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Foundation to Benefit from Trust Reformation

McCance v. McCance, SJC-09917

When Henry McCance created his charitable remainder unitrust in 1994, he intended to include language permitting him and his wife to voluntarily transfer their current and contingent income interests to his private foundation. His attorney was concerned, however, that the availability of a gift tax deduction might be affected, so the language was not included.

Several years later, the IRS issued a favorable private ruling on substantially similar circumstances. McCance proposes to reform the trust to allow an assignment of the income interests to the foundation. The Supreme Judicial Court of Massachusetts noted that it can reform a trust to conform to the settlor's intent. Both McCance and his attorney provided affidavits concerning the intent to retain the power to make voluntary transfers during the couple's lifetimes. The court remanded the matter to the Probate and Family Court to reform the trust.

Memorial Garden Loses Lease, Finds New Location

Kolb v. City of Storm Lake, No. 63/06-0067

Henry and Martha Kolb entered into an agreement with the city of Storm Lake, Iowa, in 1968, to establish a memorial garden and fountain at a chosen spot in a city park. The couple contributed farm land to a trust to provide funds for maintenance.

In 2003, the city developed a revitalization plan that would necessitate moving the garden and fountain. The Kolbs' son, Norman, sought an injunction to stop the move. When the court refused to issue an injunction, the city proceeded with demolition of the garden and fountain. Norman then claimed that because the purpose of the trust had been defeated by the city's voluntary act, the trust should benefit the Kolbs' successors. The city asked the court to apply the cy pres doctrine to allow the trust to fund the garden and fountain in a new location. The court sided with Norman.

The Supreme Court of Iowa noted on appeal that the terms of the Kolbs' trust did not provide what was to happen if the purpose of the trust failed, adding that state law establishes "a presumption that cy pres should apply if the trust does not state 'to the contrary.'" Norman argued that the city should not be able to invoke the cy pres doctrine when it caused the impossibility of maintaining the garden in its original location. The court found that the city's actions, while causing the impossibility, were the result of "natural and unavoidable change."

The original location of the garden was certainly important to the Kolbs, noted the court, but the record showed no reason why that spot was unique. The court found that the Kolbs, if alive, would have preferred that the trust continue under cy pres so that the memorial to their grandson could continue. While they might have been disappointed by the relocation, they would be even more disappointed in the complete failure of the trust, ruled the court.

Attorney Not to Blame for No Insurance

Smallegan v. Kooistra, No. 272838, LC No. 04-049107-CZ

Florence Smallegan, on the advice of her financial advisers, planned to transfer \$900,000 of appreciated stock to a charitable remainder unitrust. She intended to purchase life insurance to replace the assets in her estate. Despite rejection by one insurance company, she funded the unitrust anyway. After several other companies denied coverage, Smallegan gave up efforts to obtain life insurance.

Following her death, her son sued the attorney who drafted the documents, seeking to recover the value of the intended insurance proceeds. The trial court, applying the “four corners” rule, found no errors for which the attorney could be liable and granted summary judgment.

The Michigan Court of Appeals agreed, noting that the unitrust clearly indicated Smallegan’s intent to distribute assets to charity from her estate. Even if the attorney were guilty of malpractice for advising Smallegan to transfer the stock to the unitrust without first having the insurance, only she would have had a cause of action, not a potential beneficiary, said the court. Although Smallegan knew she had no life insurance, she made no effort in the four years between funding the trust and her death to disavow the trust, rescind it or seek recourse against her advisers, the court pointed out.

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 November, the rates are:

September 5.8% October 5.2% November 5.2%

You’ve Asked . . .

I have a client who owns an antique car that is worth about \$450,000. He purchased it a number of years ago for \$120,000. He asked whether he could use the car to fund a charitable remainder trust that would provide income to him and his wife for their lives. Is this possible?

The IRS has ruled privately that a trust may be funded with tangible personal property (Letter Ruling 9452026). Your client and his wife would be entitled to income based on the fair market value of the car, with no loss to capital gains tax. His charitable deduction would be based on charity’s remainder interest in his basis because of the unrelated use of Code §170(e)(1)(B)(i). Under Code §170(e)(3), the deduction for a charitable gift of tangible personal property is postponed until the donor no longer has an intervening interest, which would be at the time the car is sold by the trustee.

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