After Katrina, New Income Tax Changes Hope to Spur Charitable Giving

by Elaine Waterhouse Wilson, Barnes & Thornburg LLP

Congress recently enacted changes to the tax code relating to various issues raised by Hurricane Katrina, including some new incentives to spur more charitable giving. These charitable giving incentives terminate on **December 31, 2005**; accordingly, anyone wishing to take advantage of these provisions should act as soon as possible.

Generally, a taxpayer may not take a charitable income tax deduction for gifts to public charities in excess of 50% of the taxpayer's adjusted gross income ("AGI") in one year. Any excess charitable deduction is carried forward for up to five years; any deduction that is not used after five years is lost. Similarly, a C corporation may only take a charitable income tax deduction up to 10% of its adjusted taxable income in any one year. The legislation suspends the 50% limit and the 10% limit for charitable deductions in respect of cash gifts made between August 28 and December 31, 2005. Contributions must be made to qualifying public charities; gifts to donor advised funds, supporting organizations, and most private foundations will not qualify. For individuals only, the donation may be for any charitable purpose; however, for C corporations, the contribution must be for hurricane Katrina relief. These charitable deductions are protected from reduction for those taxpayers whose itemized deductions phase out. Any individuals who consistently makes gifts that generate excess charitable deductions should determine whether these new provisions can be of assistance.

This temporary suspension of the 50% AGI limitation makes it a more favorable time to use retirement assets to make charitable contributions. For example, assume a taxpayer withdraws $100 in cash from his IRA and donates that money to charity in December, 2005. The taxpayer will report this $100 as income on his Form 1040 but he will also take a charitable deduction of $100. While the full charitable deduction may offset the increase in income, other tax issues may prevent a complete "wash" for state and federal income tax purposes. For example, if an individual's AGI is increased, certain deductions and exemptions (other than the increased charitable deduction) may begin to phase out. In addition, some states base their income tax upon a taxpayer's federal AGI, without regard to charitable deductions. Therefore, in these states, a taxpayer will increase his or her gross income, but will not be entitled to the offsetting charitable deduction. Finally, the 10% early withdrawal excise tax still applies to anyone under the age of 59½. While not perfect, these new tax provisions will still interest any individual who has wanted to use retirement funds to make current charitable contributions, but has been hesitant to do so due to the adverse income tax effects.

Rev. Proc. 2005-24 CRT With Potential Claim Against Trust for Spouse's Elective Share.

by Steve R. Akers, Bessemer Trust

Rev. Proc. 2005-24, 2005-16 IRB, came out earlier this year regarding charitable remainder trusts in UPC states and other states where the surviving spouse is entitled to a share of the augmented estate. The IRS saw a problem because the taxpayer gets a deduction in year one of the trust. Several years later, the donor may die and the surviving spouse may make a claim on the assets beyond just the right to receive an annuity under the document. In that case,

the charity may not receive assets for which the donor received a deduction. The IRS "applied a sledge hammer to a mosquito."

Starting with CRTs executed on or after June 28, 2005, the IRS will treat them as not qualifying from inception in those states where donor's spouse can make a spouse's elective share claim against the CRT unless there is a waiver of the right by the spouse to take any interest in the trust in satisfaction of the spouse's elective share. The waiver is supposed to be completed within 6 months of the due date of the original tax return and the Form 5227 for the trust.

When does the spouse have to file the waiver? It is not required under the strict terms of the Rev. Proc. if the donor does not live in a UPC state or if the client is not married. However, the language in the Rev. Proc. is broad enough that if an unmarried client later becomes married, that could possibly invalidate the CRT either *ab initio* or from the date of the marriage. A change in the law or a change in domicile could result in the same phenomenon. The Rev. Proc. raises many uncertainties. The Rev. Proc. does not discuss what is required of such a waiver other than to say that it must be effective under state law. Some say that separate counsel may be required.

There is concern that the IRS could apply this concept to other transactions. In some states (such as New York) a spouse could set aside an outright charitable gift within a certain period of time. So is a waiver required on outright gifts in NY? Or if move to NY? Other possible problem areas include the right to claim from the augmented estate under the UPC for spousal election purposes, and the enlarged rights of creditors under the new Bankruptcy Act including the ability to reach self-settled trusts created within 10 years of bankruptcy.

The author understands that the Treasury Department and representatives from ACTEC, the ABA Tax Section and the ABA RPPT Section are working on ways to satisfy the IRS's policy concerns in a more targeted manner.

CRUT Sample Forms.

The IRS issued CRUT sample forms on August 22. The IRS is now starting to work on CLT forms. The forms are available at: http://www.irs.gov/irb/2005-34_IRB/ar02.html