

Taxpayer Name: Green 199- Dynasty Trust
Mart D. Green Trustee

Examiner: Liskill, Christophe

TIN: [REDACTED]

Tax Form: 1041

Date: 8/27/10, 6/23/11, 6/24/11,
7/11/11, 7/12/11, 7/13/11

Tax Year (s): 200412

Claim: Charitable Contribution Deduction Lead Sheet

Tax Period	Claim	Per Exam	Adjustment	Reference
200412	3,194,748.00	.00	0.00	401-2.1/2.3

Conclusion: *(Reflects the final determination on the issue.)*

The claim is disallowed in full as the allowable charitable deduction amount is \$17,227,772 and is less than the amount per the original return and per the amended return.

Audit Steps: *(Document audit steps taken or to be taken.)*

	Workpaper Reference
1. Review claim.	401-1.1/1.4
2. Compare computations per return and amended return to code and regulations.	401.2.1/2.12
3. Inspect trust instrument.	401-3.1 & 645
4. Review prior Appeals information and findings	645
5. Review and apply Chief Counsel Advise	401-4.2/4.5
6.	

Facts: *(Document the relevant facts.)*

The trust filed an amended return (claim) for 2004 claiming an additional charitable deduction amount of \$9,127,850 and a refund of taxes paid of \$3,194,748. The claim was not processed by the service center. The claim was forwarded to the field for review.

The claim was postmarked October 15, 2008. The original return was postmarked October 17, 2005 and was considered timely filed as October 15, 2005 was a Saturday. The claim was filed within three years of the filing of the original return and is therefore timely filed. The statute of limitations is only open to the extent of the tax or refund related to the claim issue.

The **original return** reported total charitable contributions of \$36,867,002 in 2004. This consisted of contributions of real estate of \$30,313,000 to 50% entities at fair market value (FMV) and a \$6,554,002 contribution from a flow-through entity to a 50% entity. The trust limited the contribution deduction to \$20,526,383 using the 30% of "AGI" limitation for the FMV of the real property contributed, see Statement 26 attached to the original return. However, the "AGI" computation appears to be incorrect, see below and W/P 401-2.1/2.12.

The real estate contributions per the Forms 8283 for each property show a combined basis of \$10,673,770 and a FMV of \$30,313,000. The difference between the basis and the FMV was not included as trust income on either the original return or the amended return. The Forms 8283 and the attached appraisals show the properties were purchased in 2003. Based on the Forms 8283 and some of the attached appraisal information the properties were held for more than one year. This would allow long-term capital gain treatment if the properties were sold. The Forms 8283 appear to be properly completed and were accepted as correct. However, no appraisal information was attached to the return for the property valued at \$29,500,000. **The \$6,554,002 contribution deduction was from HOB-LOB Limited Partnership per Statement 26.**

The amended return used the same contribution amounts, but revised the limitation amount. The amended return shows a charitable deduction of \$29,654,233 using 50% of Unrelated Business Taxable Income (UBTI)

401-1-Claim Lead Sheet
Rev. 01/2005

Workpaper # 401 -1.1

Exhibit

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USA000072

Taxpayer Name: Green 1993 Dynasty Trust
Mart D. Green Trustee

Examiner: Lusk, Christophe

TIN: [REDACTED]

Tax Form: 1041

Date: 8/27/10, 6/23/11, 6/24/11,
7/11/11, 7/12/11, 7/13/11

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instead of the 30% limitation, see **Statement 27-1 & 27-2** attached to the amended return. However, the percentage of the contributions allocated to UBTI was incorrect as the methodology used does not follow the regulations, see below and **W/P 401-2.1/2.12**.

The prior agent did not raise a valuation issue regarding the three donated properties. Nor was any issue raised regarding the flow-through contribution from the partnership.

Both the original return and the amended return contained computations limiting the amount of the contributions that could be deducted. The original return based the computations on "AGI" that was computed using the total income of the trust less certain items on the face of the return, including the Income Distribution Deduction (IDD) per § 661(a) and the exemption amount per § 642(b). The percentage limitation used was 30%. The deduction of IDD and the exemption for this computation is contrary to Treasury Regulation 1.681(a)-2(b)(2), **W/P 401-2.12**. The 30% limitation rate is correct if FMV is used, but the "AGI" limitation was not calculated properly.

The amended return based the computations on UBTI (Unrelated Business Taxable Income) that was computed using the identified UBTI income less taxes of \$1,955,051 on the face of the return and the deduction of \$1,000 allowable per § 512(b)(12). However, the amended return used a 50% limitation instead of a 30% limitation in computing the deduction. The deduction of the taxes appears contrary to § 512(a) as it is not directly connected to the unrelated business income. The 50% limitation appears to be contrary to § 512(b)(11) and § 170(b)(1)(A) & (C) concerning appreciated property. Again the percentage limitations do not appear to have been correctly calculated.

The trust instrument was reviewed to verify the allowance of charitable contributions and the treatment of income of the trust, **W/P 401-3.1 & 645** (complete trust instrument). The trust was created in 1993 per the return. The trust instrument contains 1993 in its name. Based on this the trust was created after 1969. Therefore, no deduction is allowed for amounts "set aside" for charitable contributions.

The trust instrument allows for contributions to charity in Article I, section 1.6. The instrument further states in Article II, section 2.2, the trust may "...*distribute to charity such amounts from the gross income of the Trust as the Trustee determines appropriate...*" Article 4, section 4.3, incorporates the "Standard Trust Provisions" as shown in Exhibit A into the trust agreement. Exhibit "A" (Standard Trust Provisions) to the David and Barbara Green 1993 Dynasty Trust state in Article III. General Trust Provisions, **W/P 401-3.1**.

"3.1. Accumulated Income Becomes Principal. Any income earned by the Trust that is not distributed or is not deemed to be distributed to or for the benefit of a Beneficiary during the fiscal year in which earned, or within a period of time which, for federal income tax purposes, is deemed to have been made during the preceding fiscal year of the Trust, shall be added to and become a part of the principal of the Trust."

The deemed distribution is in reference to § 642(c)(1) regarding an election to treat contributions in the succeeding year as paid in the current year.

The property contributed in 2004 was purchased in 2003 and was held by the trust and not distributed in 2003. No election per § 642(c)(1) appears to have been made. The property was subsequently distributed in 2004 to charitable organizations and a limited charitable contribution deduction was taken on the original return and subsequently increased on the amended return (claim). **In addition, the portion of the real property contribution attributable to the increase in FMV was not included in trust income. Treasury Regulation 1.642(c)-3(b) states the contribution deduction must be reduced by amounts not included in income.**

Taxpayer Name: Green 1990 Dynasty Trust
Mart D. Green Trustee

Examiner: Lusk, Christophe

TIN: [REDACTED]

Tax Form: 1041

Date: 8/27/10, 6/23/11, 6/24/11,
7/11/11, 7/12/11, 7/13/11

Tax Year (s): 200412

Claim: Charitable Contribution Deduction Lead Sheet

Based on the trust instrument it appears the expenditure of 2003 income for the real property with said property held by the trust and not distributed in 2003 would cause the property to be treated as principal or corpus. Alternatively, any portion of the real property contribution determined to be paid out of income (basis) would be limited to a deduction amount equal to the amount included in income of the trust. Therefore, the gain related to the increased FMV of the real property, which has not been included as income, would not be allowed as a charitable contribution deduction.

The same issue was raised for the 2006 trust year in an unrelated examination. The examination disallowed the property deduction in its entirety. The case was settled in Appeals. Appeals allowed a limited portion of the contribution related to the real property concluding it was paid out of "prior gross income." However, the Appeals settlement concluded that the 30% limitation based on income relating to the real property portion of the contribution was less than the basis of property contributed, W/P 645. Therefore, Appeals did not address the issue of basis versus FMV regarding the value of the contributed real property.

