

Charitable Deduction for Estates and Trusts

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Basic Rules on Income Taxation of Estates and Trusts



- **Essentially, taxed as individuals are taxed**
- **Many exceptions:**
 - **Grantor trusts**
 - **Distributions deduction: Sections 651 and 661**
 - **Charitable deduction under Section 642(c) rather than Section 170**
 - **No distributions deduction for distribution to charity (apparently) Section 663**



Basic Charitable Deduction Rules: Humans



- **Individuals: Section 170: Deduction for Contribution to a Domestic (US) Charitable Organization**
 - **Percentage limitation on contribution base (20% to 50%)**
 - **Type of property**
 - **Tax nature of the property (e.g., ordinary income property)**
 - **Type of charitable recipient**
 - **“For the use” vs. “to” (lower percentage limits apply)—CLT vs. CRT**
 - **Other limitations. See, e.g., Sections 170(a)(3), 170(f)**



Basic Charitable Deduction Rules: Trusts & Estates



- **Trusts and Estates: Section 642(c)**
 - **Unlimited deduction but**
 - **Requirements (*paid, or for estates also set aside, from gross income, pursuant to the terms of the governing instrument, for a charitable purpose, no US requirement*).**
 - **May be paid from a prior year's income**
 - **Special election under Section 642(c)(1): Income from one year may be deducted in that year if paid by the end of the next year**
 - **May reduce the base upon which NIIT is imposed**



Paid from Gross Income Requirement May Require Some Tracing



- It is not entirely clear whether or the extent to which the payment to charity must be traced directly to gross income actually received.
- Compare the following cases with each other: *Old Colony Trust Co. v. Commissioner*, 301 U.S. 379 (1937); *U.S. v. Benedict*, 592 U.S. 692 (1950); *Crestar Bank v. Internal Revenue Service*, 47 F. Supp. 2d 670 (1999); *Van Buren v. Commissioner*, 89 T.C. 1101 (1987); *Riggs National Bank v. U.S.*, 352 F.2d 812 (1965); *Frank Trust of 1931 v. Commissioner of Internal Revenue*, 145 F.2d 411 (1944); *Freund's Estate v. Commissioner*, 303 F.2d 30 (2nd Cir. 1962); *Sid W. Richardson Foundation v. U.S.*, 430 F.2d 710 (5th Cir. 1970); *Estate of Esposito v. Commissioner*, 40 TC 459 (1963), *acq.* 1964-1 CB (pt. 1) 4.
- In any case, it seems that some type of tracing of the contribution to gross income received by the trust or estate is required to support a deduction under section 642(c).



Paid from Gross Income Requirement May Require Some Tracing (Cont.)



- **What about income imputed from an investment entity (S corporation; partnership; LLC)?**
- **Interpose an intermediate entity which is the one that supplies the K-1 and have it distribute sufficient case that is “labelled” as gross income from that entity.**



- ***Green v. United States*, -- F. Supp. -- (W.D. OK. 2015):** The trust that was authorized to distribute any amount of its gross income to charity was entitled to an income tax deduction under section 642(c) of the Internal Revenue Code of 1986, as amended, for the full fair market value of property purchased with gross income the trust had received in prior years and was not limited to the trust's adjusted basis in the property.
- **Good news or bad?**
- **Rev. Rul. 2003-123: No deduction for conservation easement (described in Section 170(h))**
- **Intermediate (Sandwiched) Entity for Imputed Income**

Pursuant to the Terms of the Governing Instrument



- ***Weir v. US*, 362 F. Supp. 928 (1973), *aff'd*, 508 F.2d 894 (1974): “the instrument must be shown to possess some positive charitable intent or purpose of the settlor—not merely that the settlor did not exclude charity from all the possible beneficiaries of his bounty.”**
- ***Crown v. Commissioner*, 8 F.3d 571 (1973): Commutation made not paid pursuant to governing instrument.**
- **May be discretionary. Why not have it in all wills and trusts?**
- ***Brownstone v. US*, 465 F.3d 525 (2000): Exercise of general power in favor of charity insufficient—governing instrument is the one that created the power not the one that exercises it.**
- **The Way Out: Trust as partner: Rev. Rul. 2004-5, 2004-1 CB 295: But complicated—See Blattmachr, “Trusts Created by Entities,” Heckerling 2015**
- **Decanting to Another Trust?**



Donations to Split-Interest Trusts by Non-Grantor Trusts



- **PLR 9821029 (not precedent): CRT was treated as created by a non-grantor trust through the exercise of a special power of appointment held by an individual beneficiary of the trust**
- **No mention of Section 642(c) deduction (better: trust as a partner)**
- **Add special power by decanting (e.g., EPTL 10-6.6)**
- **Non-grantor trust may create a grantor trust as to itself. Example 8 in Reg. § 1.671-2(e)(6)**
- **CLT: Grantor or non-grantor trust**



Unlimited Deduction Except



- **Unlimited deduction except to the extent paid from unrelated business income (UBI). Section 681; but does not apply to estate; use section 645**
- **Meaning of UBI; effect (Section 170 limits apply)**
- **Partnership: Gross income and UBI limits apply according to the IRS**
- **Charitable purpose (not organization):**
 - **Partnerships and corporations need not “die” so grantor trust status need not end**
 - **Even if the partner or shareholder is viewed as the grantor (which it is not), a non-grantor trust can be kept from “dying”**
 - **Disallowed if made to certain foreign charities and private foundations**



Summary and Conclusions



- **Section 642(c) deduction may be preferable because**
 - **It may permit protection 100% of income**
 - **Can be retroactively claimed**
 - **Need not be a domestic (US) charity**
- **Limitations:**
 - **Tracing of gross income**
 - **Pursuant to the terms of the governing instrument (partnership “exception”)**
 - **UBI limit**
- **Consider allowing the trustee (perhaps with beneficiary consent) or the beneficiary to distribute gross income to charity**

