# ***Bequest Administration - "What to Expect When You Are Expecting....a Bequest"***

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***There is something about Wills which brings out the worst side of human nature. People who, under ordinary circumstances, are perfectly upright and amiable, go as curly as corkscrews and foam at the mouth whenever they hear the words, 'I devise and bequeath'.***
**Lord Peter Wimsey – Strong Poison, 1930**

## A. The Basics

### I. What's What and Who's Who (courtesy of Black's Law Dictionary)

What is a Will? A Will is the legal statement of a person's wishes concerning the disposal of his or her property after death which is filed with the court (probated).

What is a Testator/Testatrix? The person who created the Will.

What is an Executor/Executrix? The person named in a Will to carry out the terms of the Will.

What is an estate beneficiary? The person who benefits from the Will.

What is the relationship between the Testator, Executor and Beneficiary?

A fiduciary relationship exists whenever the Testator relies on the Executor and places special confidence in her. The Executor must act in good faith and with strict honesty and due regard to protect and serve the interests of the beneficiaries. The Executor also has a fiduciary relationship with the beneficiaries of the estate.

An Executor takes legal title in the name of the Estate to the deceased person's assets but has no right to receive any benefits from the property unless he/she is also named as a beneficiary. The right to benefit from the property, known as equitable title, belongs to the beneficiary.

The duties and powers of the Executor are conferred by the Testator when he/she creates the Will and also by state statute as are the rights of the beneficiaries.

State statutes and court decisions govern the law of estates. The validity of a Will is determined by the law of the state where the property is located. The law of the state of the permanent residence (domicile) of the Testator governs a Will (not where the death occurred).

What is a Trust? A document created at the direction of an individual, in which one or more persons hold the individual's property subject to certain duties to use and protect it for the benefit of others. The property that comprises the trust is known as the corpus or principal.

What is a Settlor or Grantor? The person who creates the trust is the Settlor or Grantor.

What is a Trustee? The person who holds the property for another's benefit is the Trustee.

What is a trust beneficiary? The person who benefits by the trust

What is the relationship between the Trustee, the Grantor/Settlor and the Beneficiary?

A fiduciary relationship exists in the law of trusts whenever the settlor relies on the trustee and places special confidence in her. The trustee must act in good faith with strict honesty and due regard to protect and serve the interests of the beneficiaries. The trustee also has a fiduciary relationship with the beneficiaries of the trust.

A trustee takes legal title to the trust corpus/principal, which means that the trustee's interest in the property appears to be one of complete ownership and possession, but the trustee does not have the right to receive any benefits from the property. The right to benefit from the property, known as equitable title, belongs to the beneficiary.

The terms of the trust are the duties and powers of the trustee and the rights of the beneficiary conferred by the settlor when he created the trust.

State statutes and court decisions govern the law of trusts. The validity of a trust of real property is determined by the law of the state where the property is located. The law of the state of the permanent residence (domicile) of the settlor frequently governs a trust of personal property, but courts also consider a number of factors—such as the intention of the settlor, the state where the settlor lives, the state where the trustee lives, and the location of the trust property—when deciding which state has the greatest interest in regulating the trust property.

What is a Testamentary Trust? When a person creates a trust in his will, the resulting testamentary trust will be valid only if the will itself conforms to the requirements of state law for wills. Some states have adopted all or part of the Uniform Probate Code, which governs both wills and testamentary trusts.

## II. Revocable Living Trusts (RLTs)

RLTs are used frequently by estate planners in order to avoid probate, preserve privacy and minimize federal estate taxes. Below is a brief explanation of how they are set up, why and how they function after the creator (grantor) dies.

Most RLTS (those created in the past 15-20 years) are individual trusts. Prior to that time, joint trusts were more popular and are still valid but have fallen out of favor. The norm now is that if your clients are a married couple, each creates his/her own trust. In addition, each spouse also creates a Will that names his/her trust as the sole beneficiary of the estate.

Once a grantor creates his/her RLT, they are instructed by their attorney to transfer all of their assets into that trust. In the case of spouses, their net worth is divvyed up so that ½ is retitled into each trust. The goal is to ensure that when each dies, they own no assets in their name alone. Instead, all assets are titled in their trusts, meaning there is no need for probate.