[REDACTED] W/P 401-4.2. A response was received in July of 2010 in the form of a Chief Counsel Advise (CCA), W/P 401-4.3/4.4B. The CCA concludes that the charitable deduction allowable to the trust should be limited to the basis of the properties purchased with accumulated income and subsequently contributed to charity. The CCA does not specifically address the corpus argument related to the purchase of the properties and donated in a subsequent year. A copy of the CCA was provided to the trust's power of attorney.

The allowable contribution deduction of the properties should be computed on the purchase price (basis) and not the FMV. In addition, the computations per the original return and amended return should be corrected for computational errors and misapplication of the code and regulations.

Based on the CCA the property contribution is allowable. The value of the contribution is limited to the basis of the property as this would represent the "gross income" of the trust per IRC § 642(c). Using the correct computational requirements the amount of the contribution would be further limited to 50% of Unrelated Business Income less the directly related expenses per §§ 681, 642(c)(4), 513(b)(1), 512(a)(1), (b)(11), & (b)(12) and 170(b)(1)(A) & (C). The allowable amount would be \$17,227,772, W/P 401-2.1/2.3. As this amount is less than the amounts per the original return and per the amended return, the claim is disallowed.

Alternative Positions:

A. The claim is disallowed in full as the amount per the amended return was not paid from income and is not allowable per § 642(c). No adjustment is required as the claim was not processed.

B. Alternatively, if the property contribution is allowable and the fair market value of the property contributed is allowed, the contribution should be limited to 30% of Unrelated Business Income less the directly related expenses for the contribution of appreciated property per §§ 681, 642(c)(4), 513(b)(1), 512(a)(1), (b)(11) & (b)(12) and 170(b)(1)(A) & (C). The allowable amount would be \$24,167,353. As this amount is more than the original return and less the amended return, the trust may be entitled to an additional deduction.

Taxpayer Name: Green 1993 Dynasty Trust Examiner: Driskill, Christophe
 Mart D. Green Trustee
 TIN: [REDACTED]
 Tax Form: 1041 Date: 8/27/10, 6/23/11, 6/24/11,
 7/11/11, 7/12/11, 7/13/11
 Tax Year (s): 200412

Claim: Charitable Contribution Deduction Lead Sheet

Argument:

The claim of \$3,194,748 should be disallowed in full as the allowable charitable deduction amount would be \$17,227,772 and is less than the amount per the original return and per the amended return.

The charitable deduction should be limited to 50% of Net UBTI or \$17,227,772, the flow-through amount from the partnership and the property contributions. The value of the property contributions should be limited to the purchase basis per the CCA and sections 642, 170 and the related regulations. As the allowable amount is less than the original return amount and the claim amount, the claim should be disallowed in full.

The claim of \$3,194,748 is disallowed in full.

Alternative Positions:

A. The claim is disallowed in full as the amount per the amended return was not paid from income and is not allowable. No adjustment is required as the claim was not processed. The claim of \$3,194,748 should be disallowed in full as the trust is not allowed any additional charitable contribution deduction. The charitable deduction should be limited to the flow-through amount from the partnership as the property contributions are from corpus and not from income of the trust. The property was purchased in 2003 and not distributed by year-end. At that point the character of the property per the trust instrument is corpus. The contribution of the property in 2004 would be from corpus and not from income. It may be argued that had the property been contributed in 2003 it would have been from income. However, this is less clear as it is an in-kind contribution and may still be considered as not from income. The question is moot, if the property was purchase and donated in the same year the deduction for charitable purposes would be limited to basis as any gain would be a short-term capital gain and the FMV could not be used per § 170(e). The property deduction should not have been taken. The amount per the original return exceeds the allowable amount. As the allowable amount is less than the original return amount and the claim amount, the claim should be disallowed in full.

B. Alternatively, if the property contribution is allowable and the fair market value of the property contributed is allowed, the contribution should be limited to 30% of Unrelated Business Income less the directly related expenses for the contribution of appreciated property per §§ 681, 642(c)(4), 513(b)(1), 512(a)(1), (b)(11) & (b)(12) and 170(b)(1)(A) & (C). The allowable amount would be \$24,167,353. As this amount is more than the original return and less the amended return, the trust may be entitled to an additional deduction.

Law: (Tax Law, Regulations, court cases, and other authorities. If Unagreed, add Argument)

IRC Section: CCA, §§ 642(c)(1) & (4), 681(a), 511, 512(a) & (b)(11), (12) & (13), 513(a) & (b), 170(a) & (b)(1) and Tres. Reg. §§ 1.642(c)-3(b), 1.681(a)-1 & 1.681(a)-2(b).

Specific citations:

Taxpayer Position: (If applicable)

The trust's power of attorney, Leslie LaReau, has tentatively stated the trust will not agree with the government's position, which is based in part on the CCA. She has indicated the trust will appeal this finding. As a closing letter has not been issued to the trust a formal position by the trust is not included at this time. However, in previous documents provided to the government, W/P 401-5.1 & 645, the trust has taken the position that the real property contributions, at FMV, are deductible as they were paid out of trust income and that the computations per the amended return correctly reflect the deductible amount.

The David and Barbara Green 1993 Dynasty Trust
200412 Form 1041
Claim - Charitable Contributions

08/23/10 cwd, 08/24/10 cwd
08/25/10 cwd, 08/27/10 cwd
06/23/11 cwd, 07/11/11 cwd
07/12/11 cwd

Primary examination position:

Based on the CCA the primary position is the property contribution is allowable and the value of the contribution should be limited to the basis of the property as this would represent the "gross income" of the trust per IRC § 642(c). In addition, the amount of the contribution would be further limited to 50% of Unrelated Business Income less the directly related expenses per §§ 681, 642(c)(4), 513(b)(1), 512(a)(1), (b)(11), & (b)(12) and 170(b)(1)(A) & (C). The allowable amount would be \$17,227,772. As this amount is less than the amount per the original return and per the amended return, the claim is disallowed.

Alternative positions:

A. No deduction is allowable for the contribution of property as the contribution was not made from gross income per IRC § 642 (c). The deduction is limited to the flow-through contribution of \$6,554,002. As this amount is less than the amount per the original return and per the amended return, the claim is disallowed.

The trust instrument for The David and Barbara Green 1993 Dynasty Trust clearly states that any income of the trust not distributed during the fiscal year is principal (corpus). Therefore, any property purchased in the prior year and not distributed would become corpus and would not be allowed as a deduction in a succeeding year.

The trust instrument allows for contributions to charity in Article I, section 1.6. The instrument further states in Article II, section 2.2, the trust may "...*distribute to charity such amounts from the gross income of the Trust as the Trustee determines appropriate...*" Article 4, section 4.3, incorporates the "Standard Trust Provisions" as shown in Exhibit A into the trust agreement. Exhibit "A" (Standard Trust Provisions) to the David and Barbara Green 1993 Dynasty Trust state in Article III. General Trust Provisions.

"3.1. Accumulated Income Becomes Principal. *Any income earned by the Trust that is not distributed or is not deemed to be distributed to or for the benefit of a Beneficiary during the fiscal year in which earned, or within a period of time which, for federal income tax purposes, is deemed to have been made during the preceding fiscal year of the Trust, shall be added to and become a part of the principal of the Trust."*

B. Alternatively, if the property contribution is allowable and the fair market value of the property contributed is allowed, the contribution should be limited to 30% of Unrelated Business Income less the directly related expenses for the contribution of appreciated property per §§ 681, 642(c)(4), 513(b)(1), 512(a)(1), (b)(11) & (b)(12) and 170(b)(1)(A) & (C). The allowable amount would be \$24,167,353. As this amount is more than the original return and less the amended return, the trust may be entitled to an additional deduction.

