IN THIS ISSUE:

Message from the Chair: ..................................................... 3
Message from the Chair - Elect: ................................. 4
FIRPTA: Increased Withholding and Other Changes ........ 5
FL Bulletin-Goodwill Article .................................................. 7
How to Make Lifetime Transfers Without Gift Tax Exposure:
Effectively Funding a Grantor Trust with Debt ................. 9
Maintaining Tax Exempt Status When Partnering with a For-
Profit Entity ........................................................................ 11
Three Tax Strategies that Magnify Charitable Gifts! ........... 14

Cover photo: by Randy Traynor
www.randytraynorphotography.com

SAVE THE DATE!

Tax Section Organizational Meeting
Omni Amelia Island Plantation
July 1 - 4, 2016

The Florida Bar Tax Section
2016-2017 Meeting Locations and Dates

2017 Tax Section Fall Meeting
Vino Hotel, St. Petersburg - October 13-15, 2016

2017 Directors Meeting
Villagio Inn & Spa, Yountville, CA - March 2-5, 2017

Tax 2017 Annual Meeting
Amelia Island, Fernandina Beach - June 30 - July 5, 2017
Message from the Chair
By: James H. Barrett, Esq., Baker & McKenzie, LLP, Miami, FL

The second half of the year has been very rewarding.

I estimate that the Tax Section held about 50 CLE’s this year with 2000 Tax Section member attendees (and 3000 overall attendees). These CLE’s covered in person CLE’s, telephone CLE’s and New Tax Lawyer lunch CLE’s. Many of the in person CLE’s were viewed by our members over the web.

On January 6-8, our International Tax Conference successfully expanded to three days, adding a day to review basic international tax concepts. Congratulations to Shawn Wolfe and Steve Hadjilogiou on leading that successful effort that will be continued for later years of the International Tax Conference.

From January 14 - 17, a group of about 10 Tax Section members travelled to Havana, Cuba, for a series of educational meetings with a broad range of individuals who were Cuban economic, legal, tax, accounting, political, engineering and cultural experts. Our meeting with the Deputy Chief of Mission of the US Embassy in Cuba was particularly informative. The meeting made clear a number of legal and tax issues that are before the US and Cuban governments as they improve their relationship between the two nations. From a humanitarian perspective, we were advised by the US embassy (and others) that the average monthly income in Cuba is $25/person from their formal salary. This is basically enough to live through about the 20th of each month. We were further advised that approximately $25/person is paid to the Cuban people through remittances, much of which are made from Florida. The remittances total approximately $1.5 to $2 billion a year. As such, the remittances may account for half of the Cuban economy. From what we could see, the remittances are saving lives but the food stores that we visited lacked basic food items like vegetables, fruits and meats. We witnessed what appeared to be malnutrition throughout Havana. I am hopeful that the current humanitarian condition of the Cuban people that we witnessed is fully considered in decisions to end the Cuban embargo. The free enterprise system has worked throughout the world, including in communist countries like Vietnam and Cuba. Because of the amount of remittances from Florida, this foreign affairs issue becomes an economic issue that directly affects the wealth of the people of Florida. As such, we should understand the significant economic benefit that Florida can expect to derive if the embargo with Cuba is lifted and the need for the remittances ends. Congratulations to Abraham Smith for taking the lead in organizing this year’s trip to Havana. My hope is that the Tax Section will repeat this trip in the future.

Our other in person CLE’s this year included our “Representing the Physician” conference on January 16 in Fort Lauderdale, the 2016 National Multistate Tax Symposium from February 3-5 in Orlando, the FICPA/Florida Bar Tax Section State Tax Conference from June 8-11 in Orlando and our Annual Wealth Protection Seminar.

Thanks to Micah Fogarty and her team for the hard work that has gone into organizing this year’s moot court competition which was successfully held on St. Pete Beach from February 17-21st. The winner of the Moot Court Competition was the team from the Charleston School of Law, the Best Brief was by the team from the University of Oregon School of Law and the Outstanding Oralist was Anna Boning, Charleston School of Law.

Dana Apfelbaum and Mitch Goldberg have done a great job of expanding the New Tax Lawyer lunches. In Miami, Datan Dorot chaired 6 New Tax Lawyer lunches this year. Attendance has been over 70 for some of those lunches in Miami. Our monthly teleconferences that were organized by Michael O’Leary (in conjunction with Brian Malec and Micah Fogarty). They continue to attract over 150 attendees. Mike Wilson and Mark Brown did a great job this year with Section Administration. Also, we held our annual meeting with the Florida Department of Revenue in Tallahassee.

The Winter 2016 directors’ meeting was held in Hawks’ Cay in the Florida Keys over the weekend of March 2nd. Our final in person meeting of 2015-2016 was held at the Fontainebleau Hotel, Miami Beach from May 19 - 22. Our CLE on May 20th at the Fontainebleau Hotel covered a broad range of economic substance issues that impact our everyday practice. Guy Whitesman and Joe Schimmel successfully co-chaired that CLE. On Saturday night, May 21st, we honored, posthumously, Bob Hudson, this year’s recipient of The Gerald T. Hart Outstanding Tax Attorney of the Year Award. Also, this year, another former chair, Nick Lioce, passed away. Both Bob and Nick were chairs who really made a difference and we are grateful for their service to the Tax Section.

We are looking to continue to expand opportunities for our members to access Tax Section CLE’s and substantive tax articles. This year, we successfully increase the opportunities for our members to write articles, make substantive presentations and participate in regulations’ comments projects. The 50 CLE’s involved dozens of speaking opportunities, many of which were presented by New Tax Lawyers. In the regulations’ comment area, we are in the midst of drafting comments to the new proposed regulations under Code Section 385 that, if finalized in their current form, would broadly impact how debt is characterized in the future. We are also finalizing our comments to the FIRPTA/corporate inversions issue that impacts many inbound US real estate investments. Brian Harris is heading up our regulations’ comments effort. Please contact Brian if you

continued, next page
CHAIR’S MESSAGE . . .
from previous page

would like to assist with one of our projects. The title of the projects can be found in the Tax Section’s monthly eblast. Please reach out to me or Bill Lane (next year’s Tax Section chair) to the extent that you would like to become more involved in Tax Section activities. In particular, please advise me, Brian Malec or Micah Fogerty if you would like to become a member of a substantive committee in our FEDTAX division. Our new list of FEDTAX division members will be on the Tax Section website, shortly. Please reach to me or French Brown if you

Message from the Chair-Elect

Service, Education, Collegiality and Friendships

My fellow Florida tax lawyers, I wish to thank all of you who have participated in the Tax Section’s operations over the last several years and I want to encourage those who might not yet have taken the opportunity to participate in the Section’s work to find an avenue of service. The Tax Section, as with all of the Florida Bar’s substantive sections, provides ample opportunities for service to our fellow members of the Bar, the State’s law schools and their students, our communities and the citizens of the State of Florida. During the Bar fiscal year now concluding, for example, the Tax Section has presented over 20 continuing legal education programs, most at no additional cost to members of the Section. Additionally, the Tax Section, through its commentary on federal regulation projects and similar federal tax administrative matters, serves our entire country and facilitates the proper administration of the federal tax laws.

