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Robert P. Achenbach, Jr.

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Post-Death Actions By Estate May Affect Amount Of Charitable Deduction

-by Robert P. Achenbach, Jr., J.D.

In general, a decedent's estate is allowed a charitable deduction for the fair market value of property passing from the estate to a charitable organization.[1] Limited interests in property passing to a charity have not been deductible under the federal estate tax charitable deduction if accompanied by a noncharitable interest.[2] A 2016 Tax Court case[3] recently affirmed by the Ninth Circuit Court of Appeals[4] involved the passing of the decedent's entire interest in family corporation stock to a trust and focused on the issue of whether the post-death activities of the trustee and corporation affected the value of the stock for purposes of the estate tax charitable deduction.

Dieringer v. Commissioner[5]

At the date of death in April 2009, the decedent's estate included a majority interest in the voting and nonvoting shares of a family corporation. The decedent's will gave the entire estate to a trust that provided for gifts to seven charitable organizations, with the remainder of the trust property passing to a foundation. Although there was some discussion among family members prior to the decedent's death that some of the decedent's stock should be redeemed by the corporation, no action was taken. The decedent's stock was appraised at a date of death value of (1) $1,824 per share for the voting stock with no applicable discount because the voting shares represented a controlling interest and (2) $1,733 per share for the nonvoting stock, including a 5 percent discount to reflect the lack of voting power. The estate did not elect an alternate valuation date.

After the decedent's death but before the remainder of the trust was transferred to the foundation, the following transactions occurred: (1) on November 30, 2009, the corporation elected to be taxed as an S corporation; (2) on November 30, 2009, the corporation redeemed all of the decedent's voting and most of the nonvoting stock in exchange for promissory notes; (3) a November 30, 2009 appraisal valued the voting shares at $916 per share and the nonvoting shares valued at $870 per share; and (4) additional shares were purchased under subscription agreements with family members at $916 per voting share and $870 per nonvoting share. The lower values for the shares reflected the change of the voting shares to a minority interest and less marketability for all the shares. The estate claimed a charitable tax deduction for all of the decedent's stock, valued at the date of death appraised value and not at the post-death value on the date of the transfer of the stock to the foundation.

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The IRS reduced the charitable deduction for the passage of the remainder shares to the foundation and assessed a deficiency based on a lower value of the property transferred to the foundation because the stock was subject to the power of the trustees, also family members, to alter the decedent's original estate plan as had actually occurred by the series of transactions on November 30, 2009 which reduced the value of the property passing to the trust through the stock redemption and subscription purchases.

The estate argued that the date-of-death value of the stock controlled for purposes of estate tax charitable deduction and that post-death activity did not affect that value.

Under I.R.C. § 2031 in general, absent an I.R.C. § 2032 alternate valuation date election, the date-of-death value determines the amount of the charitable contribution deduction.[6] Under I.R.C. § 2055(d), the amount of the charitable contribution deduction cannot exceed the value of the transferred property required to be included in the gross estate.

The Tax Court cited Treas. Reg. § 20.2055-2(b)(1) for the rule that, if a trustee has the power to divert property to be transferred for charitable purposes "to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent," the charitable contribution deduction is limited to the portion, if any, of the property that is exempt from the trustee's exercise of the power. The Tax Court found that the value of stock in the trust transferred to the charitable foundation was decreased for purposes of the charitable deduction because the trustee had substantial power over the stock prior to its transfer to the foundation. Thus, the Tax Court ruled that the estate could not use the date-of-death value of the stock passing to the foundation in claiming a charitable deduction because that value did not reflect a reduction in the value resulting from the trustees' powers to change the stock value through the redemption and purchase actions of the corporation.

The Decision on Appeal

On appeal, the appellate court did not specifically discuss the Tax Court's main reason for its holding but looked at the issue of whether the charitable deduction could be affected by any post-death actions by related parties, in this case the trustees of the receiving trust and directors of the family corporation, which included the trustees.

Although the general rule, as discussed above, is that estate assets are valued at the date of death,[7] the appellate court noted several deductions not only permit consideration of post-death events, but require them. For example, I.R.C. § 2053(a) authorizes a deduction for funeral expenses and estate administration expenses—costs that cannot accrue until after the death of the testator. Similarly, I.R.C. § 2055(c) specifies that where death taxes are payable out of a charitable bequest, any charitable deduction is limited to the value remaining in the estate after such post-death tax payment. In addition, I.R.C. § 2055(d), prohibits the amount of a charitable deduction from exceeding the value of transferred property included in a gross estate and, by negative implication, permits such a deduction to be lower than the value of donated assets at the moment of death.

The appellate court focused on the case of *Ahmanson Foundation v. United States*,[8] for the principle that deductions are valued separately from the value of the gross/taxable estate. In addition, the *Ahmanson* court held that a charitable deduction "is subject to the principle that the testator may only be allowed a deduction for estate tax purposes for what is actually received by the charity." In *Ahmanson*, the decedent's estate plan provided for the voting shares in a corporation to be left to family members and the nonvoting shares to be left to a charitable foundation. The *Ahmanson* court held that, when valuing the charitable deduction for the nonvoting shares, a discount should be applied to account for the fact that the shares donated to charity had been stripped of their voting power.

The appellate court found that although the decedent's will bequeathed the family corporation stock with a value in the gross estate which included a majority interest and voting power, the stock received by the foundation was reduced to a minority interest and lacked voting power, thus sharply reducing the value received by the foundation. The appellate court held that the charitable deduction was limited to the value of the stock as received by the foundation and not the stock's date-of-death value.

In conclusion

The estate in *Dieringer*[9] was assessed an accuracy penalty for underpayment attributable to either negligence or disregard of rules or regulations,[10] indicating that the estate in this case did not act in good faith in claiming a $18 million deduction for stock knowingly worth only $6 million, as demonstrated by values used by shareholders to purchase redeemed stock. Just as the Tax Court and appellate court refused to apply a bright-line rule that deductions had to be value at the date-of-death, so too neither court stated that deduction had to be valued based on post-death events, except to the point where interested parties had the power to alter the value of assets forming the basis of a deduction.

ENDNOTES

1 I.R.C. § 2055. See Harl and Achenbach, *Agricultural Law*, § 44.04 (2019).

2 Treas. Reg. § 20.2055-2(a), (e), (f). However, limited interests passing to a charity in trust and meeting the requirements to be a charitable remainder annuity trust, unitrust, or pooled income fund may be deductible.

3 146 T.C. 117 (2016).

4 2019 U.S. App. LEXIS 7214 (9th Cir. 2019), *aff'g*, 146 T.C. 117 (2016).

5 *Id*.

6 See also I.R.C. § 2033 (mandating that property in which the decedent had an interest be valued on the date of decedent's death).

7 See n. 6 above and accompanying text.

8 674 F.2d 761, 772 (9th Cir. 1981) ("The statute does not ordain equal valuation as between an item in the gross estate and the same item under the charitable deduction.").

9 2019 U.S. App. LEXIS 7214 (9th Cir. 2019), *aff'g*, 146 T.C. 117 (2016).

10 I.R.C. § 6662(a).