Note:

The trust is claiming as part of the charitable deduction a \$6,554,002 flow-through deduction from a partnership. No information has been reviewed showing the partnership actually distributed to the trust sufficient amounts to allow the deduction of this flow-through contribution. If this contribution is deemed as not paid from the income of the trust due to the lack of distributions the primary and alternative position B would be reduced by this amount.

Primary & Alternative Position B - Allowable deduction		Primary Position	Alter Position B
Deduction related to Non-business Income (§ 642(c))		0	0
Deduction related to UBI (§§ 642(c)(4), 681 & TR § 681(a)-2(b)(3))		17,227,772	24,167,353
Allowable charitable deduction	401-2.3	17,227,772	24,167,353
 Deduction per original return	 401-2.2	 20,526,383	 20,526,383
Deduction per amended return	401-2.2	29,654,233	29,654,233
401-Trust Computations.xls			401-2.1

USA000076

The David and Barbara Green 1993 Dynasty Trust	08/23/10 cwd, 08/24/10 cwd
200412 Form 1041	08/25/10 cwd, 08/27/10 cwd
Claim - Charitable Contributions	06/23/11 cwd, 07/11/11 cwd
	07/12/11 cwd

Information per the Original and Amended Forms 1041:

A. Form 8283 per Original and Amended Forms 1041

Item	Type	Location	Purchased	Basis	Donated	FMV
Property 1	Real Estate	Georgia	February '03	10,368,113	3/19/2004	29,500,000
Property 2	Real Estate	Oklahoma	August '02	160,477	10/5/2004	355,000
Property 3	Real Estate	Texas	June '03	145,180	10/5/2004	458,000
Total property contributions				10,673,770		30,313,000

Note: Should use 30% limitation using FMV or 50% limitation using basis, 170(b)(1)(A) & (C)

Flow-through contribution from K-1, 50% limitation	6,554,002
Total contributions per return	36,867,002

B. Computations per Original Return ("AGI")

	Original Return
Total Income	58,760,085
Professional fees	(18,898)
Deductions not subject to 2% floor	(372)
Income Distribution Deduction (should not be in computation)	(12,166,111)
Exemption (should not be in computation)	(100)
"AGI" (this is trust taxable income, § 1.681(a)-2(b)(2))	46,574,604
Limitation	(32,602,223)
30% of AGI	13,972,381

No UBTI calculation was made. The contributions were not allocated between UBTI and taxable income.

Deduction per return (did not correctly apply § 170 rules to allocate various percentages)	
Allowable 30% Contributions (this should be based on UBTI)	13,972,381
Flow-through contribution from K-1	6,554,002
Total Charitable Deduction per return (used incorrect methodology)	20,526,383

C. Computations per Amended Return ("UBTI")

	Amended Return
Gross Income	58,760,085
Investment Income	47,914
a. Unrelated Business Taxable Income (UBTI)	58,712,171
Taxes (can't reduce UBTI, but can reduce trust taxable income)	(1,955,051)
Deduction allowed per § 512(b)(12)	(1,000)
b. "Net" UBTI (mixed UBTI and taxable trust income computations)	56,756,120

UBTI percentage (b / a) (used incorrect methodology) 96.67%

Contribution allocated to UBTI, percentage x contributions (used incorrect methodology)	35,638,743
UBTI 50% limitation	(28,378,060)
Unallowable contributions based on UBTI per § 1.681(a)	7,260,684

Total contributions per return (did not correctly apply § 170 rules to allocate various percentages)	36,867,002
Unallowable contributions based on UBTI per § 1.681(a)	(7,260,684)
Allowable Deduction Attributable to UBTI per § 681 (used incorrect methodology > 50% of UBTI)	29,606,318
Allowable Deduction Attributable to Non-UBTI per § 642(c) (doubled this amount)	47,914
Total Charitable Deduction per amended return	29,654,232

401-Trust Computations.xls 401-2.2

USA000077

The David and Barbara Green 1993 Dynasty Trust
200412 Form 1041
Claim - Charitable Contributions

08/23/10 cwd, 08/24/10 cwd
08/25/10 cwd, 08/27/10 cwd
06/23/11 cwd, 07/11/11 cwd
07/12/11 cwd

Calculation per Examination	Primary Position	Alter Position B
Contributions	Basis	FMV
Property contributions, 50% limit (basis) or 30% limit (FMV), 170(b)(1)	10,673,770	30,313,000
Flow-through contribution from K-1, 50% limitation	6,554,002	6,554,002
Total contributions	17,227,772	36,867,002
Unrelated Business Income (UBI) W/P 401-2.6 & 2.12		
Gross UBI per amended return	58,712,171	58,712,171
Deduction allowed per § 512(b)(12)	(1,000)	(1,000)
Net UBTI (TR § 1.681(a)-2(b)(1))	58,711,171	58,711,171
Trust Income W/P 401-2.7		
Total Income	58,760,085	58,760,085
Taxes (1,955,051)		
Professional fees (18,898)		
Deductions not subject to 2% floor (372)		
Deduction allowed per § 512(b)(12) (1,000)	(1,975,321)	(1,975,321)
Trust Taxable Income (§ 1.681(a)-2(b)(2))	56,784,764	56,784,764
Unrelated Business Income percentage		
Net UBTI	58,711,171	58,711,171
Trust Taxable Income (§ 1.681(a)-2(b)(2))	56,784,764	56,784,764
Unrelated Business Income percentage (§ 1.681(a)-2(b)(2))	103.39%	103.39%
§ 1.681(a)-2(b)(2) - can't exceed 100% of taxable trust income		
Contributions allocated to Non-Business Income	Basis	FMV
Total payments to charity	17,227,772	36,867,002
Non-business income percentage	0.00%	0.00%
Amount allocated to Non-Business Income (§ 642(c))	0	0
Contributions allocated to Unrelated Business Income	Basis	FMV
Total payments to charity	17,227,772	36,867,002
Amount allocated to Non-Business Income	0	0
a. Amount allocated to Unrelated Business Income (actual)	17,227,772	36,867,002
Limitation on Contributions allocated to UBI	50%	30%
Net UBI	58,711,171	58,711,171
Percentage limitation (§ 170(b)(1)(A) or (C))	50.00%	30.00%
b. Limitation based on percentage of UBI (§ 512(b)(11))	29,355,586	17,613,351
50% of Unrelated Business Income		29,355,586
Flow-through contribution from K-1, 50% limitation, § 170(b)(1)(A)		(6,554,002)
Remaining 50% limitation		22,801,584
Property contributions, 30% limit (FMV), § 170(b)(1) (lesser of actual or 30%)		(17,613,351)
Unused contributions due to limitation		5,188,232
b. Limitation based on percentage of UBI (§ 512(b)(11))		24,167,353
Smaller of actual payment or limitation (a or b) 401-2.4	17,227,772	24,167,353
401-Trust Computations.xls		401-2.3

USA000078

Primary Position



Table 4. Worksheet for Limit on Deductions

Who can use this worksheet. You can use this worksheet if you made charitable contributions during the year, and one or more of the limits described in this publication under *Limits on Deductions* apply to you. You cannot use this worksheet if you have a carryover of a charitable contribution from an earlier year.

General instructions:

- The terms used in this worksheet are explained earlier in this publication.
- If your answer to any line is less than zero, enter zero.
- For contributions of property, enter the property's fair market value unless you elected (or were required) to reduce the fair market value as explained under *Giving Property That Has Increased in Value*. In that case, enter the reduced amount.

Step 1. List your charitable contributions made during the year.

1. Enter your contributions to 50% limit organizations (include contributions of capital gain property if you reduced the property's fair market value. Do not include contributions of capital gain property deducted at fair market value.)	1	17,227,772
2. Enter your contributions to 50% limit organizations of capital gain property deducted at fair market value	2	
3. Enter your contributions (other than of capital gain property) to qualified organizations that are not 50% limit organizations	3	0
4. Enter your contributions "for the use of" any qualified organization. (But do not enter here any amount that must be entered on line 6.)	4	0
5. Add lines 3 and 4.	5	0
6. Enter your contributions of capital gain property to or for the use of any qualified organization. (But do not enter here any amount entered on line 1 or 2.)	6	0

Step 2. Figure your deduction for the year and your carryover to the next year.