Importantly, Tax Section work is undertaken within a spirit of collegiality which cannot fail to allow you to build close friendships with similarly-situated tax lawyers throughout our great State, and elsewhere.

Personally, I became involved in the Section nearly 30 years ago because I was encouraged to do so by more experienced lawyers I viewed as mentors who suggested that participating in the Section would be critical to my professional development. If you are in the position to mentor either a young associate or simply a young tax lawyer whom you know through other circumstances regarding his or her professional development, rest assure that there are ample opportunities for that young lawyer’s professional development through your Florida Bar Tax Section. The Co-Directors of the Section’s “New Tax Lawyers Committee”, Dana Afpelbaum and Mitch Goldberg, their committee members, and I, are available to assist a new tax lawyer with his or her integration into the Section’s activities.

You and your family are invited to attend the Tax Section’s 2016-2017 Organizational Meeting at the beautiful Omni Amelia Island Plantation Resort from Friday, July 1 through Monday evening, July 4th.

The meeting schedule has been designed to allow you to enjoy all of the wonderful family and recreational activities available to the Resort guests while the Tax Section’s business jumps off to a great start for the 2016-2017 fiscal year. The “business schedule” also will include the traditional family-friendly events and the 2016 “Ullman Tax Year in Review” CLE program under the supervision of the Tax Section’s Chair-elect, Joe Schimmel.

The deadline to take advantage of the “early-bird discount” for your meeting registration fees and to reserve lodging at the Omni using the Bar’s special room rate is Friday, June 10th. This year, the meeting registration fees will cover the costs of attending the Chair’s Welcome Reception and Dinner on Saturday evening, the after-dinner entertainment for that evening, the Ullman Tax Year in Review and many other events.

In addition to the Section’s activities, the Resort will be treating kids and their families to a carnival theme party on July 2nd and a pirate invasion and dinner on Sunday, July 3. Please consult www.weeklyresortguide.com for additional information and to reserve activities or recreational equipment which often “sell out” over the holiday weekend.

The Section’s leadership, my wife Sylvia and I look forward to renewing old friendships and making new acquaintances at Amelia Island!

William R. Lane, Jr.
Chair Elect, 2015-2016
FIRPTA Increased Withholding and Other Changes

By: Scott M. Snyder, Chepenik Trushin LLP, North Miami, FL

Most international tax professionals have familiarity with the Foreign Investment in Real Property Tax Act (“FIRPTA”), especially those that provide planning for foreign clients investing in U.S. real estate. Navigating through FIRPTA can be challenging for many practitioners, specifically when dealing with REITs. However, on December 18, 2015, the President signed into law the Protecting Americans from Tax Hikes Act of 2015 (“PATH Act”). The PATH Act significantly alters FIRPTA withholding for foreign persons disposing of investments in U.S. real estate. Of particular note are six modifications: (1) an increase in the FIRPTA withholding rate in certain situations; (2) an exemption for qualified shareholders of REIT stock; (3) the elimination of the “cleansing rule” for REITs; (4) a definition for domestically controlled REITs; (5) an exemption from FIRPTA for qualified foreign pension funds; and (6) an exemption from FIRPTA for shareholders of 10 percent or less of publicly traded REIT stock.

1. Increase in FIRPTA Withholding Rate

The PATH Act increases the FIRPTA withholding rate from 10 percent to 15 percent on certain dispositions and distributions of United States Real Property Interests (“USRPIs”). Similarly, the withholding rate for the transfer of a partnership interest or the beneficial interest in a trust or estate has been increased from 10 percent to 15 percent. The new withholding rate applies to all such dispositions that take place after February 16, 2016. However, the new FIRPTA rules allow for a 10 percent withholding rate where the amount realized on the disposition of property being used as a residence is between $300,000.00 and $1 million. In other words, if a foreign person sells his or her personal residence for $999,000.00 the amount to be withheld shall be $99,900.00. However, if the foreign person sells his or her personal residence for $1,000,100.00, the amount to be withheld on the sale shall be $150,015.00. The amount withheld is offset by the gain on the disposition of the USRPI and is refundable to the extent the amount withheld exceeds the underlying tax liability.

The increased FIRPTA withholding rate is not an actual increase in tax, but a means of ensuring compliance with U.S. tax law. An exemption found in the old rule remains in place, providing that a foreign person is not subject to FIRPTA withholding where the property sold is used as a residence and the amount realized does not exceed $300,000.00.

2. Qualified Shareholders of REIT Stock Exempt

The PATH Act provides a new exception from FIRPTA withholding for qualified shareholders. A qualified shareholder is defined in section 897(k)(3)(A). Qualified shareholders owning REIT stock are exempt from FIRPTA withholding because the REIT stock is not a USRPI. Rather, REIT distributions made to qualified shareholders are treated as a sale or exchange of stock under sections 301(c)(3), 302, or 331; whereas, the portion of the distributions attributable to other investors is classified as income subject to dividend withholding. This exemption is limited to the extent that a qualified shareholder has an investor that owns, whether indirectly through the qualified shareholder or otherwise, more than 10 percent of a REIT in which the qualified shareholder owns an interest.

3. “Cleansing Rule” for REITs Eliminated

The FIRPTA “cleansing rule” previously provided that an interest in a corporation was not a USRPI where (1) the corporation did not own USRPIs on the date of disposition and (2) all USRPIs held during the applicable testing period were disposed of in transactions where the full amount of gain was subject to U.S. tax. The “cleansing rule” caused confusion in the REIT context with regard to whether a shareholder could claim a stock loss resulting from a liquidation of an unprofitable investment in a foreign-controlled private REIT as an effectively connected income (“ECI”) loss. The PATH Act repeals the cleansing rule’s application to REITs, thereby eliminating the technical concern.