However, sadly, there are a significant number of people who create a trust and never retitle their assets, or forget to retitle new assets they acquire after their trust is created resulting, at their death, in the necessity of some or all of their assets passing through their will and then into the trust. Although probate truly is NOT a fate worse than death, two of the three primary purposes of the creation of an RLT (probate avoidance and privacy) are defeated.

In addition to clients forgetting or procrastinating on the transfer of their assets to their trust, they often do not really understand their estate plan and inadvertently disrupt the plan after the first spouse dies.

So how it all is **supposed** to work?

Assume that Joe and Jill each created an RLT, that both funded their trusts properly and that Joe dies first. On his death, Jill becomes the income beneficiary of the trust and can, in certain limited circumstances, invade principal. Those circumstances include paying medical bills, a place to live, food, etc…basically expenses that allow Jill to continue the lifestyle she and Joe shared prior to his death. However if Jill meets a dashing salsa instructor and uses the trust to fund his new dance studio, she has violated the terms of the trust. In any event, in a perfect world, Jill should use her trust assets first because they are not protected from estate taxes vs. Joe's now revocable trust, which **is** protected, no matter how large it grows between the time of his death and Jill's death.

If both trusts name a charity as a beneficiary after both spouses have died, the charity would be a residuary beneficiary of each trust but, may have to wait to receive funds until the second dies. It depends upon whether the charity is named to receive an immediate residuary gift (fairly rare), a specific gift (i.e., I leave the Red Cross $10,000 from my trust upon my death) or a residuary gift (i.e., upon the death of the income beneficiary of my trust (in this case Jill), I leave the Red Cross 10% of my trust).

When Joe dies, his trustee (most likely Jill) would probably notify a residual charitable beneficiary that they are an eventual beneficiary or, if they are a specific beneficiary, she should definitely notify them. This is a very iffy area of the law in my experience as to the residuary gifts. In CA, trustees must notify all eventual and immediate beneficiaries; not so much in other states. This makes matters very difficult for a charity because if you are aware that your donor has died, and believe he/she has named you in s trust, there is no subtle way for you to obtain information about your gift. You must contact the spouse or his/her attorney. If Joe had left you a bequest in a Will, you could anonymously get a copy from the courthouse but that option is not available with an RLT. Each organization must decide how actively they want to pursue a possible trust distribution if several months goes by and they are not contacted.

If by chance you are offered an accounting and copy of the trust use it wisely even if your gift will not be immediate. Keep in mind that the donor's surviving spouse may truly not understand that the deceased spouse's trust is not a piggy bank with no restrictions, especially if he/she has not consulted an attorney. Things can go very very badly in this area as you will see in my stories with "bad endings" portion of this presentation.

To summarize, a few key points:

1. Knowing the difference between a Will, an RLT and a Testamentary Trust helps you ask the right questions.

2. Knowing whether you are receiving a bequest under a Will or a distribution under a trust helps you know what documents you can expect and are entitled to receive.
3. Knowing that the surviving spouse may get muddled in using the terms "bequest, distribution" etc. helps you be aware that you should not necessarily rely on what they tell you vs. what you read in the actual documents.

   ALWAYS READ THE ACTUAL ESATE PLANNING DOCUMENTS; DO NOT RELY UPON VERBAL OR WRITTEN SUMMARIES.

## III. Avoiding Problems BEFORE Your Donor Dies

Karen Gallardo will cover this topic at lunch but a few suggestions:

1. Read every Will and Trust you can get your hands on so that the basic terms become familiar to you. This will allow you to assess proposed estate plans and spot unusual terms which may negatively impact your eventual gift.
2. If you find language which works particularly well for your organization, make note of it (create a database) for the future so that you have language to suggest when a donor wants to include something out of the ordinary in their Will or Trust.
3. Donors are extremely "creative", and sometimes unrealistic, in how they may direct charities to use their gifts; be prepared to incorporate their ideas but also steer them toward language that you can live with and which allows you to fully utilize their gift.

## IV. You've been notified that you are an estate or trust beneficiary and your donor is deceased - what to ask for and when

At a bare minimum, all non-profits should ask for a copy of the governing instrument (i.e., the Will, Trust, beneficiary designation form for an IRA/life insurance/pension plan). If you do not have these documents, or their equivalent, how can you be sure that you are following your donor's wishes as to how the gift will be used?