7. Enter your adjusted gross income	7	58,711,171
8. Multiply line 7 by 0.5. This is your 50% limit	8	29,355,586
Contributions to 50% limit organizations		
9. Enter the smaller of line 1 or line 8.	9	17,227,772
10. Subtract line 9 from line 1	10	0
11. Subtract line 9 from line 8	11	12,127,814
Contributions not to 50% limit organizations		
12. Add lines 1 and 2.	12	17,227,772
13. Multiply line 7 by 0.3. This is your 30% limit	13	17,613,351
14. Subtract line 12 from line 13	14	12,127,814
15. Enter the smallest of line 5, 13, or 14	15	0
16. Subtract line 15 from line 5	16	0
17. Subtract line 15 from line 13	17	17,613,351
Contributions of capital gain property to 50% limit organizations		
18. Enter the smallest of line 2, 11, or 13	18	0
19. Subtract line 18 from line 2	19	0
20. Subtract line 15 from line 14	20	12,127,014
21. Subtract line 18 from line 13	21	17,613,351
Contributions of capital gain property not to 50% limit organizations		
22. Multiply line 7 by 0.2. This is your 20% limit	22	11,742,234
23. Enter the smallest of line 6, 17, 20, 21, or 22	23	0
24. Subtract line 23 from line 6	24	0

Step 3. Summarize your deductions and carryovers.

25. Add lines 9, 15, 18, and 23. Enter the total here and on Schedule A (Form 1040).	25	17,227,772
26. Add lines 10, 16, 19, and 24. Enter the total here. Carry it forward to Schedule A next year.	26	0

401-2.4

Alternative Position B



Table 4. Worksheet for Limit on Deductions

Who can use this worksheet. You can use this worksheet if you made charitable contributions during the year, and one or more of the limits described in this publication under *Limits on Deductions* apply to you. You cannot use this worksheet if you have a carryover of a charitable contribution from an earlier year.

General instructions:

- The terms used in this worksheet are explained earlier in this publication.
- If your answer to any line is less than zero, enter zero.
- For contributions of property, enter the property's fair market value unless you elected (or were required) to reduce the fair market value as explained under *Giving Property That Has Increased in Value*. In that case, enter the reduced amount.

Step 1. List your charitable contributions made during the year.

1. Enter your contributions to 50% limit organizations. (Include contributions of capital gain property if you reduced the property's fair market value. Do not include contributions of capital gain property deducted at fair market value.)	1	6,554,002
2. Enter your contributions to 50% limit organizations of capital gain property deducted at fair market value	2	30,313,000
3. Enter your contributions (other than of capital gain property) to qualified organizations that are not 50% limit organizations	3	0
4. Enter your contributions "for the use of" any qualified organization. (But do not enter here any amount that must be entered on line 6.)	4	0
5. Add lines 3 and 4	5	0
6. Enter your contributions of capital gain property to or for the use of any qualified organization. (But do not enter here any amount entered on line 1 or 2.)	6	0

Step 2. Figure your deduction for the year and your carryover to the next year.

7. Enter your adjusted gross income	7	58,711,171
8. Multiply line 7 by 0.5. This is your 50% limit	8	29,355,586

Contributions to 50% limit organizations

9. Enter the smaller of line 1 or line 8	9	6,554,002	
10. Subtract line 9 from line 1	10		0
11. Subtract line 9 from line 8	11	22,801,584	

Contributions not to 50% limit organizations

12. Add lines 1 and 2	12	36,867,002	
13. Multiply line 7 by 0.3. This is your 30% limit	13	17,613,351	
14. Subtract line 12 from line 8	14	0	
15. Enter the smallest of line 5, 13, or 14	15	0	
16. Subtract line 15 from line 5	16		0
17. Subtract line 15 from line 13	17	17,613,351	

Contributions of capital gain property to 50% limit organizations

18. Enter the smallest of line 2, 11, or 13	18	17,613,351	
19. Subtract line 18 from line 2	19		0
20. Subtract line 15 from line 14	20	0	
21. Subtract line 18 from line 13	21	0	

Contributions of capital gain property not to 50% limit organizations

22. Multiply line 7 by 0.2. This is your 20% limit	22	11,742,234	
23. Enter the smallest of line 6, 17, 20, 21, or 22	23	0	
24. Subtract line 23 from line 6	24		0

Step 3. Summarize your deductions and carryovers.

25. Add lines 9, 15, 18, and 23. Enter the total here and on Schedule A (Form 1040)	25	24,167,353	
26. Add lines 10, 16, 19, and 24. Enter the total here. Carry it forward to Schedule A next year	26		0

401-2.5

Unrelated Business Income

SKIPPED?

§681/§642(c)(4)
limitation on
the Charitable
Deduction.

While the §642(c) charitable deduction is normally unlimited, percentage limitations apply if a TRUST HAS UNRELATED BUSINESS INCOME (UBI) that exceeds \$1,000. THIS RULE DOES NOT APPLY TO ESTATES.

Unrelated
Business
Income

Unrelated business income IS:

- income generated by a trade or business operated by the trust or
- income generated by a trade or business operated by a partnership in which the trust has an interest.

Unrelated business income usually IS NOT:

- income from rents,
- income from interest,
- income from royalties or
- income from annuities.

Allowable
Charitable
Deduction for
Unrelated
Business
Income

If a TRUST receives unrelated business income, trade or business income, the allowable charitable deduction is computed in two steps.

1. The deduction allocable to the non-business income remains unlimited.
2. The deduction allocable to the *unrelated trade or business income* is limited by the percentages that would be allowed if the deduction were computed using §170. In making these §170 percentage limitation computations, the unrelated trade or business income is used in the percentage computations instead of the adjusted gross income of the trust.

Continued on next page

Unrelated Business Income, Continued

Example 8: Unrelated Business Income Computation

Wife established a §2056(b)(7) Qualified Terminable Interest Property Trust (QTIP) for the benefit of Husband. The governing instrument requires that all income be paid to Husband for life. On Husband's death, one-half of the income is payable to Son and one-half of the income is payable to a qualified charity classified as a private foundation. Husband died on January 1, 1999. During 1999, the trust received \$50,000 in gross income, \$31,000 in income from a BUSINESS OPERATED BY THE TRUST and \$19,000 of taxable interest. During 1999, one-half of the income, \$25,000, was paid to the charity and one-half of the income, \$25,000, was paid to Son. The normal §170 limitation for contributions to a private foundation is 20% of the donating individual's adjusted gross income.

