

# tea leaves and storm warnings

how a Biden tax agenda might affect  
charitable gift planning

- and -

recent litigation on prearrangement

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## reading tea leaves

how a Biden tax agenda might affect  
charitable gift planning

## preliminaries

### CARES Act extenders in appropriations bill

- "unlimited" income tax charitable deduction
  - extended through 2021
  - note interaction w/ 60 pct. limit,  
deductions subject to lower limitations
- ditto 300 above the line
  - 600 joint, but not retroactive
  - moved from sec. 62 to sec. 170
  - 50 pct. penalty for overstatement

## proposed legislation

a. above the line deduction for nonitemizers

[cf. sec. 212 of pandemic relief bill,  
moved from sec. 62 to sec. 170, w/ penalty]

- HR 1704, Pappas (D-NH), Walorski\* (R-IN)  
(03/09/21)
- S 618, Lankford\* (R-OK), six cosponsors
- would allow nonitemizers to claim up to  
one-third of standard deduction
- through 2022 only [several previous iterations  
would have been permanent]

## proposed legislation, cont'd

### a. above the line, cont'd

- HR 1081, Smith (R-NJ) (02/15/21)
  - would move charitable deduction above the line altogether, subject to 170 percentage limitations
  
- previous sessions
  - HR 1260, Davis (D-IL) (02/14/19)
    - also subject to "Pease" limitation

[these would require "circular" calculations]

## proposed legislation, cont'd

### b. expanded charitable IRA "rollover"

- S 243, Cramer (R-ND), Stabenow\* (D-MI),  
Daines\* (R-MT), Rosen (D-NV), Cornyn\* (R-TX)  
(02/02/21)
- previous sessions back to 2009
- 100k limit outright age 70.5
- up to 400k combined life income age 65
- payout entirely ordinary income
- participant and/or spouse, not assignable

## preliminaries, cont'd

### SECURE Act changes

- suspension of RMDs for 2020 not extended
- required beginning date now age 72
- no age limit on deductible contributions to IRS
  - but deductions claimed for contributions after age 70.5 will reduce excludible QCDs dollar for dollar
- death of "stretch" IRA

## death of "stretch" IRA

possible workarounds

- testamentary CRT
  - net income w/ makeup?
  - payout taxed as ordinary for many years
- testamentary gift annuity
  - per PLR 2200230018
    - no realization event, but
    - no investment to recover
    - IRS declined to rule as "speculative"
    - *i.e.*, entire payout ordinary

## possible tax legislation

### practicalities

- Democrats would need ten votes to break cloture
- therefore reconciliation is likely vehicle
  - note this is how both the 2001 and 2017 tax bills were enacted
  - note 05 April parliamentarian ruling re revisions to existing budget resolutions
- Byrd rule would apply if not revenue neutral beyond ten-year budget window

## Biden tax proposals,

Obama "green books," comparisons w/ S 994

### 1. individual income tax

#### a. strengthening incentives for deductible giving

- restore top marginal rate to 39.6 pct.
  - for incomes over 400k
  - note 2021 floor for 37 pct. bracket is 523.6k single, 628.3k joint
- tax long-term gains and qualified dividends at ordinary rates
  - for incomes over 1 mil.
  - note various "mark to market" proposals

## income tax changes, cont'd

### a. strengthening incentives, cont'd

- eliminate 1031 deferral for "like kind" exchanges
  - for gains over 500k
  - note 2017 tax bill already limited to real property
  - possible opportunities for rollout into CRT
  
- taxing carried interest as ordinary income
  - note 2017 tax bill extended holding period to three years

## income tax changes, cont'd

### b. weakening incentives for deductible giving

- cap benefit of itemized deductions at 28 pct.
  - for incomes over 400k
- restore "Pease" limitation
  - reduces allowable itemized deductions by 3 pct. of AGI over threshold, up to 80 pct. otherwise allowable
  - threshold 250k/300k, adjusted
    - in 2017 was 261.5k
- possible repeal of 10k cap on SALT deduction

## Biden proposals, Obama "green books," etc.

### 2. transfer taxes

- revert exclusion to 3.5 mil., no adjustment
  - Sanders bill would cut gift tax exclusion to 1.0 mil.
- restore top marginal rate to 45 pct.
  - currently 10 mil. exclusion adjusted to 11.7 mil., top rate 40 pct.
  - note some proposals would impose higher rates up to 77 pct. for estates over 1 bil.
  - some speculation compromise at 5 mil., adjusted

## transfer taxes, cont'd

- repeal 1014 basis adjustment at death
  - or treat death as realization event
- require minimum ten-year term for GRATs,  
w/ minimum remainder value 500k
- limit duration of exemption from generation-  
skipping transfer tax to 90 years
- relaunch regulation project under 2702,  
limiting valuation discounts for family  
limited partnerships