4. Defining Domestically Controlled REITs

Foreign investors selling shares of a “domestically controlled” REIT are exempt from FIRPTA withholding. “Domestically controlled” is defined as any qualified investment entity, such as a REIT, in which less than 50 percent of its shares have, at all times during the testing period, been held, directly or indirectly, by foreign investors. However, under FIRPTA, it was difficult to determine whether REITs were “domestically controlled.” The PATH Act provides some clarity, defining a United States shareholder as any shareholder owning less than 5 percent of a publicly traded REIT unless the REIT has actual knowledge to the contrary. Under FIRPTA, it was often unclear whether a REIT was “domestically controlled” when it was owned by another REIT. The

continued, next page
PATH Act elucidates this issue as well, providing that (1) a publicly traded REIT that owns an interest in a subsidiary REIT is treated as a domestic shareholder of the subsidiary REIT if the parent REIT is itself “domestically controlled”; and (2) a private, subsidiary REIT is treated as a domestic shareholder in proportion to the extent of the parent REIT’s domestic ownership.22

5. Foreign Pensions Exempt from FIRPTA

“Qualified foreign pension funds” are retirement funds that are subject to non-U.S. governmental regulation and meet certain other requirements set forth in section 897(l)(2). The PATH Act creates a new exemption from FIRPTA withholding for qualified foreign pension funds, as well as for any other entity where all of its interests are held by a qualified foreign pension fund.23 The exemption applies to dispositions and distributions from qualified foreign pension funds.24 The extent to which a retirement fund must be subject to non-U.S. governmental regulation to constitute a qualified foreign pension fund is not entirely clear.

6. Exemption for Publicly Traded REITs

The PATH Act expands the exclusion for publicly traded REITs, providing that a publicly traded REIT will not be treated as a USRPI unless the holder owns more than 10 percent of a particular class of stock.25 Shareholders owning 10 percent or less of a class of stock in a publicly traded REIT will be exempt from FIRPTA on their distributions.26 The expanded exclusion does not apply to U.S. real property holding corporations or privately held REITs.

Presumably treasury regulations will provide additional clarity left out by the PATH ACT. However, the increased visibility that the PATH Act has already provided is certainly a boon to any international tax professional that finds themselves navigating FIRPTA.

(Endnotes)

2 § 322, 2029 Stat. at 857.
3 § 325, 2029 Stat. at 862.
4 § 322, 2029 Stat. at 857.
5 § 323, 2029 Stat. at 861.
6 § 322, 2029 Stat. at 857.
8 § 1445(e)(5).
9 Treas. Reg. § 1.1445-2(e).
10 26 U.S.C. § 1445(b)(5).
11 § 1445(c)(4).
12 Treas. Reg. § 1.1445-1(f).
13 § 1445(b)(5).
14 § 897(k)(3)(A).
15 § 897(k)(2)(A).
16 § 897(k)(2)(C).
17 § 897(k)(2)(B).
18 § 897(c)(1)(B)(iii).
19 § 897(h)(4)(B).
20 Id.
21 § 897(h)(4)(E)(i).
22 § 897(h)(4)(E).
23 § 897(l)(1).
24 Id.
25 § 897(k)(1).
26 Id.
The Taxation of Personal Goodwill in Auto Dealership Sales

By: Paul W. Jezierny, Shutts & Bowen LLP, Orlando, FL

Acquisitions of automobile dealerships occurred at a feverish pace in 2015 and it appears that this level of activity will continue through 2016. In total, 472 dealerships changed hands over the course of 2015. This represents a 47% increase over the number of acquisitions only one year earlier. Rising in tandem with the record high acquisition activity are dealership valuations, causing many sellers to recognize substantial gain on the sale. However, given that most sellers in today’s dealership market are privately held or family owned operations, careful tax planning can result in substantial tax savings. This article examines one method that dealership owners use to minimize their tax liability.

To recognize the potential for tax savings in dealership sales, it is important to first understand how dealerships and the deals themselves are structured. Often, there are four separate entities involved in the deal. On the seller’s side there is usually one entity that holds title to the dealership’s vehicle and parts inventory, furniture, fixtures, and equipment and is also a party to the franchise agreement with the manufacturer (the “Seller Operating Entity”), and another entity that owns the real property and improvements upon which the Operating Entity’s assets are located (the “Seller Holding Entity”, and collectively with the Seller Operating Entity, the “Seller Entities”). The group of assets collectively owned by the Seller Operating Entity and the Seller Holding Entity comprise the trade or business we know as the “dealer-ship”. In most cases the equity in the Seller Entities will share the same or substantially similar ownership.

In order to acquire the dealership, the purchaser frequently will form two separate entities: one for the purpose of acquiring Seller Operating Entity’s assets (the “Purchaser Operating Entity”) and another to acquire the Seller Holding Entity’s assets (the “Purchaser Holding Entity”, and collectively with the Purchaser Operating Entity, the “Purchaser Entities”). Like the Seller Entities, the ownership of the Purchaser Entities will be the same or substantially similar.

The terms of the agreement to sell the dealership are then memorialized in an asset purchase agreement between the Seller Operating Entity and the Purchaser Operating Entity and a real estate purchase agreement between the Seller Holding Entity and the Purchaser Holding Entity. At closing the assets are transferred from the Seller Entities to the Purchaser Entities using instruments such as bills of sale and assignments. The deal is structured as a sale of the Seller Entities’ assets, rather than equity, for a variety of reasons. The primary motivation for doing so is to enable the Purchaser Entities to receive a stepped-up basis in the acquired assets and to avoid having to assume the Seller Entities’ liabilities.

The Seller Operating Entity will use the proceeds from the sale to pay off the loan used to acquire its vehicle inventory (known as a “floorplan loan”) and the Seller Holding Entity will use the proceeds to satisfy any mortgages on the real property. The proceeds that are left over are then distributed to the owners of the Seller Entities.

Included within the assets sold by the Seller Entities is the goodwill or “blue sky” as it is known in industry parlance. This is the value of the dealership that is attributable to the expectancy of continued customer patronage. There are a litany of factors that can give rise to this value: selling a certain brand of vehicle, having an experienced sales or service staff, the location of the dealership or the quality of the dealership’s facilities. The standard in the industry is to value the dealership’s blue sky by multiplying its trailing twelve month adjusted pretax earnings by a multiple thereof, known as the “blue sky multiple”. Blue sky multiples are largely subjective and often are the most negotiated aspect of the deal.