Step	Action																		
1	<p>Compute the §642(c) unlimited charitable deduction for the amount of payment allocated to the non-business income using the rules of §512 and §513.</p> <table> <tr> <td>Gross Unrelated Trade or Business Income</td><td>\$31,000</td></tr> <tr> <td>Less \$1,000 De Minimis Amount, §512(b)(12)</td><td><1,000></td></tr> <tr> <td>Net Unrelated Trade or Business Income</td><td>\$30,000</td></tr> <tr> <td>Total Income for year</td><td>\$50,000</td></tr> <tr> <td>Less Net Unrelated Trade or Business Income</td><td><30,000></td></tr> <tr> <td>Non-business income</td><td>\$20,000</td></tr> <tr> <td>Non-business income, \$20,000</td><td></td></tr> <tr> <td>Total Income, \$50,000</td><td></td></tr> <tr> <td>(TAXABLE) 1, 642 (a) - 2 (b)</td><td></td></tr> </table> <p>x. Payment to Charity \$25,000 = \$10,000</p> <p><i>Regulations do computations differently. Based on UBI vs. Total trust income. w/p 401-2.12</i></p>	Gross Unrelated Trade or Business Income	\$31,000	Less \$1,000 De Minimis Amount, §512(b)(12)	<1,000>	Net Unrelated Trade or Business Income	\$30,000	Total Income for year	\$50,000	Less Net Unrelated Trade or Business Income	<30,000>	Non-business income	\$20,000	Non-business income, \$20,000		Total Income, \$50,000		(TAXABLE) 1, 642 (a) - 2 (b)	
Gross Unrelated Trade or Business Income	\$31,000																		
Less \$1,000 De Minimis Amount, §512(b)(12)	<1,000>																		
Net Unrelated Trade or Business Income	\$30,000																		
Total Income for year	\$50,000																		
Less Net Unrelated Trade or Business Income	<30,000>																		
Non-business income	\$20,000																		
Non-business income, \$20,000																			
Total Income, \$50,000																			
(TAXABLE) 1, 642 (a) - 2 (b)																			
2	<p>Compute the charitable deduction relating to the unrelated business income using the §170 percentage limitations.</p> <table> <tr> <td>Net Unrelated Trade or Business Income</td><td>\$30,000</td></tr> <tr> <td>§170 limitation for private foundation payments</td><td>x 20%</td></tr> <tr> <td>Limitation on Deduction</td><td>\$6,000</td></tr> <tr> <td>Total Payment to Charity</td><td>\$25,000</td></tr> <tr> <td>Less Amount Allocated to Non-Business Income</td><td><10,000></td></tr> <tr> <td>Payment Allocable to Unrelated Trade or Business Inc.</td><td>\$15,000</td></tr> <tr> <td>Smaller of Payment and Limitation</td><td>\$6,000</td></tr> </table>	Net Unrelated Trade or Business Income	\$30,000	§170 limitation for private foundation payments	x 20%	Limitation on Deduction	\$6,000	Total Payment to Charity	\$25,000	Less Amount Allocated to Non-Business Income	<10,000>	Payment Allocable to Unrelated Trade or Business Inc.	\$15,000	Smaller of Payment and Limitation	\$6,000				
Net Unrelated Trade or Business Income	\$30,000																		
§170 limitation for private foundation payments	x 20%																		
Limitation on Deduction	\$6,000																		
Total Payment to Charity	\$25,000																		
Less Amount Allocated to Non-Business Income	<10,000>																		
Payment Allocable to Unrelated Trade or Business Inc.	\$15,000																		
Smaller of Payment and Limitation	\$6,000																		
3	<p>The allowable charitable deduction is the sum of Steps 1 and 2.</p> <table> <tr> <td>Deduction related to Unrelated Business Income</td><td>\$6,000</td></tr> <tr> <td>Deduction related to Non-Unrelated Business Income</td><td>\$10,000</td></tr> <tr> <td>Total Allowable charitable Deduction</td><td>\$16,000</td></tr> </table>	Deduction related to Unrelated Business Income	\$6,000	Deduction related to Non-Unrelated Business Income	\$10,000	Total Allowable charitable Deduction	\$16,000												
Deduction related to Unrelated Business Income	\$6,000																		
Deduction related to Non-Unrelated Business Income	\$10,000																		
Total Allowable charitable Deduction	\$16,000																		

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6-26

401-2.7

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General Requirements

Income Tax Charitable Deduction for Estates and Trusts

The charitable deduction rules for estates and trusts differ markedly from both the estate tax charitable deduction rules and the income tax charitable deduction rules for individuals. These differences are summarized below.

	Income Tax Deduction on Form 1040, §170	Estate Tax Deduction on Form 706, §2055	Income Tax Deduction on Form 1041, §642(c)
Percentage Limitations	There are various percentage limitations based on the adjusted gross income for the year. For individuals, the maximum is 30% of the adjusted gross income.	The deduction is unlimited. The entire estate can be offset by the charitable deduction.	THE DEDUCTION IS UNLIMITED; THE ENTIRE AMOUNT OF INCOME CAN BE OFFSET BY THE CHARITABLE DEDUCTION.
Permissible Recipient	A deduction is allowed only if the recipient is a domestic charity.	Permissible recipients are not limited to domestic charities.	PERMISSIBLE RECIPIENTS ARE NOT LIMITED TO DOMESTIC CHARITIES.
Permissible Property	May be any type of property will qualify for the deduction; however, the type may affect the percentage limitations.	Any type of property will qualify for the deduction as long as the property is included in the gross estate	THE DISTRIBUTION TO CHARITY MUST BE AN ITEM OF GROSS INCOME.
Reason for contribution	The transfer to the charity may be for any reason.	The distribution to the charity must be made pursuant to the governing instrument.	THE DISTRIBUTION TO THE CHARITY MUST BE MADE PURSUANT TO THE GOVERNING INSTRUMENT.
Time of payment	The payment must be made during the tax year.	The payment must eventually be made.	THE AMOUNT MUST BE PAID OR SET ASIDE DURING THE TAX YEAR OR IN THE FOLLOWING YEAR IF A SPECIAL ELECTION IS MADE.

Continued on next page

From Gross Income

General Rule In contrast to the income tax charitable deduction for individuals, §642(c) has a special requirement concerning the **SOURCE** of the charitable contribution. Section 642(c) requires that the contribution be made **FROM THE GROSS INCOME** of the trust or estate.

Gross Income Because the term used in §642(c) is "gross income" instead of "DNI" or "fiduciary accounting income," a deduction is allowed for charitable contributions allocable both to capital gains receipts and ordinary income receipts.

Allocation Rules for Estates The applicable principal and income act and the governing instrument are used to determine the amount of gross income that is allocated to a charitable bequest. The allocation of income varies depending on **THE TYPE OF BEQUEST, THE APPLICABLE LAW, AND THE TIMING OF PAYMENTS**. Listed below are different allocations using the Uniform Principal and Income Act included as Exhibit 2-1.

Type	Example	Uniform Principal and Income Act Allocation Rule
Bequest of Specific Property	I give Blackacre to Charity.	"...the income from the property bequeathed or devised to them respectively, less taxes, ordinary repairs, and other expenses of management, and operation of the property, and an appropriate portion of interest accrued since the death of the testator and of taxes imposed on income (excluding taxes on capital gains) which accrue during the period of administration"
Bequest of A Pecuniary Amount Not in Trust	I give \$100,000 to charity.	No share of income
All other Bequests	I give 50% of my estate to charity.	"... to all other legatees and devisees, except legatees of pecuniary bequests not in trust, the balance of the income, less the balance of taxes, ordinary repairs, and other expenses of management and operation of all property from which the estate in proportion to their respective interest in the undistributed assets of the estate computed at times of distribution on the basis of inventory value."

Continued on next page

Lesson 6

6-7-00

1VT 6-16-00

Charitable Deduction

Overview

Introduction

The first five lessons of this course focused on the structure of Subchapter J, particularly the allocation of income between the estate or trust and its beneficiaries. In contrast, the topic of this lesson is a special §642(c) charitable deduction that is allowed for estates and trusts. While §2055 and §2522 allow a charitable deduction for the estate tax and gift tax and §170 allows a charitable deduction for individuals and corporations, §642(c) includes special rules for a charitable deduction that apply only to trusts and estates. MANY EXAMINATIONS OF A DECEDENT'S ESTATE TAX RETURN AFFECT THE AMOUNT OF THE ALLOWABLE INCOME TAX CHARITABLE DEDUCTION.

Code Sections

The code sections applicable to this lesson are as follows: §642(c)(2), §663(a)(2), §664, and §681.

Objectives

At the end of this lesson, you will be able to:

1. List the §642(c) charitable deduction requirements.
2. Given a set of facts, compute the allowable §642(c) deduction.

In this lesson

This lesson covers the following topics.

