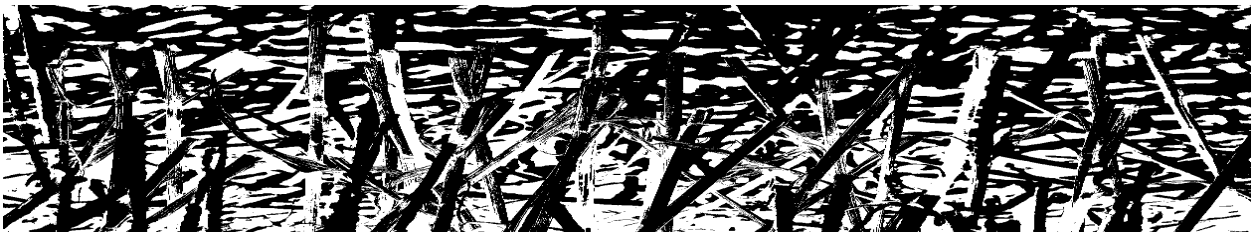

Jack Straw Fortnightly*

on a lighter note

The 7520 rate for April is 1.2 pct., down another sixty basis points from March, down 2.4 percentage points since the crest at 3.6 pct. in November and December 2018, and the lowest rate since June 2013, if anyone can remember that far back.

Meanwhile mid-term Treasury yields, on which the 7520 rate is based, are already down another thirty basis points from mid-March, when the April rate was calculated. And the equity markets are still off twenty something pct. from record highs in February, having recovered less than half the ground they lost when the panic hit.[1]

You hear talk that this is an opportunity to make discounted gifts, using depressed asset values and historically low 7520 rates for additional leverage. Because it will all come back, y'know. Again.

Forgetting for the moment that the bull market since March 2009 was fueled largely by quantitative easing and stock buybacks. And we don't have a lot of margin left for lower interest rates.

But most of this reading of tea leaves is above Jack's pay grade, so we will just sit back and watch nothing change.

two point two

And now we have this massive stimulus package, which should at least allow folks in lower income ranges to pay rent for a month or two and/or keep up interest payments on their credit cards. Trickle up, says Jack.

Many, many moving parts, but for the moment we will focus on the two incentives for cash gifts to charity. For nonitemizers, an income adjustment, or "above-the-line deduction," for up to three hundred dollars, and for itemizers a temporary suspension of the percentage limitation altogether.

Cash gifts, outright.

There is some uncertainty out there whether the three hundred above the line applies only to gifts made in tax year 2020, or whether this is meant to be permanent. Which would be a foot in the door for something with more meaningful numbers attached.[2]

The uncertainty arises because the legislative text literally says the

deduction is allowed for contributions made in "taxable years beginning in 2020." Of course, there is only one calendar year "beginning in" 2020, and very few individuals are reporting on non-calendar fiscal years, so the reference to "years" plural might suggest that "beginning after December 31, 2019" was intended. Or not.

That phrase, "beginning after December 31, 2019," is in fact used in the effective date provision a few sentences later. And you can readily find commentary online from otherwise sensible people who argue that this somehow informs the reading of the substantive text. But Jack being the pedant's pedant will have none of it.

More to the point, the Joint Committee estimate shows revenue losses only in 2020 and 2021, and includes a parenthetical note that literally says "sunset 12/31/20."

three or six

But there is still the question, if it is three hundred per "eligible individual," can it be six hundred on a joint return. You wanna say yes, but there is nothing in the text of the legislation itself that makes this clear.

Your correspondent is inclined to say yes, reasoning by analogy from an existing provision for an above-the-line deduction for certain expenses incurred by an "eligible educator," which is also capped, at two fifty. [3]

There is no formal guidance construing that provision, but in multiple pieces of informal guidance, including an online "tax topic" and Publication 17 itself, IRS has made it clear that joint filers may deduct up to five hundred if each spouse is an "eligible educator," and if each has separately incurred two fifty or more in "qualified expenses."

It seems a similar rule should apply here.

no limits

But the real excitement is the "unlimited" deduction for outright cash contributions during calendar 2020 to 170(b)(1)(A) charities.[4]

Most of the languaging in section 2205 of the bill is actually familiar, as we have had temporary suspensions of deduction limitations in the past, keyed to federally declared disasters, most recently in the spending bill enacted in December 2019.[5]

The difference here is that the limitation is suspended as to all cash contributions to any (b)(1)(A) charities, not just to disaster relief efforts.

There is also an implicit reminder here that the temporary increase in the limitation for cash gifts to sixty pct. of adjusted gross, enacted as part of the 2017 tax bill, may be in need of a technical amendment that somehow does not seem to be forthcoming.

What the Congress intended, according to the Joint Committee "blue book" for the 2017 tax bill, page 51, was to allow a deduction for cash contributions up to sixty pct. of adjusted gross, minus whatever deductible contributions the taxpayer may also have made in the current tax

year, or carried forward from prior years, that were subject to lower percentage limitations. Excess cash gifts were to be carried forward.