In addition, if your organization is named as a residuary (percentage) beneficiary, you should insist on an inventory of the assets valued as of the date of death and a full accounting or its equivalent. See Appendix A Initial Letter for suggested initial letter. Once your organization has been notified that you are a beneficiary, an initial letter should be sent promptly. This will ensure that all future correspondence comes to the correct person and demonstrates that your organization is both grateful and interested in the gift.

Please do not ask the executor/attorney/trustee how much your bequest will be (unless it is a specific amount). Most likely they really do not know…yet. There are still

many steps to be followed before that information is available and truly they are not trying to make your job more difficult but, rather, make sure they do not raise your expectations unnecessarily. In addition, the statutory period of a contest of Will or Trust may not yet have passed, meaning nothing is guaranteed. It is better to ask that when that information is avaible it would be most appreciated. And feel free to explain why you need it sooner than later (for those of who include expected bequests in your budget). It is appropriate to check back in three months or so if you have not heard anything and repeat your inquiry.

## B. Beyond the Basics

### I. <u>What If The Answer is "No -- I Will Not Give You A Copy Of The Will (or Trust)!"</u>

Particularly with non-probate trusts and beneficiary designation forms, you may be told that that information cannot be provided to you for reasons of privacy (i.e., the privacy of the other beneficiaries). Strategies to overcome that argument:

(a) Ask that you be sent a redacted copy of the document and only the page or pages which involve your organization. Caveat: you may, in certain circumstances, find that you need the full document later – for example, the attorney claims that the document states no accounting is required but you don't have the full document.

(b) If the document in question is a Will, call the probate court where the Will was recorded and ask for a copy. There is a small charge but you do not need a certified copy so the cost should be minimal.

(c) Ask the trustee/executor/life insurance company to write you a letter, on their letterhead, quoting the exact language of the designation form. Most responsible people are unwilling to put an inaccurate quotation from the document in a letter.

### II. <u>"I Will Not Provide You An Accounting!"</u>

Be prepared to hear that your organization is ungrateful and should be treating this gift as "manna from heaven". A reasonable reply is that your organization, as a tax-exempt non-profit, has a fiduciary duty to the general public and specifically to this donor, to ensure that all funds that the donor intended to come to you are received. This can be a tricky balancing act because, although some will understand, a significant portion of people believe that you are double- checking their work and are offended. Explain upfront that this is not a reflection of your opinion of their abilities as trustee or executor and that it is simply standard business practice for your organization for every estate and trust that you oversee. Also, finding a way to commiserate about the difficulties of bureaucracy can sometimes remove the "you versus them" feeling. And thanking them for their service as fiduciary would help too…simply put, being a fiduciary is a pain in the neck.

You can also indicate that your organization follows the Financial Accounting Standards Boards (FASB) standards which require a non-profit to monitor and review its assets, including bequests.

You may also be told that you are the only beneficiary to make this request and asked whether your organization will pay the cost of an accounting from your share. Preparation of an accounting is a legitimate expense of the administration and should not be shouldered by any one beneficiary. This issue tends to arise at the end of an estate/trust administration when the executor or trustee is ready to be finished with the headache of administration. From their standpoint, telling them at the 11th hour that you are due an accounting and the expense will cause him/her to have to recalculate the distributions is unreasonable. You may well be legally entitled to the accounting but they will often be angry. Try talking about the LEAST amount of information that you will need. Emphasize that you do not need a formal accounting but rather an informal account showing a beginning balance, itemized expenses and income, as well as the calculation of the distributions. This can help your request appear less burdensome and helps the fiduciary understand exactly what you need. Most importantly you should let the trustee or executor (or attorney) know up front and repeatedly that you will need an accounting. If they balk later, you can point to your earlier letter(s) demonstrating that this is not the 11th hour.

If you are still hitting a brick wall and this is a probate case, remember that very likely, an accounting will be required by the probate court. In most states, they are mandatory; in a few, only upon request of any beneficiary. You do not necessarily need an attorney to make the request.