## planning strategies

short term, anticipating retroactivity

- anti-clawback regs finalized November 2019
  - increased exclusion available only to extent actually used
  - any DSUEA treated as consumed first
- therefore, maximize use of available exclusion, but w/ mechanisms built in for flexibility

## flexibility, cont'd

- disclaimers must be made w/in nine months
- partial QTIP election on extended gift tax return through mid-October 2022
  - no "Clayton" election on inter vivos gift
- "Wandry" formula clauses

### note:

these devices could as easily default to charitable dispositions as to marital

## flexibility, cont'd

- spousal lifetime access trust (SLAT)
  - possibly give third party nonfiduciary power to add charitable beneficiaries
    - would trigger "grantor" trust status
    - cannot be used to satisfy pledge

## longer term strategies

- "smoothing" capital gains realizations
  - installment sales to IDGTs
    - not available for marketable securities
  - charitable remainder unitrust
- shifting income to zero tax states,  
e.g., through incomplete nongrantor trusts
  - IRS now takes "no rule" position
- exit plan for open 1031 exchange
  - roll out to charitable remainder trust

# storm warning

*Dickinson and Fairbairn*  
and the problem of prearrangement

## context

strong income tax incentive for contribution of appreciated property to (b) (1) (A) charities

- deduction at FMV offsets ordinary income
- but no recognition of long-term gain

if funding life income gift

- gain recognized over twenty-plus years
- analogy to installment sale

but outright, e.g., to DAF, no recognition

unless

## prearrangement

recipient org wants to sell immediately  
to diversify portfolio,  
to limit exposure to UBTI

if no ready market, needs an exit plan

for closely held business interests,  
typically redemption

for real estate, "buyer in the wings"

IRS may challenge, arguing form over substance,  
*i.e.*, recognition event followed by  
contribution of proceeds

## enforceability

*Palmer v. Commissioner*, 62 T.C. 684 (1974), *aff'd*  
*on other grounds*, 523 F.2d 1308 (8th Cir. 1975)

transfer of controlling stock interest  
to private foundation controlled by taxpayer

redemption the following day

court says

- gift complete before redemption vote
- taxpayer as foundation manager acted consistently w/ fiduciary responsibility in voting to redeem

enforceability, but by whom

Rev. Rul. 78-197, 1978-1 C.B. 83  
acquiescing in result

"under similar facts," IRS will not seek to  
recharacterize unless

- org receives property subject to existing  
obligation to sell
- "or can be compelled by [issuing] corp  
to surrender for redemption"

widely understood to apply outside immediate  
context of stock redemption

enforceability, but by whom

the Tax Court has said it has not adopted this formulation, but

in *Rauenhorst v. Commissioner*, 119 T.C. 157 (2002), treated the rev. rul. as a concession

*i.e.*, IRS would not be heard to argue redemption was "a practical certainty" where not yet legally enforceable at transfer

compare *Blake v. Commissioner*, 697 F.2d 473 (2d Cir. 1982), *aff'g* T.C.Memo. 1981-579

recipient org bound by promissory estoppel

which brings us to

*Dickinson v. Commissioner*, T.C.Memo. 2020-128  
(09/03/20)

- restricted stock in closely held corp
  - subject to call by board
- transfer to Fidelity DAF
- almost immediately tendered for redemption
- several other key employees did likewise
- board of directors waived restriction,  
citing anticipated tender by Fidelity

on the other hand

under a promissory estoppel analysis,

- did Fidelity promise to tender stock for redemption?
- to whom was promise made?
- what action did promisee take in reliance?
- was transfer to DAF conditional?

under Rev. Rul. 78-197 rubric,

- did Fidelity receive stock under existing obligation to tender for redemption?
- could issuing corp have forced?

## meanwhile

*Fairbairn v. Fidelity Charitable*, 18-cv-04881  
(N.D.Cal. 02/26/21)

- large block of publicly traded stock to DAF
- price spike immediately preceding contribution
- Fidelity sold entire block w/in hours,  
as price fell sharply [causation?]
  
- alleged promises re how Fidelity would sell,
- negligence resulting in losses to
  - value of tax deduction,
  - amounts subject to advisory privilege

## Fairbairn, cont'd

- motion to dismiss for lack of standing to assert claim on behalf of DAF itself
- denied, court finds "special relationship"
- summary judgment motion arguing estoppel by inconsistency w/ tax reporting position
- denied, court notes return is still open
- re "unclean hands," court says no evidence Fidelity was harmed by undisclosed info

## Fairbairn, cont'd

- bench trial over seven days in October
- submitted December 04
- opinion issued February 26
  - some alleged promises not broken, others not proven
  - standard of care re negligence claim
    - advisor acting for client account vs.
    - DAF acting on its own account

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