Topic	See Page
Overview	6-1
General Requirements	6-3
From Gross Income	6-5
Paid or Set Aside	6-9
Pursuant to the Instrument	6-13
For A Charitable Purpose	6-14
Charitable Deduction Questions	6-15

Continued on next page

6-1

3379-001

401-2.10

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2006
Computations used wrong method?

8/25/10

THE DAVID AND BARBARA GREEN 1993 DYNASTY TRUST
 DEDUCTION UNDER IRC SEC. 512(b)(11)
 2006 FORM 1041

Cash Contributions Paid 1/1/2006 - 12/31/2006, and Capital Gain property deducted at Tax Basis
 Cash Payments by David & Barbara Green 1993 Dynasty Trust
 Cash Payments from K-1 - Hob-I ob, Limited Partnership
 Capital Gain Property Deducted at Cost
 Total Cash Contrib. Paid 1/1/2006 - 12/31/2006, and Capital Gain property deducted at Tax Basis

19,300
 19,662,476
 0
 19,681,776
 26,211,000

Capital Gain Property Deducted at Fair Market Value - See attached Forms 8283

UBI Net Income before Contribution Deduction

Total Income
 State Income Tax
 Deduct Not Subject to 2%
 Exemption Under Sec. 512

UBI + OTHER INCOME
 FILE COPY

52,153,228
 (1,520,225)
 (948,199)
 (1,000)
 49,683,804

- 1 Contributions to 50% limit organizations. Include Capital Gain property deducted at cost, not FMV
- 2 Contributions to 50% limit organizations of capital gain property deducted at FMV
- 3 Contributions (other than capital gain property) to qualified organizations not 50% limit organizations
- 4 Enter contributions "for the use of" qualified organizations
- 5 Add Line 3 and line 4
- 6 Enter contributions of capital gain property to or for use of qualified organizations (not on lines 1 or 2)
- 7 Enter UBT net income before contribution deduction
- 8 Multiply line 7 by 0.5. This is the 50% limit

(1) 19,681,776
 (2) 26,211,000
 (3) 0
 (4) 0
 (5) 0
 (6) 0
 (7) 49,683,804
 (8) 24,841,902

Contributions to 50% limit organizations

- 9 Enter the smaller of line 1 or line 8
- 10 Subtract line 9 from line 1
- 11 Subtract line 9 from line 8

Contributions not to 50% limit organizations

- 12 Add lines 1 and 2
- 13 Multiply line 7 by 0.3. This is the 30% limit
- 14 Subtract line 12 from line 8
- 15 Enter smallest of line 5, 13, or 14
- 16 Subtract line 15 from line 5
- 17 Subtract line 15 from line 13

Contributions of capital gain property to 50% limit organizations

- 18 Enter smallest of line 2, 11, or 13
- 19 Subtract line 18 from line 2
- 20 Subtract line 15 from line 14
- 21 Subtract line 18 from line 13

Contributions of capital gain property NOT to 50% limit organizations

- 22 Multiply line 7 by 0.2. This is the 20% limit
- 23 Enter the smallest of line 6, 17, 20, 21, or 22
- 24 Subtract line 23 from line 6
- 25 Add lines 9, 15, 18, and 23. This is current year deduction

TOTAL DEDUCTION ALLOWED

Deduct 2006
 Carryover (not allowed)

(9) 19,681,776
 (10) 0
 (11) 5,160,126
 (12) 45,892,776
 (13) 14,905,141
 (14) 0
 (15) 0
 (16) 14,905,141
 (17) 5,160,126
 (18) 0
 (19) 0
 (20) 9,745,015
 (21) 0
 (22) 9,936,781
 (23) 0
 (24) 0
 (25) 24,841,902

24,841,902

401-2.81

Attachment D

USA000086

Regs. § 1.681(a)-1(c)

Estates, trusts, beneficiaries, decedents

a noncharitable purpose, or (3) invested against the interests of the charitable beneficiaries.

Further, if the circumstance set forth in paragraph (a) or (c) of this section is applicable, the deduction is limited to income actually paid out for charitable purposes, and is not allowed for income only set aside or to be used for those purposes. If the circumstance set forth in paragraph (b) of this section is applicable, deductions for contributions to the trust may be disallowed. The provisions of section 681 are discussed in detail in §§ 1.681(a)-2 through 1.681(c)-1. For definition of the term "income", see section 643(b) and § 1.643(b)-1.

TD 6259, 10/15/57, amended TD 7428, 8/19/76

§ 1.681(a)-2 Limitation on charitable contributions deduction of trusts with trade or business income.

Caution: The Treasury has not yet amended Reg § 1.681(a)-2 to reflect changes made by P.L. 91-172.

(a) **In general.** No charitable contributions deduction is allowable to a trust under section 642(c) for any taxable year for amounts allocable to the trust's unrelated business income for the taxable year. For the purpose of section 681(a) the term "unrelated business income" of a trust means an amount which would be computed as the trust's unrelated business taxable income under section 512 and the regulations thereunder, if the trust were an organization exempt from tax under section 501(a) by reason of section 501(c)(3). For the purpose of the computation under section 512, the term "unrelated trade or business" includes a trade or business carried on by a partnership of which a trust is a member, as well as one carried on by the trust itself. While the charitable contributions deduction under section 642(c) is entirely disallowed by section 681(a) for amounts allocable to "unrelated business income", a partial deduction is nevertheless allowed for such amounts by the operation of section 512(b)(11), as illustrated in paragraphs (b) and (c) of this section. This partial deduction is subject to the percentage limitations applicable to contributions by an individual under section 170(b)(1)(A) and (B), and is not allowed for amounts set aside or to be used for charitable purposes but not actually paid out during the taxable year. Charitable contributions deductions otherwise allowable under section 170, 545(b)(2), or 642(c) for contributions to a trust are not disallowed solely because the trust has unrelated business income.

(b) **Determination of amounts allocable to unrelated business income.** In determining the amount for which a charitable contributions deduction would otherwise be allowable under section 642(c) which are allocable to unrelated business income, and therefore not allowable as a deduction, the following steps are taken:

(1) There is first determined the amount which would be computed as the trust's unrelated business taxable income under section 512 and the regulations thereunder if the trust were an organization exempt from tax under section 501(a) by reason of section 501(c)(3), but without taking the charitable contributions deduction allowed under section 512(b)(11).

(2) The amount for which a charitable contributions deduction would otherwise be allowable under section 642(c) is then allocated between the amount determined in subparagraph (1) of this paragraph and any other income of the trust. Unless the facts clearly indicate to the contrary, the allocation to the amount determined in subparagraph (1) of

this paragraph is made on the basis of the ratio (but not in excess of 100 percent) of the amount determined in subparagraph (1) of this paragraph to the taxable income of the trust, determined without the deduction for personal exemption under section 642(b), the charitable contributions deduction under section 642(c), or the deduction for distributions to beneficiaries under section 661(a).

(3) The amount for which a charitable contributions deduction would otherwise be allowable under section 642(c) which is allocable to unrelated business income as determined in subparagraph (2) of this paragraph, and therefore not allowable as a deduction, is the amount determined in subparagraph (2) of this paragraph reduced by the charitable contributions deduction which would be allowed under section 512(b)(11) if the trust were an organization exempt from tax under section 501(a) by reason of section 501(c)(3).