If you have a trust matter, use the internet to research the state code and determine if an accounting is required. Even if the trust is not subject to review by the probate court, you may be entitled to an accounting. For example to find the probate code in Virginia you would type "Virginia state code" into a Web browser. The majority of states now have their entire state code (laws) on the Web. Once you have found the document, try the word "probate" or "Wills" in the search engine and start reading. You would be surprised how often the exact paragraph you want is there and written in more or less plain English.

If you are not even certain if your donor is deceased and no one will return your phone calls, try accessing the Social Security death index. The website is: http//ssdi.genealogy.rootsweb.com. It can be helpful to know the donor's date of death, especially if you are only finding out about the estate several years later. If you have not been notified, that may be an indication that the fiduciary is not doing their job correctly, at a minimum, and can be the question that starts the ball rolling. You may also be led to a link to the donor's obituary which can help you find family members to assist you, or at least, to whom you may want to send a letter of thanks (and an indication that you have not received your bequest yet). Of course, you must also consider the possibility that your organization as removed as a beneficiary…be very sure before you press too hard!

If your primary contact is a family member of the deceased, immediately offer to direct your requests to the attorney/ Trust Officer/CPA. All of these professionals should be more familiar with the information you are requesting. In the best-case scenario, they will advise their client to comply with your requests, since they are both routine and required under many state codes. Always maintain an air of "seeking information" versus searching for mistakes. If you do end up talking with the professional and they also balk at sharing information, ask them to suggest a way to help you fulfill your organization's fiduciary duty to understand how your share was calculated. In other words, make your problem theirs, if possible.

Asking for the name and information of the professional involved can also set the expectation that the estate/trust will be administered professionally. If the executor/trustee is handling the administration you might let them know that having an attorney or CPA involved will help protect them against liability (be careful here not to imply a threat). This may prompt them to have an attorney review their work to date. Most fiduciaries do not engage a professional in order to save money. A gentle reminder that you view this expense as routine and expected may help persuade the fiduciary to avoid going it alone.

A final avenue of assistance is the Office of the Attorney General (A.G.) of the state in which your deceased donor resided. Not every A.G. is charged with overseeing gifts to charities; check the state government web site. It is often worth starting with a quick call to the A.G to ask for clarification of what is required under the state's code and how best to protect your interest. Otherwise, write a short letter indicating the problem (you have received no inventory or accounting, the executor will not return your phone calls etc.) and ask for assistance.

## III. How to review what you have received – Accounting 101

You have been successful and have a copy of the Will or Trust and an accounting (or its equivalent - copies of brokerage statements, estate and fiduciary tax returns). Now what?

*Accountings*

An accounting is a detailed listing of every penny in and out of the estate or trust since the date of the donor's death. It is the gold standard for conducting a proper review of an estate or trust gift. See Appendix B – Accounting for a sample. Items to look for:

i. Executor /personal representative fees: A rough rule of thumb for executor fees is that they should total no more than 5% of an estate of less than $1m. The larger the gross estate, the smaller the percentage should be. Research the state code (look under "probate") to determine if there is a statute specifying executor fees.

ii. Attorneys and other professional fees: These are more difficult to predict. Review the inventory and determine what types of assets were held. If the bulk of the estate was held in marketable securities and was easily liquidated, that is a clue that the fees should be within normal ranges. If the donor owned unusual assets or an unusual situation arose, the fees will be higher. Examples of unusual situations would be (a) ownership of or shares in a closely-held and/or family business; (b) an insolvent estate; (c) a Will contest; (d) an IRS audit; (e) a previously unknown spouse claimed a share of the estate or (e) a named beneficiary cannot be found. These are but a few examples of the problems that can run up attorney's fees. If the attorney offers to provide you with detailed billings, accept! If you think the fees are too high, ask for detailed billings if they have not been offered. The vast majority of attorneys bill their time fairly but there are exceptions. In general, if the attorney's fees do not exceed the executor's fee, I have a basic comfort level. You should not hesitate to ask questions about the legal fees. As a residuary beneficiary, part of your share paid the fees and you are entitled to information about how your money was spent. Be wary of both the attorney and a CPA charging fees for tax return preparation. CPA fees are usually significantly less than attorney's fees because many CPAs charge a flat fee for the preparation of tax returns. If asked, you should readily agree to have any tax returns prepared by a CPA.