In some cases, a dealership’s blue sky value, or a portion thereof, may be attributable to the services of a particular individual who is active in the dealership’s operations or management. Where such value exists, the dealership’s blue sky can be bifurcated into two separate categories: enterprise and personal goodwill. Enterprise goodwill is an asset of the Seller Operating Entity, while personal goodwill is an asset of the individual. If this individual is an owner of the Seller Operating Entity and the Seller Operating Entity is a C-corporation, it can be beneficial if the Purchaser Operating Entity acquires the personal goodwill directly from the individual.

Blue sky is a capital asset, the sale of which results in capital gain. Provided the Seller Operating Entity has been in existence for longer than one year, the sale of its blue sky will give rise to long-term capital gains. If the Seller Operating Entity is a C-corporation, the Seller Operating Entity will pay tax on the gain recognized from the sale at the corporate rate of 35%. When the proceeds are distributed from the Seller Operating Entity

continued, next page
THE TAXATION OF PERSONAL GOODWILL...

from previous page

to its shareholders, those shareholders will pay tax on the distribution at a rate of up to 20%. However, if the personal goodwill portion of the blue sky is sold directly from the individual to whom it is attributable to the Purchaser Operating Entity the proceeds therefrom will be taxed only once and at a rate of 15%. The following example illustrates the tax savings that can result from structuring the sale of the personal goodwill this way:

Dealership A is a C-corporation with tangible assets worth $20 million, blue sky worth $7 million and no liabilities. $2 million of the blue sky's value is enterprise goodwill and $5 million is personal goodwill. Dealership A sells its assets to Dealership B for their fair market value of $27 million. As a result of the sale of its assets, Dealership A will pay $9,450,000 in corporate income tax and Shareholder Z will pay an additional $3,510,000 in taxes when it receives the sale proceeds as a dividend, combining for a total tax liability of $12,960,000. Compare this result to if Dealership A had sold its tangible assets and enterprise goodwill to Dealership B for $22 million and Shareholder Z sold its personal goodwill to Dealership B for $5 million: Dealership A would have a tax liability of $7,700,000 and Shareholder Z's tax liability would be $750,000, resulting in a total tax liability of $8,450,000. Thus, selling the personal goodwill directly from Shareholder Z to Dealership B would result in a tax savings of $4,510,000.

If the Seller Operating Entity is a pass-through entity such as a limited liability company or S-corporation, bifurcating the enterprise and personal goodwill is not as necessary because these entities are not subject to entity-level tax and their income maintains its character when it passes through to their owners. If the sale of the blue sky would result in long-term capital gain to the pass-through entity, it is long-term capital gain to the owners.

There is an obvious temptation for shareholders of a Seller Operating Entity organized as a C-corporation to allocate as much of the blue sky value as possible to personal goodwill to avoid the higher taxes that must be paid on the enterprise goodwill. However, the existence of personal goodwill and the value allocated to it must be properly supported. Consideration must also be given to whether the shareholder will enter into a non-compete or consulting agreement with the Buyer Operating Entity. If so, the income the shareholder is paid under these agreements will be taxed as ordinary income rather than capital gains.

If the shareholder has entered into a non-compete or an employment agreement with the Seller Operating Entity and the agreement does not terminate upon the acquisition of the Seller Operating Entity’s assets, no personal goodwill will be deemed to exist. This is because by entering into the non-compete, the shareholder’s personal relationships essentially become the property of the Seller Operating Entity by virtue of the shareholder’s inability to utilize those personal relationships to create or join another business that is in competition with the Seller Operating Entity.

The existence of personal goodwill will be bolstered by evidence that its sale was separately negotiated between the parties. A separate written agreement memorializing the agreement between the Buyer Operating Entity and the shareholder to sell the personal goodwill is quite common in practice and lends support for the existence of personal goodwill.

While there is no single rule for determining the value of personal goodwill, factors such as the following should be given consideration in making this determination: (1) the number of years the shareholder has been active in the management of the dealership; (2) the degree to which the public identifies the dealership with the shareholder; (3) the extent of the personal relationships between the shareholder and the dealership’s customers; and (4) the volume of sales for which the shareholder is personally responsible. Obtaining a third party valuation of the personal goodwill is also highly advisable.

In summary, given the record-high valuations for auto dealerships at the moment, it is prudent for sellers to explore all possible options available to them to assist in minimizing their tax liability. Allocating a portion of the purchase price to the personal goodwill is just one option sellers can pursue, but if done correctly, the tax savings can be considerable.

(Endnotes)


2 26 C.F.R. 1.197-2(b)(1) (defining goodwill as “the value of a trade or business attributable to the expectancy of continued customer patronage. This expectancy may be due to the name or reputation of a trade or business or any other factor.”).

3 Haig Partners.

4 This is the federal corporate rate; it does not account for state and local corporate tax rates.


7 Muskat v. U.S., No. 06- ev- 30- JD (D.N.H. Apr. 2, 2008), aff’d, 554 F.3d 183 (1st Cir. 2009).

8 Norwalk v. Commissioner, T.C. Memo 1998-279.
How to Make Lifetime Transfers Without Gift Tax Exposure: Effectively Funding a Grantor Trust with Debt

By: Elysa Merlin Lankri, Dorot & Bensimon PL, North Miami Beach, FL

On December 31, 2012, the federal estate and gift tax rate and exemption were set to decrease from 55% and $5,120,000 to the 2001 rate and exemption amount of 35% and $675,000. With this in mind, many taxpayers made gifts to trusts utilizing all or a portion of the $5,120,000 unified credit that was available to them in 2012.

Since many taxpayers did not have available cash to gift, they used illiquid assets, such as real property. Today, some of these same taxpayers want to enable the development of the real property that was previously gifted, but the trust cannot obtain a bank loan, since vacant non-income producing property is not attractive collateral for banks. Accordingly, taxpayers must consider how to transfer funds to such a trust without making a further gift in excess of their already used up unified credit. One option for transferring funds without exceeding a taxpayer’s unified credit is to make a loan to a trust, provided that the loan is bona fide and not recharacterized by the IRS as a gift.

The Code does not set forth any guidelines for determining whether a particular transfer is a loan or some other form of transaction; instead, case law must be relied upon to make this determination. Intrafamily transactions are subject to rigid scrutiny, and a transfer of assets is presumed to be a gift unless the transferor can establish that it is something other than a gift; so transferors must beware.1

Intent to Enforce the Debt

With an intrafamily loan, it must be established that (1) the debt instrument given by the transferee is a bona fide debt; and (2) on the date of the transfer, there existed an intention on the part of the transferor to enforce the debt as well as an intention on the part of the transferee to pay the debt.2 The Tax Court in Estate of Van Anda v. Commissioner examined this issue within the context of a purported loan made from a husband to his wife to enable her to purchase a home. Notwithstanding the formalities that the couple undertook to evidence their purported indebtedness, the court found that, in substance, no bona fide debt existed, because the parties lacked any real intention of making repayment or enforcing the obligation.