(c) **Examples.** (1) The application of this section may be illustrated by the following examples, in which it is assumed that the Y charity is not a charitable organization qualifying under section 170(b)(1)(A) (see subparagraph (2) of this paragraph):

Example (1). The X trust has income of \$50,000. There is included in this amount a net profit of \$31,000 from the operation of a trade or business. The trustee is required to pay half of the trust income to A, an individual, and the balance of the trust income to the Y charity, an organization described in section 170(c)(2). The trustee pays each beneficiary \$25,000. Under these facts, the unrelated business income of the trust (computed before the charitable contributions deduction which would be allowed under section 512(b)(11)) is \$30,000 (\$31,000 less the deduction of \$1,000 allowed by section 512(b)(12)). The deduction otherwise allowable under section 642(c) is \$25,000, the amount paid to the Y charity. The portion allocable to the unrelated business income (computed as prescribed in paragraph (b)(2) of this section) is \$15,000, that is, an amount which bears the same ratio to \$25,000 as \$30,000 bears to \$50,000. The portion allocable to the unrelated business income and therefore disallowed as a deduction, is \$15,000 reduced by \$6,000 (20 percent of \$30,000, the charitable contributions deduction which would be allowable under section 512(b)(11)), or \$9,000. ALLOWED 16,000 (\$25,000 - 9,000)

Example (2). Assume the same facts as in example (1), except that the trustee has discretion as to the portion of the trust income to be paid to each beneficiary, and the trustee pays \$40,000 to A and \$10,000 to the Y charity. The deduction otherwise allowable under section 642(c) is \$10,000. The portion allocable to the unrelated business income computed as prescribed in paragraph (b)(2) of this section is \$6,000, that is, an amount which bears the same ratio to \$10,000 as \$30,000 bears to \$50,000. Since this amount does not exceed the charitable contributions deduction which would be allowable under section 512(b)(11) (\$6,000, determined as in example (1)), no portion of it is disallowed as a deduction.

Example (3). Assume the same facts as in example (1), except that the terms of the trust instrument require the trustee to pay to the Y charity the trust income, if any, derived from the trade or business, and to pay to A all the trust income derived from other sources. The trustee pays \$31,000 to the Y charity and \$19,000 to A. The deduction otherwise allowable under section 642(c) is \$31,000. Since the entire income from the trade or business is paid to Y charity, the amount allocable to the unrelated business income computed before the charitable contributions deduction under section 512(b)(11) is \$30,000 (\$31,000 less the deduction of \$1,000

17,614

401-2.12

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contrary decision or judgment of either a majority of the Trustees or of the Related Trustee.

However, this paragraph (c) shall not be construed as in any way limiting the third party reliance provisions outlined immediately above in paragraph (b) of this Section.

(d) Delegation of Duties by a Trustee: Any Trustee may, with the written consent of the remaining Trustees, be relieved of any or all powers, authority, duties, and discretion vested in or imposed upon that Trustee by this Trust Agreement by delivering to the remaining then serving Trustees a written statement delegating these powers, authority, duties, and discretion to them. Any act performed according to such written statement shall be binding upon all persons interested in this Trust.

(e) Disclaimer of Powers, Duties and Responsibilities: Any Trustee may disclaim, in whole or in part, any specific or general power, duty, or responsibility imposed by law or by the terms of this Trust Agreement. Thereafter, the remaining Co-Trustees shall exercise sole power, duty, responsibility over such disclaimed powers, duties, or responsibilities. Such disclaimer shall not, however, affect the remaining non-disclaimed powers, duties, and responsibilities of such Trustee.

ARTICLE III.

GENERAL TRUST PROVISIONS

3.1. Accumulated Income Becomes Principal. Any income earned by the Trust that is not distributed or is not deemed to be distributed to or for the benefit of a Beneficiary during the fiscal year in which earned, or within a period of time which, for federal income tax purposes, is deemed to have been made during the preceding fiscal year of the Trust, shall be added to and become a part of the principal of the Trust. See 401-3.2

3.2. Location and Transfer of Location of Trust. The general location of this Trust shall be the State of Oklahoma, and its administration shall be conducted within the State of Oklahoma. Accordingly, the laws of the State of Oklahoma shall apply in construing

401-3.1

Mark Chandler

317-685-7566

Dora Duckworth

316-232-7494

ISSUE PAPER - CHARITABLE CONTRIBUTIONS

Examination Hints:

1. The trust document should be checked to see if charitable contributions are allowed in it and if the amounts are to be paid from income.
2. For a will the charitable bequest needs to be checked to see if it is payable from the assets of the estate or from the income of the estate. Amounts payable from corpus are not deductible on the Form 1041 even if the estate was not required to file a Form 706.
3. Amounts distributed from partnerships must meet the requirements in Rev. Rul. 2004-5.
4. Excess amounts are not allowed to be carried forward nor are they allowed to be included in any NOL computation.

ISSUE: What types of distributions made to a charity by a trust can qualify as a charitable deduction.

FACTS: Trusts are claiming as charitable contributions amounts in excess of trust income. In addition they are claiming as charitable contributions amounts from other than trust income.

LAW AND ARGUMENT: A trust or estate is able to claim as a deduction under IRC §642(c) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a charitable purpose.

The Service has identified several common problems in this area, including:

1. double deductions (deductions for the same amounts are claimed on both the Form 706, Estate Tax Return and on the Form 1041, Trust Return);
- * 2. deductions on the Form 1041 of amounts which were not intended to be paid from trust income (amounts which are paid out of the corpus of the estate, and not from the estate's income);
3. deductions on the Form 1041 in excess of reported income;
4. deductions on the Form 1041 in excess of the amounts specified under the will or trust document;
5. charitable contributions giving rise to net operating loss deductions; and
6. deductions on the Form 1041 of pass-through contribution amounts.

Double deductions: IRC §2055(a) (2) allows a deduction from the estate value for amounts of the bequests, legacies, devises, or transfers that are paid to or for charitable organizations. This deduction is allowable on the Federal Estate Tax Return (Form 706). Another deduction for the same amounts is not allowed on the Form 1041 at the time when the amounts are actually paid to the organizations. If the estate is not large enough that it is required to file a Form

1

1101-3.2

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706, they are not entitled to claim the specific charitable bequest on the Form 1041 unless the bequest is to be paid from current income.

- * Deductions not intended to be paid from trust income: Some Forms 1041 claim charitable deductions for funds which have come from the corpus of the trust or estate, but which the trustee deducts against trust income. This is particularly true of some specific bequests. However, IRC §2055(a) allows deductions from the value of the corpus of the estate for such bequests, and not from the income earned by the estate. Again, if the estate is not large enough that it is required to file a Form 706; they are not entitled to claim the specific charitable bequest on the Form 1041 unless the bequest is to be paid from current income.

- * Deductions in excess of reported income: IRC §642(c) (1) sets the general rule that for an estate or trust, "there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by section 170(a)...) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purposes specified in section 179(c)..." Many Forms 1041 related to estates are being filed claiming a deduction for the total amount which will be paid to the charitable organization and not the amount that is actually paid from the estate's income. Yearly charitable contributions from a trust are limited to that year's gross income, pursuant to IRC §642(c) (1).

Deductions in excess of the amounts specified under the terms of the will or trust instrument: Other Forms 1041 claim deductions for amounts paid to charities, but have no specific provision in their governing instrument allowing the trustee to make such charitable contributions. Such claimed contributions should be disallowed as not being "pursuant to the terms of the governing instrument," §642(c) (1).

Charitable contribution deductions creating a net operating loss: Treasury Regulation Section 1.642(d)-1(b) precludes a trust or estate of including in their computation of a net operating loss any excess charitable contributions. This means that if the monies paid to or for the charitable organization are more than the income earned for the year, the excess is not deductible by the trust or estate. The estate or trust must be able to show (1) that the monies were paid pursuant to the will or trust document, (2) that the monies paid were from income, and (3) that if the trust or estate does have a net operating loss that it was not increased based upon excess charitable contributions.