But what section 170(b)(1)(G) says instead is that cash gifts come off the top, potentially forcing some gifts that are subject to lower limitations to be carried forward -- in effect, "wasting" a carryforward year as to those items.[6]

The "unlimited" deduction for 2020 does not suffer from this "flaw," if indeed it is a flaw.[7] Section 2205(a)(1) says right at the start that "qualified" contributions are to be "disregarded" in applying the ordering rule for deductions subject to lower limitations.

So if a taxpayer also makes contributions and/or has carryforwards subject to lower percentage limitations, she can still take advantage of the temporary "unlimited" deduction for cash gifts without "wasting" a carryforward year for those items. Excess cash gifts will simply be carried forward.[8]

but what about

So then folks are asking, what about contributions of appreciated property for which you make a step-down election? are these in effect "cash" gifts for purposes of the "unlimited" deduction?

Jack says no, the word "cash" means literally cash. The step-down election does not convert a noncash gift to cash, it merely allows you to take advantage of the fifty pct. limitation where you would otherwise have been limited to thirty pct.

Okay, but what about funding a charitable remainder trust with cash? if the remainder is to a (b)(1)(A) charity, is this not a "qualified" contribution? Again Jack says no, a future interest in trust is not "cash."

Also, the remainder trust to which the cash is actually contributed is not itself a (b)(1)(A) charity. If as one supposes the tax policy informing the temporary "unlimited" deduction is to put cash immediately into the hands of (b)(1)(A) charities, obviously a remainder after one or more measuring lives or a term of years does not accomplish this.[9]

However, following the same logic, Jack does think a cash contribution directly to a (b)(1)(A) charity in exchange for a gift annuity would qualify, to the extent of the "gift" element of the transaction.

But these are just the informed opinions of one (fictional) person. IRS has a lot on its plate these days, but if the idea here is to stimulate immediate cash gifts, one supposes this will become a guidance priority.

make it stop

Yet another batch of ING rulings released the other day, PLRs 202014001 through 005.

Like the batch we discussed in our previous issue, these rulings involve a scenario in which one member of the distributions committee is a "friend," apparently unrelated to the settlor. And like that previous batch these also involve a trust from which the distributions committee is given power to decant into other trusts for

the benefit of members of the settlor's "family," defined more broadly than the class of permitted distributees or contingent remaindermen.[10]

The "friend" is of course a permitted distributee during the settlor's life, and also a contingent remainderman as to ten pct. at the settlor's death, subject to defeasance by the settlor's exercise of a reserved limited testamentary appointment power.

We are not going to rehearse here yet again Jack's overheated objections to the analysis IRS has been giving these trusts for the past seven or eight years. But Jack does want to point out that the presence of a nonrelative in the mix should raise questions of pre-arrangement.

Who is this "friend"? Should we expect she will actually receive ten pct. of the remainder at the settlor's death? or anything at all in the way of discretionary distributions during the settlor's life?

What is her intended function on the distributions committee, apart from preventing the nieces and nephews (in the particular case) using their "unanimous member power" to empty out the trust? Is the contingent ten pct. remainder in effect compensation for her fulfilling that role?

The "favorable" rulings on the question whether these are in fact nongrantor trusts have been couched in conditional language -- "[b]ased solely on the facts and representations submitted and except as caveated below" --, and IRS has consistently declined to rule whether the settlor has retained sufficient "administrative controls" to cause the trust to be treated as a disregarded entity, saying this is a question of facts and circumstances that would be more appropriately dealt with in an examination of "income tax returns of the parties involved."

Your correspondent would like to believe that the fact that some subclass of INGs has been put on the "no rule" list indicates IRS may be preparing to audit some of these trusts. We will see.

medicinal herbs

The Treasury inspector general has issued a report saying IRS could be doing more to enforce section 280E, which disallows deductions for expenses incurred in conducting a business that consists of trafficking in controlled substances, here specifically cannabis.

Among other concerns, TIGTA noted that dispensaries might be using the simplified method for tracking inventory permitted to smaller businesses by section 471(c), enacted as part of the 2017 tax bill, to bury otherwise nondeductible operating expenses in their cost of goods sold. The report urged IRS to issue guidance in effect formalizing the position it took in CCA 201504011.

IRS essentially blew off the report, saying they have limited resources, which they are directing toward higher priorities.

Meanwhile there are at least six cases pending in the Tax Court involving the disallowance of

deductions for operating expenses under section 280E. One of these has already resulted in a published opinion, *Northern California Small Business Assistants Inc. v. Commissioner*, 153 T.C. No. 4 (10/23/19), denying the taxpayer's motion for partial summary judgment.

A majority rejected the taxpayer's argument that section 280E imposes an excessive "penalty" in violation of the Eighth Amendment, but several dissenters argued that the Sixteenth Amendment, which authorizes the Congress to tax "income," does not authorize a tax on gross receipts without reduction for cost of goods sold.

These cases have been consolidated, and for the moment they have been removed from the trial calendar. Appeal will lie to the 9th Circuit.

and very briefly

Ed Morrow had another item up on LinkedIn, this time concerning a lawsuit pending in federal district court in northern California, in which a couple have sued Fidelity Charitable for mishandling the sale of stock they had contributed to a donor advised fund.