Existence of Bona Fide Debt

As far as whether a debt is valid on its face, the Tax Court has set forth a list of factors that are instructive.3 The court in Todd v. Commissioner looked at seven factors to determine whether the debt was bona fide: whether (1) the promise to repay was evidenced by a note or other instrument; (2) interest was charged; (3) a fixed schedule for repayments was established; (4) collateral was given to secure payment; (5) repayments were made; (6) the borrower had a reasonable prospect of repaying the loan, and whether the lender had sufficient funds to advance the loan; and (7) the parties conducted themselves as if the transaction was a loan. No one of these factors is determinative and all relevant facts and circumstances are considered.

There are additional Tax Court cases that have looked to factors similar to those set forth in the Todd case, such as whether records maintained by the transferee and/or transferee reflected the transaction as a loan, the manner in which the transaction was reported for Federal tax purposes is consistent with a loan, and the transferee’s ability to obtain similar financing from outside lending institutions (i.e., the real world comparison).4

Creation of Bona Fide Debt

Based on the willingness of the courts to recharacterize certain transfers as gifts, how can a taxpayer make a bona fide loan and avoid such recharacterization? Taxpayers should not only ensure that the debt created is bona fide, but also establish, as of the date of the transfer, that the transferor intends to enforce the debt and the transferee intends to pay the debt. Accordingly, there should not be any arrangements (whether express or implied) as of the date of the transfer for the transferee to forgive the debt. A transfer will be more likely to be upheld as a loan if the transferee has the means to repay the loan and intends to do so. A transfer made to a family member with a known inability to make repayments will not be considered favorably in determining whether the transfer should be treated as a loan.

Since this is a facts and circumstances test, the more factors in the taxpayers favor, the more likely the taxpayer will be to ensure that a bona fide debtor-creditor relationship is created. First and foremost in ensuring the creation of a bona fide debt is to draft a promissory note with a fixed schedule for repayments that charges an appropriate interest rate.5 Failure by the trust to pay regular and periodic interest, while not fatal, looks more like an equity arrangement; especially if the loan is not

continued, next page
HOW TO MAKE LIFETIME TRANSFER . . .
from previous page

secured. If interest is charged and paid at the AFR, then a taxable gift will likely be avoided on most interfamily loans.\textsuperscript{6} The parties should consider, however, using an interest rate higher than the AFR if the loan is unsecured or will be in second position (due to additional financing on the real property) to compensate the lender for the additional risk.

The parties to the transfer should each consider retaining separate counsel to represent themselves in negotiating the terms of the note. The parties should be sure to characterize the transaction as a loan on their respective federal income tax returns and in their accounting ledgers. The note can be bolstered by securing the payment with collateral. Further, the note should set forth consequences for failure to make payments. The borrower should make all payments pursuant to the terms of the note. If the borrower fails to make payments, then the lender should make a demand for repayment.

For taxpayers looking to transfer funds in excess of their unified credit and without exposing themselves to gift taxes, the creation of a bona fide debtor-creditor relationship is crucial. This is not impossible to achieve if certain precautions are taken by taxpayers that demonstrate that the transfer was not a gift. If these steps are taken, then structuring a loan to a trust can be an effective way to transfer funds without federal gift tax consequences.

(Endnotes)


3 \textit{Todd v. Comm’r}, TC Memo 2011-123.


5 This may not necessarily be the AFR. Current credit market realities should play a role to demonstrate the arms-length nature of the loan.

6 See Internal Revenue Code § 7872. But again, current credit market realities must be taken into consideration.

\textbf{Elysa Merlin Lankri} is an associate at Dorot & Bensimon PL in North Miami Beach, where she focuses her practice on international and domestic tax planning and compliance for individuals. She currently serves as one of the 2015-2016 Fellows of the Tax Section of The Florida Bar.
MAINTAINING TAX EXEMPT STATUS WHEN PARTNERING WITH A FOR-PROFIT ENTITY

By Joseph M. Percopo, Mateer Harbert, P.A., Orlando, FL

During the Great Recession, charitable tax-exempt entities suffered a decline in funding and donations.¹ Charitable donations are beginning to return but are still below the levels prior to the Great Recession.² Amid uncertain economic times, the recovery for some charities is coming too slowly to sustain operations and therefore they face a tough situation. Does the tax-exempt entity begin scaling back by cutting services and slashing payrolls in order to stay afloat? One potential alternative to cutting services and payroll is for tax-exempt entities to partner with for-profit entities. There are a variety of benefits partnering with a for-profit can bring, such as additional cash flow, expertise, property, and a sales force to name a few. Should the tax-exempt entity opt for this alternative, the principal issue it must consider is whether partnering with a for-profit will cause a loss of exempt status? This article reviews the relevant code sections and regulations for tax-exempt entities, as well as IRS advice and cases that have addressed this very issue. The article concludes that tax-exempt and for-profit entities may engage in partnerships, joint ventures and management relationships while maintaining tax exempt status, only if the rules outlined are properly followed.

Basic requirements of §501(c)(3) under code and regulations

As with all analysis regarding potential tax issues, first the IRC and related regulations must be reviewed.³ IRC § 501(c)(3) exempts from federal income tax entities that are operated (i) exclusively for charitable purposes, (ii) no part of the net earnings inures to the benefit of any private shareholder or individual, and (iii) do not engage in propaganda, influencing legislation, and do not participate in any political campaigns.⁴ Regulation §1.501(a)-1(c) defines “private shareholder or individual” as “persons having a personal and private interest in the activities of the organization.” However, the term “private shareholder or individual” does not refer to unrelated third parties.⁵

Regulation §1.501(c)(3)-1(d)(1) provides exemption from federal taxation if “(i) the entity is ‘operated exclusively for one or more’ charitable purposes, (ii) the entity serves a public benefit rather than a private interest, and (iii) the entity may not be “organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.”⁶

Tax-exempt and for-profit relationships

The first question that must be addressed is: are tax-exempt entities working with for-profits in a variety of different relationships, but all are subject to the same rules. Revenue Ruling 2004-51 and Revenue Ruling 98-15 permit tax-exempt entities to work with for-profit entities.⁷ However, for the tax-exempt entity to maintain its tax exempt status, it has the burden of demonstrating that it operates according to the rules and regulations of §501(c)(3).⁸

The second question that must be addressed is: what type of relationship is permitted among the entities? Joint ventures & partnerships are expressly permitted by the IRS.⁹ Other permissible structures may also include profit splits, commissions, or management/consulting fees, provided they do not constitute a private inurement.¹⁰ People of God Community v. Commissioner states that not “all contingent compensation arrangements made by charitable organizations will preclude tax-exempt status,” and such arrangements are part of business life.¹¹

The two prongs of §501(c)(3)

§501(c)(3) has two prongs that must be met to determine if tax exempt status may be maintained.¹² The first, requires the joint venture to operate exclusively for public benefit. The second, requires no net earnings inure to private shareholders or individuals. In reviewing these prongs, case law and revenue rulings are helpful in further defining each of the elements.