Contributions of pass-through amounts: Charitable deductions are limited on an individual's Form 1040 and if the individual has large amounts of income the individual may not be entitled to claim any itemized deductions. The Service has identified several cases where the charitable deduction is being claimed on the trust and the net of the trust income is then being distributed to the individual. In this way the individual receives a 100% benefit of the charitable deduction. Many

trusts are deducting as charitable contributions amounts that were distributed to them from partnerships and S-Corporations. These amounts are not paid from income and should not be allowed as a deduction on the trust's return nor are they distributable to the beneficiary. The only exceptions to this rule would be for ESBTs and for distributions from partnerships that fall within the parameters of Revenue Ruling 2004-5. 401- 3.3

Westlaw

Rev. Rul. 2004-5, 2004-3 I.R.B. 295, 2004-1 C.B. 295, 2004 WL 75769 (IRS RRU)

Page 1

C

Rev. Rul. 2004-5, 2004-3 I.R.B. 295, 2004-1 C.B. 295, 2004 WL 75769 (IRS RRU)

Internal Revenue Service (I.R.S.)
IRS RRURevenue Ruling
CHARITABLE DEDUCTIONS

Published: January 20, 2004

Section 170.--Charitable, etc., Contributions and Gifts

Is a charitable deduction under section 642(c) for a trust's distributive share of a charitable contribution made by a partnership from the partnership's gross income prohibited because the trust's governing instrument does not authorize the trustee to make charitable contributions?

Section 651.--Deduction for Trusts Distributing Current Income Only, 26 CFR 1.651(a)-1: Simple trusts; deductions for distributions: in general. 26 CFR 1.651(a)-4: Charitable purposes.

Is a charitable deduction under section 642(c) for a trust's distributive share of a charitable contribution made by a partnership from the partnership's gross income prohibited because the trust's governing instrument does not authorize the trustee to make charitable contributions?

Section 652.--Inclusion of Amounts in Gross Income of Beneficiaries of Trusts Distributing Current Income Only

Is a charitable deduction under section 642(c) for a trust's distributive share of a charitable contribution made by a partnership from the partnership's gross income prohibited because the trust's governing instrument does not authorize the trustee to make charitable contributions?

Section 681.--Limitation on Charitable Deduction

Is a charitable deduction under section 642(c) for a trust's distributive share of a charitable contribution made by a partnership from the partnership's gross income prohibited because the trust's governing instrument does not authorize the trustee to make charitable contributions?

Section 702.--Income and Credits of Partner, 26 CFR 1.702-1: Income and credits of partner.

Is a charitable deduction under section 642(c) for a trust's distributive share of a charitable contribution made by a partnership from the partnership's gross income prohibited because the trust's governing instrument does not authorize the trustee to make charitable contributions?

Section 642.--Special Rules for Credits and Deductions, 26 CFR 1.642(c)-1: Unlimited deduction for amounts paid for a charitable purpose.

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Charitable deductions. This ruling concludes that a trust is not prohibited from taking a charitable deduction under section 642(c) of the Code for the trust's distributive share of a charitable contribution made by a partnership from the partnership's gross income even though the trust's governing instrument does not authorize the trustee to make charitable contributions.

Charitable deductions. This ruling concludes that a trust is not prohibited from taking a charitable deduction under section 642(c) of the Code for the trust's distributive share of a charitable contribution made by a partnership from the partnership's gross income even though the trust's governing instrument does not authorize the trustee to make charitable contributions.

ISSUE

Is a charitable deduction under § 642(c) of the Internal Revenue Code for a trust's distributive share of a charitable contribution made by a partnership from the partnership's gross income prohibited because the trust's governing instrument does not authorize the trustee to make charitable contributions?

FACTS

The governing instrument of trust *TR* provides that all the income is to be distributed annually to *A* for life and upon *A*'s death, *TR* will terminate and all the assets will pass to *B*. *TR*'s governing instrument does not authorize the trustee to make charitable contributions.

One of *TR*'s assets is an interest in partnership *PRS*. During the taxable year, *PRS* contributes cash from its gross income to a charitable organization for a purpose specified in § 170(c). None of *TR*'s income for the taxable year is "unrelated business income" within the meaning of § 681(a). In computing its income tax for the taxable year, *TR* takes into account its distributive share of *PRS*'s income, gain, loss, deductions (including charitable contributions), and credits.

LAW AND ANALYSIS

Section 642(c)(1) provides that a trust (other than a trust subject to §§ 651 and 652) is allowed a deduction in computing its taxable income for any amount of the gross income, without limitation, that pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)). The deduction is in lieu of the charitable deduction allowed by § 170(a).

A trust subject to §§ 651 and 652 is known as a simple trust. A trust that is not a simple trust is known as a complex trust and is subject to the provisions of §§ 661-663. Section 1.651(a)-1 of the Income Tax Regulations provides that a trust may be a simple trust for one year and a complex trust for another year.

Under § 651(a), the terms of a simple trust (1) provide that all of the trust's income is to be distributed currently and (2) do not provide that any amounts are to be paid, permanently set aside, or used for the charitable purposes specified in § 642(c). Under § 1.651(a)-4, a trust is not considered to be a trust that may pay, permanently set aside, or use any amount for charitable purposes for any taxable year in which the trust is not allowed a charitable deduction under § 642(c).

Section 702(a)(4) provides that in determining a partner's income tax, each partner shall take into account separately the partner's distributive share of the partnership's charitable contributions (as defined in § 170(c)).

Section 1.702-1(a)(4) provides that each partner shall take into account, as part of the charitable contributions paid by the partner, the partner's distributive share of each class of charitable contributions paid by the partner.

ship within the partnership's taxable year. Section 170 determines the extent to which the amount may be allowed as a deduction to the partner.

Section 1.702-1(b) provides that the character in the hands of a partner of any item of income, gain, loss, deduction, or credit described in § 702(a)(1) through (8) shall be determined as if that item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

Section 1.702-1(c)(1) provides that if it is necessary to determine the amount or character of the gross income of a partner, the partner's gross income shall include the partner's distributive share of the gross income of the partnership, that is, the amount of gross income of the partnership from which was derived the partner's distributive share of partnership taxable income or loss (including items described in § 702(a)(1) through (8)).

For a trust to claim a charitable deduction under § 642(c) for amounts of gross income that it contributes for charitable purposes, the governing instrument of the trust must give the trustee the authority to make charitable contributions. This requirement is an essential element to qualify the trust to claim a deduction for a charitable contribution made directly by the trust. In the case of a trust's investment in a partnership, the partnership may make a charitable contribution from the partnership's gross income, and that income is never available to the trust. For federal tax purposes, however, the trust must take into account its distributive share of the partnership's income, gain, loss, deductions (including charitable contributions), and credits. Under these circumstances, a trust's deduction for its distributive share of a charitable contribution made by a partnership will not be disallowed under § 642(c) merely because the trust's governing instrument does not authorize the trustee to make charitable contributions. See *Estate of Bluestein v. Commissioner*, 15 T.C. 770 (1950), *acq.*, 1951-1 C.B. 1, and *Estate of Lowenstein v. Commissioner* 12 T.C. 694 (1949), *acq.* 1949-2 C.B. 2, *aff'd sub nom. First National Bank of Mobile v. Commissioner*, 183 F.2d 172 (5th Cir. 1950), reaching similar conclusions under the statutory predecessor to § 642(c).

In the present situation, PRS's charitable contribution is made from PRS's gross income. TR is allowed a charitable deduction for its distributive share of this contribution, even though TR's governing instrument does not authorize the trustee to make charitable contributions. Because none of TR's income for the taxable year would be considered "unrelated business income" for purposes of § 681(a), the amount of the charitable deduction is not limited under § 681. TR is a complex trust for the taxable year because it is allowed a charitable deduction under § 642(c) for that year.

The same result would apply if TR were always a complex trust because it was not required to distribute all its income currently.

HOLDING

A charitable deduction under § 642(c) for a trust's distributive share of a charitable contribution made by a partnership from the partnership's gross income is not prohibited even though the trust's governing instrument does not authorize the trustee to make charitable contributions.

DRAFTING INFORMATION

The principal author of this **revenue ruling** is Charlotte Chyr of the Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this **revenue ruling**, contact Charlotte Chyr at (202) 622-3080 (not a toll-free call).

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