The claim is they put in something over fifty million worth of a single stock issue -- publicly traded, but just under ten pct. of outstanding shares -- on oral promises from a Fidelity rep that the sale would be handled in such a way as not to crash the stock price. But then Fidelity immediately dumped the entire holding -- on the same day as the contribution, no less -- causing the stock to lose close to a third of its value.

The plaintiffs are seeking monetary damages for the lost value of their income tax charitable deduction, but also restitution of the lost value to the donor advised fund itself.

In his writeup, Ed points out that if in fact Fidelity took the stock subject to enforceable instructions, this would affect the deductible value, even of publicly traded stock, and if those restrictions were not disclosed on form 8283, the plaintiffs might find that IRS is ready to disallow the claimed deduction altogether.

Fidelity of course denies that any instructions concerning the disposition of the stock were enforceable, but last November the court denied a motion to dismiss premised in large part on that argument, and just a few weeks ago, in denying Fidelity's motion for partial summary judgment, the court made the curious statement that

> even if, as Fidelity Charitable claims, a legally enforceable promise would mean the donation did not qualify as a tax deductible DAF donation, the misrepresentation claim does not require Fidelity Charitable to have made a promise that the Fairbairns could sue to enforce; instead, the misrepresentation claim is based on Fidelity Charitable falsely promising that it was making a legally-enforceable promise.

Sort of a catch-22, says Jack.

There is a great deal not to like in the court's more recent order, but we are not going to get into that today, except to briefly note that on

pages 3 and following, the court makes clear that it has no understanding of the meaning of the phrase "condition subsequent" as used in future interests law.

Your correspondent would be inclined to defer a closer analysis of this case until it goes up on appeal, but Jack suggests that the parties are more likely to settle, off the record, with Fidelity paying something to compensate the plaintiffs for the lost value of their itemized deduction.

scraps

[1]

These figures change daily, of course, and it appears we may have hit an inflection point on March 31, from which yields and share prices have slightly recovered.

[2]

The linked measure, HR 5293, introduced in December by Rep. Mark Walker (R-NC) with at last count nine co-sponsors, would allow nonitemizers an above-the-line deduction of up to one-third of the amount of the standard deduction.

Rep. Walker had offered the same legislative text, as HR 3988 in the previous session, before the standard deduction was doubled, while Sen. James Lankford (R-OK) introduced an identical bill, S 1213 in the Senate. Both those measures died in committee.

Sen. Lankford also offered this language as an amendment to the stimulus package itself, but that proposal did not make it to the floor.

But proponents of the "universal" charitable deduction want you to know that what they are talking about is moving the charitable deduction above the line altogether, for all taxpayers. Subject of course to the existing AGI percentage limitations, though this would require a bit of a "circular" calculation. But not these nickels and dimes.

In other words, something like HR 651, introduced last January by Rep. Christopher H. Smith (R-NJ) on behalf of himself and Rep. Henry Cuellar (D-TX), or HR 1260, introduced last February by Rep. Danny K. Davis (D-IL). The latter bill would still treat the above-the-line deduction as "itemized" for purposes of the "Pease" limitation -- yet another computational complexity.

The Ways and Means committee has not yet set either of these bills for hearing, and your correspondent does not expect they will.

[3]

Adjusted for inflation from 2014 in fifty dollar increments, but so far the adjustment has worked out to be zero.

[4]

Not nonoperating private foundations, not supporting orgs, not donor advised funds, not carryforwards of cash gifts made in

prior years. Also, as we will discuss in a moment, not split-interest trusts. But the purchase of a gift annuity presumably yes, to the extent of the gift element.

Kristen Jaarda over at Crescendo had an excellent summary up on LinkedIn just after the bill was signed into law, and hosted a wide ranging discussion in the comment thread.

[5]

The incentive for contributions to disaster relief in the December spending bill reached back two years, to the start of 2018. Which, since those contributions had already been made, is simply handing money to itemizers.

[6]

You do only get five. In various forms of informal guidance, including Publication 526, IRS has confirmed this reading, *i.e.*, sixty pct. cash contributions first, potentially crowding out contributions subject to lower percentage limitations.

[7]

Jack has elsewhere remarked that the "blue book," which was not issued until a year after the 2017 tax bill was enacted, should maybe not be seen as an accurate description of legislative intent.

It would not be difficult to construct arguments why cash gifts subject to the sixty pct. limitation "should" come off the top. And it is not as though staff did not know how to draft around this, given the multiple examples of temporary suspensions of the deduction limitations for disaster relief.

[8]

Your thirty pct. and twenty pct. contributions might still be limited by fifty pct. contributions that are not "qualified" cash contributions, but it has ever been thus.

[9]

The same reasoning would apply to a contribution to a pooled income fund. The sponsoring charity does not get immediate access to the cash.

[10]

The present batch had actually been issued to the querents several weeks before the batch released eight weeks ago, and they were signed by a different lawyer in a different branch of the chief counsel's office. Whatever any of that may mean, again tea leaves. But still the same text copied and pasted into the legal analysis.

Jack says, stranded starfish have no place to hide