Prong 1 - Exclusive benefit for public purpose

Revenue Ruling 98-15 reviews two fact patterns and evaluates whether a tax-exempt entity partnering or forming a joint venture with a for-profit entity maintains tax exempt status.¹³ The factors reviewed in each situation were (1) who controlled the board of directors, (2) was there restraint on actions (such as requiring majority of board to approve certain items), (3) was there control under management agreements, such as ability to terminate agreement (permits payments from gross receipts as long as reasonable and comparable to what other management firms receive), (4) whether there are common owners/founders (or related parties) between tax-exempt entity and for-profit, and (5) whether governing documents expressly state a charitable purpose and priority over profits. Example 1, of Revenue Ruling 98-15, found that the partnership did not cause the tax-exempt entity to lose its tax exempt status where a tax-exempt entity appoints the majority of the board, certain important actions requires majority board approval, reasonable management agreement with unrelated third party, no interested parties in both entities, and the documents continued, next page
expressly provide for charitable priority. Conversely, Example 2, of Revenue Ruling 98-15, found where the tax-exempt entity selects only half of the board (therefore, the tax-exempt entity could not control certain actions of the partnership), the management agreement with a related party and unreasonable terms causes the tax-exempt entity to lose its tax exempt status (despite not having related parties between the tax exempt entity and for-profit entity, and founding documents expressing a charitable purpose).

Revenue Ruling 2004-51 reviews a proposed partnership between a tax-exempt entity and a for-profit entity. The factors reviewed were (1) the governing documents, (2) whether the partnership furthered a charitable purpose, (3) whether the partnership permits the exempt organization to act exclusively in furtherance of exempt purpose, (4) whether private inurement exists, and (5) who has formal and informal control of the partnership. The example discusses a tax-exempt entity that operates a school (educational). The school forms an LLC taxed as a partnership with a for-profit entity. The governing documents provide that the primary purpose of the organization is to further education (which correlates directly with the tax-exempt entity's exempt purpose). Additionally, the tax-exempt entity has the exclusive control over the items related to education, while the for-profit has control to select locations for training seminar links and approve the audio/visual elements to broadcasting the curriculum. Any other action requires the mutual consent of both partners. The partnership is managed by a board of six directors with the tax-exempt entity appointing three of the directors and the for-profit appointing three directors. The proposed partnership was negotiated at arm's length and all contracts and transaction costs were for fair market value. Revenue Ruling 2004-51 concludes that the tax-exempt entity will maintain its tax exempt status under the facts described above. This ruling differs slightly from Revenue Ruling 98-15 in that the board was shared equally in this ruling versus being controlled by the tax-exempt entity. However, both stand for the proposition that the partnership or joint venture must operate to further charitable purpose and must maintain control over material items of the venture.

Two earlier General Counsel Memorandums (“GCM”) that discuss tax-exempt and for-profit partnerships and joint ventures are worth mentioning briefly. GCM 39005 addresses whether a tax-exempt entity participating as a general partner in a limited partnership may maintain tax-exempt status. The memorandum concludes that tax-exempt status is not lost where the “partnership arrangement permits the exempt organization to act exclusively in furtherance of the purposes for which exemption may be granted.” GCM 39862 addresses whether a tax-exempt entity jeopardizes exemption by engaging in a joint venture with a for-profit where the entire gross or net revenue stream of the tax-exempt entity is directed into the joint venture for a period of time. The memorandum held that tax-exempt status was lost because: (1) the transaction caused the tax-exempt entity's net earnings to inure to a private individual; and (2) the private benefit from the transaction was not considered incidental to the public benefits achieved.

American Campaign Academy v. C.R.R., provides that in order to operate “exclusively for exempt purposes” there can be no private benefit other than an incidental benefit. The court additionally provides that “an organization’s conferral of benefits on disinterested persons may cause it to serve ‘a private interest’ within the meaning of section 1.501(c)(3)-1(d)(1)(ii)” and thus disqualify the tax-exempt entity from tax exemption.

Redlands Surgical Services, provides that a tax-exempt entity may form partnerships and enter into contracts with for-profit entities to further its charitable purposes on mutually beneficial terms, “so long as the nonprofit organization does not thereby impermissibly serve private interests.” The Tax Court in this case denied tax-exempt status because the tax-exempt entity did not have “formal or informal control sufficient to ensure furtherance of charitable purposes.” The Ninth Circuit affirmed this decision holding that where control of the partnership is ceded by the tax-exempt entity, there is an impressive private interest.

St. David’s Health Care System v. United States, addresses whether a hospital, having formed a partnership with a for-profit company, has so ceded control over operation to its partner that it no longer engages “primarily” in activities that accomplish its charitable purpose. The court found that St. David’s had not maintained sufficient control, and therefore, the entity was not operated exclusively for exempt purposes. However, the court also held that a tax-exempt entity and for-profit entity partnership, where the tax-exempt entity maintains control, will be considered to operate in furtherance of exempt purpose.

Prong 2 - Private Inurement of Net Earnings

Church of Scientology of California v. Commissioner, addresses private inurement of net earnings, and holds that the term only applies to “a person having a personal and private interest in the activities of an organization,” but does not apply to “unrelated third parties.” Therefore, if there is an unrelated third party, the second prong is not applicable; however, an unrelated third party can still cause the tax-exempt entity to fail under the first prong. The court further states that “net earnings’ include more than net profits and [net earnings] may inure to an individual in more ways than in the distribution of dividends,” and “the amount or extent of such benefit is not determinative of a finding of private inurement.”

