

# **Split Interest Trusts Created by Entities**

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1. Introduction
  - a. When Entities Create Trusts. Reg. § 1.671-2(e)(4).
  - b. Grantor: Entity vs. Owner(s). Effects
  - c. Split-Interest Trusts: Charitable Remainder Trusts (CRTs) and Charitable Lead Trusts (CLTs).
2. Basic Charitable Deduction Rules
  - a. Individuals: Section 170
    - i. Percentage Limitation on Contribution Base (20% to 50%)
    - ii. Type of Property
    - iii. Tax Nature of the Property (e.g., ordinary income property)
    - iv. Type of Charitable Recipient
    - v. “For the Use” vs. “To.”
    - vi. Other Limitations. See, e.g., Sections 170(a)(3), 170(f).
  - b. Trusts: Section 642(c)
    - i. Requirements (paid, or for estates also set aside, from gross income, pursuant to the terms of the governing instrument, for a charitable purpose).
    - ii. Limitation if paid from unrelated business income (UBI).  
Section 681. But Does Not Apply to Estate. Use Section 645.
    - iii. Meaning of UBI. Effect of Section.
  - c. Corporations: Section 170(a)
    - i. 10% Reduction Limitation
    - ii. Special Rules.
  - d. S-Corporations and Partnerships: Section 170(a)

- i. But Pass Through to Shareholders or Partners: Sections 1366(a)(1)(A) and 702(a)(4).
  - ii. Trust as Partner: Rev. Rul. 2004-5, 2004-1 CB 295
  - iii. Allowed Even If Trust Does Not Provide for Charitable Payments
  - iv. Rev. Rul. 2004-5 and UBI.
- 3. More on Donations by Individuals by Split-Interest Trusts
  - a. Reg. §1.170A-8(a)(2): Contribution of an income interest is “for the use” of charity; contribution of a remainder is “to” charity.
  - b. Hence, contribution to a CRT falls under the “normal” limitations (e.g., 20%, 30% or 50%).
  - c. Reg. § 1.170A-8(c): Donations “For the Use” of Charity
    - i. 20% Limitation
    - ii. Deficit Reduction Act of 1984 Change (So 30%)
    - iii. Appreciated Property and Private Foundation Charities.
- 4. Donations to Split-Interest Trusts by Non-Grantor Trusts
  - a. PLR 9821029 (not precedent): CRT was treated as created by a non-grantor trust through the exercise of a special power of appointment held by an individual beneficiary of the trust.
  - b. No mention of Section 642(c) deduction.
  - c. Add Special Power by Decanting (e.g., EPTL 10-6.6).
  - d. CLT: Grantor or Non-Grantor Trust.
- 5. Deduction for Creation of CLT
  - a. Section 170(f)(2)(B)
    - i. Only If a Grantor Trust.
    - ii. Effect: Trade Current Deduction for Later Income.

- iii. Recapture of Deduction When Grantor Trust Status Ends: Code (Total Income Imputed) vs. Regulations (Total Payments to Charity)<sup>1</sup>
    - iv. Payment Due Upon Death.
  - b. Non-Grantor Trust CLT
    - i. Section 642(c) Deduction (Maybe, Limited by Section 681).
    - ii. Ordering Rule of Income Paid.
- 6. Split-Interest Trusts Created by Corporations or Partnerships
  - a. PLR 9205031 (not precedent) and PLR 8102093: CRT Could Be Created by C corporation; PLR 9340043: CRT Could Be Created by S corporation; PLR 9419021 and PLR 199952071: CRT Could Be Created by Partnership (or LLC Treated as Partnership).
  - b. Reasons for Entity to Create CRT.
    - i. Same as for Individuals.
    - ii. Cannot Distribute to Shareholder(s) or Partner(s) Tax Free.
  - c. PLR 9512002: S corporation Could Create Charitable Lead Trust; PLR 8145101: C Corporation Could Create Charitable Lead Trust. (These were non-grantor trust CLATs.)
- 7. Determining If the Entity or Its Owner(s) Created the Split-Interest Trust.
  - a. This Is Important Where the Deduction Is Not Passed Through (C Corporation)
  - b. Where a Non-Grantor Trust Is a Partner, a Section 642(c) Deduction May Be Unlimited. (But Does Section 681 Apply If Trust Uses UBI?). Rev. Rul. 2005-4.

