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# Professional Partners

## Parents Get a Lesson in Tuition Payments

**Sklar v. Comm'r., 125 T.C. No. 14**

Michael and Marla Sklar's five children attended two Orthodox Jewish day schools, for which the parents paid tuition and fees of more than \$27,000 in 1995. They claimed a charitable deduction for 55% of the expenses (\$15,000), based on the schools' estimates that 45% of the education their children received was secular and 55% was religious. The couple contended that the religious education qualified as an "intangible religious benefit" under Code §170(f)(8).

The Tax Court noted that it is well-established that no charitable deduction is available if the taxpayer receives a substantial benefit in return for a transfer to a charity, citing numerous cases holding that tuition paid to schools providing both a secular and religious education is not deductible because the payments are not made with "detached and disinterested generosity."

Where a portion of a payment is deductible as a charitable contribution, the taxpayer must show that the payment exceeds the fair market value of the benefit received and that the excess payment was made with the intent of making a gift [*U.S. v. American Bar Endowment*, 477 U.S. 105]. The court said the couple did not show that any part of their payment was a charitable contribution.

The Sklars claimed they did not need to show an intent to make a gift because what they received was an intangible religious benefit under Code §§170(f)(8) and 6115. The court disagreed, noting those sections merely provide an exception to the substantiation and disclosure requirements. These

exceptions apply only where the recipient organization is exclusively religious, unlike schools that provide both a secular and religious education. The couple was not entitled to the deduction.

## Unitrust Can Return Funds Added by Mistake

**Ltr. Rul. 200601003**

Martha, dissatisfied with the performance of her investment in warrants, directed that they be liquidated and the proceeds forwarded to her brokerage account. When the proceeds were transferred, they were mistakenly added to Martha's charitable remainder unitrust account instead of her brokerage account. The mistake was not discovered until several years later. Although Martha did not claim a charitable deduction for the transfer, her annual unitrust distribution was calculated based on the value of the proceeds.

When Martha and her attorney discovered the mistake, they sought court approval to withdraw the funds. The court determined that no valid donation had been made and ordered a return of the funds. The amount refunded to Martha was the amount transferred, reduced by the amount of unitrust distributions received in the intervening years attributable to the transferred funds and increased by the earnings attributable to the funds as of the date of the court order. The court's ruling was conditioned on a favorable ruling from the IRS.

In general, no amount, other than the unitrust or annuity trust amount, may be paid to or for the use of any person other than a charity [Code §664(d)(2)]. A transfer of funds from a charitable remainder trust to a disqualified person is an act of self-dealing [Code §4941(d)(1)(E)].

The IRS determined that the transferred funds were never part of the corpus of the unitrust for tax purposes. The restoration of funds to the taxpayer, as directed by the court, will not disqualify the trust or constitute an act of self-dealing. The taxpayer and the trust must file amended returns for the intervening years, with the taxpayer reporting any interest generated by the funds when they were invested in the short-term instruments.

## Spousal Waiver Deadline Extended Indefinitely

### Notice 2006-15

The IRS stirred up a hornet's nest last year when it said that certain charitable remainder trusts would not be qualified unless the donor's spouse signed an irrevocable waiver of any right to trust assets in the event the spouse elected against the donor's will (Rev. Proc. 2005-24). The issue arose because, under the laws in some states, an electing spouse is entitled to a portion of the decedent's "augmented" estate, which may include the assets of a charitable remainder trust. Code §§664(d)(1)(B) and (d)(2)(B) specifically provide that charitable remainder trusts are qualified only if they operate continuously from their creation as either annuity trusts or unitrusts. The trusts must provide that no amount, other than the annuity trust or unitrust payments, may be paid to any person other than a charity. The IRS in 2005 required spousal waivers for trusts created on or after June 28, 2005. Trusts created prior to that time were grandfathered, provided the surviving spouse did not, in fact, reach trust assets as the result of an election. The IRS has now extended the grandfather date "until further guidance is issued."

## Rate of the Month

In valuing split-interest charitable gifts (charitable remainder trusts, charitable lead trusts, charitable gift annuities, remainder interests in homes and farms), donors may use the §7520 rate for the month of the transfer or the rate from either of the two prior months. For transfers in July, the rates are:

May 5.8%    June 6.0%    July 6.0%

## You've Asked . . .

*Two elderly clients – sisters – own a summer cottage that they inherited many years ago from their father. They are no longer able to use the home and have no one to whom they can leave it at their deaths. Could the home be used to fund a charitable remainder trust that would provide them income for their lives?*

Real estate is generally an excellent asset with which to fund a charitable remainder trust. However, the IRS has ruled that a trust funded by grandparents and their six grandchildren was an "association," not a trust (Ltr. Rul. 9547004). The IRS applies this "association" theory where trusts are created by multiple donors who are not spouses. Depending upon the form of joint ownership (joint tenants with right of survivorship or tenants in common), the sisters could create separate trusts, funding them with their 50% undivided interests. Each could create a survivorship interest for the other and avoid gift tax by retaining the right to revoke the other's interest in their wills.

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