Alive Fellowship of Harmonious Living v. Commissioner explains that the “forbidden inurement may take the form of a cash dividend” but “[i]t may also take less obvious forms such as the provision of goods and services to the organization’s members, the payment of excessive

continued, next page
rent for the use of property,27 or the payment of excessive salaries for services rendered.”28

Conclusion
A tax-exempt entity may engage in a joint venture, partnership, or other arrangement with a third party, for-profit entity, and maintain tax exempt status. To maintain tax exempt status, the entity must be (1) operated exclusively for exempt purposes (Prong 1) and (2) not allow inurement of net earnings to a “private shareholder or individual” (Prong 2). The principal factor for the Prong 1 is that the tax-exempt entity must maintain control (review structure, management, and terms). A simple and favorable method for demonstrating control is for the tax-exempt entity to appoint a majority of the board of directors, and include in the governing documents that the charitable purpose has priority over profits. If a tax-exempt entity cedes control to the third party entity, it loses tax exempt status. Additionally, tax-exempt entities fail Prong 1 where there is an excessive private benefit to an unrelated individual (excessive rent, wages, commission, etc.). The principal factor for review for Prong 2 is whether a “private shareholder or individual” receives a benefit. This term applies to persons that have a personal and private interest in the payor organization. In determining private inurement, it includes more than cash dividends, such as provision of goods and services to members, paying excessive rent, or excessive salaries for services rendered. Prong 2 is very fact specific. Therefore, each arrangement must be individually evaluated (the goal here is not to provide a benefit to insiders). It is important to note, that Prong 2, unlike Prong 1, does not apply to unrelated third parties and is only applicable to insiders. Provided the tax-exempt entity and for-profit adhere to the rules above, the tax-exempt entity may maintain its tax exempt status.

(Endnotes)
1 Charitable Giving and the Great Recession, Reich, Rob & Wimer, Christopher, Standford, CA: Standford Center on Poverty and Inequality (2012).
2 Id.
3 All references to the IRC or code are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated, and all references to regulation(s) is/are to Treasury Regulations under the Internal Revenue code of 1986, as amended, unless otherwise indicated.
4 For purposes of this article, there is an assumption that the joint venture, partnership, or other arrangement between entities does not involve propaganda, influencing legislation, or participating in political campaigns.
5 People of God Community v. Commissioner, 75 TC 127, 133 (Tax Court 1980).
6 Id.
10 Alive Fellowship of Harmonious Living v. Commissioner, T.C. Memo. 1984-87, 47 T.C.M. 1134 (1984) (“the payment or reasonable compensation for services rendered does not constitute the forbidden inurement”).
11 75 TC 127, 133 (Tax Court 1980); The court further held that a portion of “gross earnings to those vested with the control of a charitable organization constitutes private inurement [just as payments from net earnings].” Id.
12 IRC Reg. §1.501(c)(3)-1(d)(1) provides for a third possible prong: the tax-exempt entity cannot be operated for private benefit. However, this is encompassed by the first prong. Thus, if tax-exempt entity fails this third prong, the entity would also fail the first prong. See Western Catholic Church v. Commissioner, 73 T.C. 196, 213 (1979), affd. per order 631 F.2d 736 (7th Cir. 1980).
16 Id.
18 Id. (A third reason for denying tax exempt status was due to a violation of federal law. However, it is inapplicable to this discussion).
20 Id. at 1069; See also PLR 2014-26035 (June 27, 2014) (stating “[p]rohibited private interests include those of unrelated third parties as well as insiders. Christian Stewardship Assistance Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989)” and “[p]rivate benefits include an “advantage; profit; fruit; privilege; gain; [or] interest. Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982)”.
21 113 T.C. 47, 92-93 (1999), aff’d 242 F.3d 904 (9th Cir. 2001).
22 Id.
23 242 F.3d 904 (9th Cir. 2001).
24 349 F.3d 232 (5th Cir. 2003).
26 Id.
27 Texas Trade School v. C.I.R., 30 T.C. 642 (1958) (holding that charity paid excessive rentals to a dominant group of persons which managed its affairs and it made valuable improvements upon the real estate owned by such persons, and, therefore, it lost tax exempt status.).
28 Harding Hospital Inc. v. U.S., 505 F.2d 1068, 1073 (6th Cir. 1974); see also Mabee Petroleum Corp. v. U.S., 203 F.2d 872 (5th Cir. 1953) (held that salary paid to founder of charitable foundation to which all of founder’s stock in corporation was transferred, was excessive and constituted an inurement of net earnings of corporation to benefit of private individuals.); Church by Mail, Inc. v. C.I.R., 48 T.C.M. (CCH) 471 (T.C. 1984) aff’d, 765 F.2d 1387 (9th Cir. 1985) (held that there was private inurement due to excessive proceeds being paid to a business (for services) that was owned by founders and officers of the tax-exempt entity).
Three Tax Strategies that Magnify Charitable Gifts!

By: Sasha Klein, Sabadell Bank and Trust, Palm Beach, FL and
Mark Parthemer, Bessemer Trust Company, Palm Beach, FL

It is always an appropriate time for client’s to give to a worthy cause. The lasting impact to the charity, its recipients, and the family is priceless. Today’s increased tax environment also favors charitable giving by making income tax deductions more valuable. So why not help your client’s make each donated dollar more impactful?

When making a donation, it makes sense to explore strategies ensuring charitable dollars go further for the causes important to the family. Federal tax law, notwithstanding the current increases in rates, encourages supporting charitable organizations by exempting them from federal taxes and providing a charitable deduction to individuals.

Clients turn to their advisors for guidance when contemplating charitable gifts. There are, of course, many ways to make a charitable gift. Direct giving is the simplest, but following are three strategies that result in enhanced tax advantages by making donations through non-grantor trusts.

1. **A Minimization Strategy – Charitable Deduction Planning.**

Current tax law allows individuals who itemize their deductions to deduct gifts to “qualified” charities. However, individuals are exposed to deduction limitations when making a donation directly to a charity. The most punitive is based on adjusted-gross-income (AGI) percentage limitations, factoring in whether the donated item is appreciated property as well as whether the recipient is a public or private charity (see chart below). It is worth noting that contributions exceeding the ceiling can be carried forward for 5 years, where thereafter they expire, with all unused amount evaporating. Further, amounts unused at death also lapse.

In contrast, making a charitable gift through a trust receives the following benefits, each of which result in minimizing the donor’s taxable income:

1. No AGI percentage limitations; contributions can reduce a trust’s taxable income to zero;
2. No 3% phase-out, which otherwise limits total itemized deductions for high-earning taxpayers (aka the Pease Provision); and
3. Reduced taxable amount of net investment income (NIIT, i.e., the 3.8% tax) because the charitable deduction for trusts is taken “above-the-line.”

