the federal capital gains tax rate is 28%.

Potential Excess Benefit Transaction with Investment Advisor – A new Pension Protection Act provision is that the entire amount of the payment be treated as the amount of the excess benefit differs from the generally applicable rule of section 4958, which provides that the excess benefit is the amount by which the value of the economic benefit provided exceeds the value of the consideration received.

Expenditure Responsibility for International Grant - In general, expenditure responsibility requires that a foundation make all reasonable efforts and establish reasonable procedures to ensure that the grant is spent solely for the purpose for which it was made, to obtain reports from the grantee on the expenditure of the grant, and to make reports to the Secretary regarding such expenditures, see Sec. 4945(h).

Legal/Tax Issues in Case Study #3 – Corporate Foundation Look-Alike

Public Charity vs. Private Foundation Tax Rules – IRC 170(b)(1)(A) outlines the rules relative to public charity deductibility, and IRC 170(b)(1)(B) outlines the rules relative to private foundation deductibility. The rules relating to the contribution of long term capital gain property limitations to a public charity are covered here IRC 170(b)(1)(C)(i) and Reg 1.170A-8(d)(1).

C-Corporation Deduction Rules - IRC 170(b)(2), IRC 170(d)(2) and Reg. 1.170A-11(c) cover the 10% of net income deduction limitation and the five year carry forward provisions for any unused deduction.

Legal/Tax Issues in Case Study #4 – Doctors with a Real Estate Investment

Partial Interest Gifts - IRC 170(f)(3) disallows any partial interest gifts. The exceptions can be an entire undivided interest (IRC 170(f)(B)(iii)) or qualified split-interest contributions like charitable remainder trusts – see IRC 664(d)(2).

Qualified Appraisal Requirements and Substantiation – Pension Protection Act Definitions

Qualified Appraisers

The provision defines a qualified appraiser as an individual who (1) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements to be determined by the IRS in regulations; (2) regularly performs appraisals for which he or she receives compensation; (3) can demonstrate verifiable education and experience in valuing the type of property for which the appraisal is being performed; (4) has not been prohibited from practicing before the IRS by the Secretary at any time during the three years preceding the conduct of the appraisal; and (5) is not excluded from being a qualified appraiser under applicable Treasury regulations.

Qualified Appraisals

The provision defines a qualified appraisal as an appraisal of property prepared by a qualified appraiser (as defined by the provision) in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed by the Secretary.

See Reg. 1.170A-13(c)(1)(i) and Reg. 1.170A-13(c)(3)(i).

Charitable Remainder Trust Provisions – Charitable remainder trusts are discussed at length in Chapter 13. Flip unitrust provisions can be seen in Reg. 1.664-3(a)(1)(i)(c)-1.6643(a)(1)(i)(f).

Irrevocable Life Insurance Trust – This trust, if designed properly, allows for the death benefit to be both income and estate tax free - IRC 2042(1) and(2).

Legal/Tax Issues in Case Study #5 – Stabilizing a Family Foundation

Charitable Lead Annuity Trust – For a comprehensive overview of charitable lead trusts, see IRC 170(f)(2)(B), 2055(e)(2)(B) and 2522(c)(2)(B).

Private Foundation Qualifying Grant – The 5 percent minimum distribution rule is covered here IRC 4942(e). Grants to public charities, like community foundations component funds, qualify as distributed income.

Anonymous Grants – Private foundations must disclose all grants on the 990-PF tax return. Community foundations also have to disclose the amount and organization of all grants, however, they are aggregated from all the sponsoring organizations component funds. The public charity 990 tax return does not require each grant to be “attached” to specific funds.

Legal/Tax Issues in Case Study #6 – Asset Compression and Anonymity

Charitable Lead Annuity Trust Valuation – The IRS approved a CLT funding with limited partnership interests, as the partnership’s income comprised solely of passive investment income.

Thus it was not a business enterprise and the income was not unrelated business taxable income (UBTI) – see PLR 9810019.

Charitable Gift Annuity – Complete coverage of gift annuities can be found at Reg. 1.170A-1(d)(1), Rev. Rul. 55-388, 1955-1 CB 233; Rev. Rul. 80-281, 1980-2 CB 282 – in particular the tax deductibility of the qualified installment bargain sale transaction.

Charitable Gift Annuity Reinsurance Provisions – Qualifying reinsurance provisions can be found in 170(f)10 charitable reverse split dollar rules. There have also been two relatively recent PLRs 200847014 and 200852037 that allow for some flexibility in the reinsurance design. A number of additional articles can be found at <http://charitablesolutionsllc.com/library.html> and the American Council on Gift Annuities – www.acga-net.org.

Legal/Tax Issues in Case Study #7

IRA Rollover – A qualified charitable IRA rollover, outlined in IRC 408(d)(8)(A), allows an individual 70 ½ and older, to make a direct contribution of up to \$100,000 of their retirement account to a public charity (excluding donor advised funds and supporting organizations). It was extended through December 31, 2011. The direct distribution is not included in income.

Charitable Gifts of Life Insurance – Since nearly all life insurance gain is ordinary income, the deduction is limited to the lesser of fair market value or adjusted cost basis – see IRC 170(e)(1)(A).

Legal/Tax Issues in Case Study #8

Charitable Gifts of S-Corp Stock – Chris Hoyt wrote an excellent article on S-Corp at http://lawprofessors.typepad.com/trusts_estates_prof/2011/09/donations-by-s-corporations-and-shareholders-.html . It is also covered in IRC 512(e).

Trust Tax Law for Charitable Contributions – IRC 512(B)(2) allows for a trust to take a charitable income tax deduction up to 50% of its Unrelated Business Taxable Income (UBTI). Further, a trust is taxed at individual rates for recognized long-term capital gains at the 15 percent federal rate.