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<sup>1</sup> For a more complete discussion of the recapture rule, *see* Blattmachr, "Some Recapture Considerations and Other Problems Relating to Charitable Lead Trusts," LISI Charitable Planning Newsletter #172 (February 7, 2011) at <http://www.leimbergservices.com/>.

c. Treas. Reg. § 1.671-2(e)(4) provides:

“If a gratuitous transfer is made by a partnership or corporation to a trust *and is for a business purpose of the partnership or corporation*, the partnership or corporation will generally be treated as the grantor of the trust. For example, if a partnership makes a gratuitous transfer to a trust in order to secure a legal obligation of the partnership to a third party unrelated to the partnership, the partnership will be treated as the grantor of the trust. However, *if a partnership or corporation makes a gratuitous transfer to a trust that is not for a business purpose of the partnership or corporation but is for the personal purposes of one or more of the partners or shareholders*, the gratuitous transfer will be treated as a constructive distribution to such partners or shareholders under federal tax principles and the partners or the shareholders will be treated as the grantors of the trust. For example, if a partnership makes a gratuitous transfer to a trust that is for the benefit of a child of a partner, the gratuitous transfer will be treated as a distribution to the partner under section 731 and a subsequent gratuitous transfer by the partner to the trust.” (Emphasis added.)

d. How To Ensure the Creation of the CRT or CLT Is For a Business Purpose of the Entity:

- i. General Contributions for the Community Where the Business Operates
- ii. Greater Certainty: the Google. Org Model a For Profit Charitable Organization.

[http://www.nytimes.com/2006/09/14/technology/14google.html  
?pagewanted=all](http://www.nytimes.com/2006/09/14/technology/14google.html?pagewanted=all)

8. Avoiding Recapture Under Section 170(f)(2)(B):
  - a. Partnerships and Corporations Need Not “Die” So Grantor Trust Status Need Not End.
  - b. Even If the Partner or Shareholder Is Viewed as the Grantor (Which It Is Not), a Trust Can Be Kept from “Dying.
9. Charitable Lead Trusts and Life Insurance: Setting the Record Straight:
  - a. Problem: Only CLTs That Are Grantor Trusts Entitled the Grantor to an Income Tax Deduction But Without Any Further Deduction on Income Earned and That Is Paid to Charity
  - b. Solutions Sought: No or Low Taxable Income
    - i. Fund the CLT With Municipal Bonds
      1. Return So Low (or Risky) CLT Likely Will Fail.
      2. Section 7520 Rate Greater than Municipal Bond Rates.
    - ii. Fund the CLT with a Roth IRA.
      1. Worthwhile?
      2. Can a Roth IRA Be Transferred to a Grantor Trust?<sup>2</sup>
    - iii. Fund the CLT with a Paid Up Non-MEC Life Policy
      1. MEC vs. Non-MEC
      2. No Application of Section 170(h)(10)
    - iv. Fund a Shark-Fin CLAT with Large Life Policy and a Little Cash

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<sup>2</sup> See, e.g., Horwitz & Damicone, “A Decent Proposal,” 150 Trusts & Estates 46 (Nov. 2011).

1. Can Low Payments Be Made Annually?<sup>3</sup>
  2. Recapture Upon Death? Vested Solution?
  - v. Fund the CLAT with Cash and a Policy That Is Not Paid Up
    1. Doomsday Result Under Section 170(f)(10)
    2. No Income Tax Deduction, No Gift Tax Deduction, IRS “Confiscation” of All Assets
    3. The Uncertainty Principle
  - vi. Fund the CLAT with Cash and Substitute a Non-MEC Policy Late
    1. Self-Dealing Under Section 4941
    2. Step Transaction and Section 170(f)(10)
10. Summary and Conclusions

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<sup>3</sup> See R. Fox and M. Teitelbaum, “Validity of Shark-Fin CLATs Remain in Doubt Despite IRS Guidance.” LISI Charitable Planning Newsletter #162 (October 2010). Cf. D. Pratt, S. Goldberger and P. Lee, “Biting Back: Responding to the Attack on Shark-Fin CLATs,” LISI Charitable Planning Newsletter # 163 (October 2010).