This last point is extremely important in understanding the mechanics of the NIIT. Following is an example comparing the impact of a $150,000 charitable gift directly (left column, $0 benefit) or through a non-grantor trust (right column, $5,700 savings). Again, the short answer is that because this tax is computed on AGI. A major difference results because charitable contribution deductions are taken into account when determining a trust’s AGI (referred to as modified adjusted gross income, or MAGI) but not for individuals. For individuals, charitable deductions reduce AGI to determine taxable income for income taxes only. Example

<table>
<thead>
<tr>
<th>Cash</th>
<th>Public Charity</th>
<th>Public Charity/Foundation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>50%</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td>30%</td>
<td>20%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Appreciated Property</th>
<th>Public Charity</th>
<th>Public Charity/Foundation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>50%</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td>30%</td>
<td>20%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Married Individual IRC $170 Deduction</th>
<th>Trust – IRC $642 (c) Deductions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage Income $260,000</td>
<td>Interest Income $100,000</td>
</tr>
<tr>
<td>Interest Income $100,000</td>
<td>Dividend Income $50,000</td>
</tr>
<tr>
<td>Dividend Income $50,000</td>
<td>AGI $150,000</td>
</tr>
<tr>
<td>MAGI $410,000</td>
<td>Less: Charitable Deduction $150,000</td>
</tr>
<tr>
<td>Less: Threshold Exemption ($250,000)</td>
<td>AGI $0</td>
</tr>
<tr>
<td>Subtotal $160,000</td>
<td>NII Tax at 3.8% $0</td>
</tr>
<tr>
<td>Lessor of (1) excess of MAGI over Threshold and (2) NII $150,000</td>
<td>NII Tax at 3.8% $0</td>
</tr>
<tr>
<td>NII Tax at 3.8%</td>
<td></td>
</tr>
</tbody>
</table>

continued, next page
2. A Maximization Strategy – Charitable Remainder Trust (CRT)
A CRT is an irrevocable trust that makes annual distributions to one or more persons (frequently the creator or jointly to the creator and spouse) for a period of time or the recipient’s lifetime. Such annual distributions to the recipient will include taxable income, but critically the CRT itself is not subject to income tax on ordinary income, capital gains or net investment income. The payments are either a fixed dollar amount (charitable remainder annuity trust or CRAT) or a fixed percentage (which cannot be less than 5% or greater than 50%) of the trust assets revalued annually (charitable remainder unitrust or CRUT). For both the annuity and unitrust structures, the annuity or unitrust amount is paid to the recipient first from net income, and if there are deficiencies, then from principal.

Example:
When the CRT terminates, the remaining assets are distributed to the designated charity or charities. Even though a CRT is irrevocable, the creator may retain the right to change the charity named in his trust instrument.

A CRT is effective for individuals who want to: (i) sell a highly-appreciated asset; (2) minimize or defer capital gain taxes/NIIT; (3) maximize cash flow; and (4) give to charity. Additionally, the creator gets an immediate income tax deduction equal present value of the charity’s remainder interest in the year of the donation. Any unused portion can be carried forward for 5 years. Using a CRT also creates investment leverage because when an appreciated asset is sold, there is a deferral (and possible elimination) of capital gains tax permitting the gross (of tax) proceeds to be invested for a longer period of time.

3. Charitable Remainder Trust Maximization Strategy with a Twist – Net Income Make-Up Charitable Remainder Unitrust (NIMCRUT)
A strategy that has been idle for many years is back! A NIMCRUT is a variation on the CRUT strategy. The biggest difference being that instead of defining the annual distributions as only a fixed percentage of the trust assets, revalued annually, a NIMCRUT’s distribution is capped at the lesser of (1) trust net income and (2) a fixed percentage of the trust assets valued annually. Any resulting deficiencies will be “made-up” in future years when there is income in excess of the required annual distribution, but until then the NIMCRUT does not need to raise cash nor distribute principal (e.g., if the underlying asset has not yet been sold or otherwise produce sufficient income). Recognize this approach is not permitted for annuity trusts.

Example:
Donor's Age: Irrelevant
NIMCRUT's Term of Years: 20
IRS Discount Rate: 2.2%
NIMCRUT Payout Rate: 6%
Fair Market Value of Contributed Assets: $100,000
Basis: $10,000
Federal Income Tax Rate: 39.6%
Federal Capital Gains Tax Rate: 23.8%
Given those assumptions, the present value of the charitable remainder interest will be $29,823. The donor will be entitled in the year of the gift to an income and gift tax charitable deduction in that amount. If the donor is able to fully use the income tax charitable deduction in the first year (after applying the appropriate percentage limitations), his income tax charitable deduction of $29,823 will result in an income tax savings of approximately $11,810 ($29,823 x 39.6%). He also avoids capital gains taxes of $21,420 ($90,000 x 23.8% capital gains rate) when the securities are sold by the NIMCRUT.

Assuming the donor survives the term of the NIMCRUT and assuming the NIMCRUT assets appreciate in value by 6% annually and also earn 2% income annually, the annual distributions will increase over the years. The distributions over the term of the NIMCRUT will be $146,660. Additionally, the charity will receive $150,357 at the termination of the NIMCRUT.

Note, if the donor dies before the term of years, the fair market value of the NIMCRUT at the time of death will be included in the estate and the estate will receive an offsetting estate tax charitable deduction in that amount. If there is a surviving recipient, the deduction will be less than the full value of the assets and tax may be due.

NIMCRUTs are typically deployed for larger, more tax sensitive scenarios, as well as those situations where the underlying asset is illiquid and may not be sold for some time. Another enhancement that may create greater efficiency is a properly structured NIMCRUT with a limited partnership interest. Such structure can result in considerable tax deferral, though it is not a structure looked upon favorably by the IRS.

In conclusion, charitable planning through trusts can be complicated, but has the opportunity to magnify the value of charitable dollars for your clients.
Tax Section CLEs Available for Purchase

34th International Tax Conference (Course No. 1950R and Course No. 2095R)
A Deep Dive Into Wealth Protection/Tax and Advanced Planning (Course No. 2053R)
Advanced Asset Protection (Course No. 2074R)
Asset Protection Fundamentals (Course No. 1878R)
Essential Updates & Wealth Protection Building Blocks (Course No. 2211R)
How to Be an Estate Planning Wizard (Course No. 1991R)
Representing the Physician: The Only Constant is Change (Course No. 1829R)
Tax Planning with Substance: A Multi-Area Survey of the Economic Substance Doctrine (Course No. 2056R)