Two other quick things to keep in mind about fees:

(a) Very small estates will often have attorney fees that appear to be large relative to the overall amount of assets. Unfortunately, smaller estates can take as much time as larger ones and insolvent estates can take even more. For an attorney, the cost/benefit of handling these estates and trusts necessitates a fee that justifies his or her time. Certainly, ask questions if a fee seems inordinately high but keep in mind the cost/benefit of the administration. A review of the detailed billings should help you determine if the fees were justified. Be reasonable.

(b) Watch out for more than one person billing for the same work. Remember that extraordinary fees, if substantiated, are allowable. Most probate codes allow an attorney to ask and receive what are often called extraordinary (XO) fees for work beyond the normal duties of an estate attorney. For example, if an attorney must litigate a creditor's claim, XO fees will often be charged. These fees will be in addition to the normal fees but should not be exorbitant and generally need to be justified to the probate court. On the other hand, you should not be paying an attorney's rate for cleaning out a house; that task should be delegated to someone in the firm who charges a substantially lower rate or even better, contracted to an outside firm.

iii. Expenses. Apply the reasonableness test here. If you see thousands of dollars in reimbursements to the executor with no further explanation, ask for detailed information. It is not worth your time to quibble about a FEDX charge but it is worth asking why the cable service was not disconnected for a year after a donor's death. Couching your requests in a reasonable way (e.g., "I am confused why the cable service was not cut off for over a year?") is a productive way to ask questions. Acting as an executor is a labor-intensive, somewhat thankless job and things can slip through the cracks. However, expenses can also be a "piggy bank" used by the executor or trustee to dole out a little extra to family members, former employees, etc. Do ask about unexplained charges (example: air mattresses, sheets, pillows and comforters purchased so that family members have "a place to rest while they inventory the home"). Alone, this would be something to ask about but in conjunction with hotel expenses, it is a glaring red flag.

If a mistake has been made (or poor judgment exercised) which has cost your organization money, consider asking the executor or attorney reduce his or her fee by the disputed amount in lieu of actually replacing the funds in the estate account. On the other hand, if the executor is taking no fee, you can afford to be more lenient as long as the questionable items do not exceed the fee to which the fiduciary would have been entitled.

*Brokerage statements*

A nicely laid out accounting is a lot easier to review than several years of brokerage statements but at times you do not have a choice. Create a spreadsheet on which you place the information you glean from the brokerage statement divided into categories such as income, expenses, sales of assets and distributions. When you have completed your review, you should have a rough accounting.

Generally, large brokerage houses operate in the same fashion with the same overall fee schedules. Smaller trust companies and brokerages may merit a closer evaluation as they do not always have the large audit systems in place to ensure that the estate and trust administrations are closely monitored. It may take some time for the distributions to begin. This can occur for a variety of acceptable reasons, but if no legitimate reason exists, consider asking for a refund of the brokerage fees for the period of the unnecessary delay.

Do monitor the actions of fiduciaries with regard to the liquidation of stocks and bonds. Know your own organization's preference in terms of immediate liquidation vs. holding the stock. In general I find that most nonprofits do not consider it their job to play the market but rather ensure that the value of gift as of the date of death remains intact. Early liquidation ensures that principal will be preserved but there are exceptions

such as receiving notice of a stock bequest on one of those disastrous days on Wall Street. Be sure to put your request that the fiduciary liquidate or not liquidate the stock in writing. You may need to prove you made this request if the fiduciary ignores you and losses result or gains are missed.

*The Dreaded 706 AKA: The U.S. Estate Tax Return*

The filing of state and U.S. Estate Tax returns are not as common now since the substantial increase in the filing threshold (as of 2014 $5,340,000). If you do have an estate in which an estate tax return (not fiduciary income tax returns which are discussed below) it can be a bit daunting. As a non-profit your main concern is whether your organization's share paid any portion of the estate tax. In normal situations the answer should be no. There are exceptions such as language in the Will or Trust or if you are receiving a certain type of asset. If you find yourself in this situation and see that your share has been charged first ask the tax preparer why. If the answer makes no sense and the amount involved is large, seek outside help. Sadly, family members may sometimes "punish" charities by paying all of the estate taxes from their share and hope that your organization will not notice.

If you are reviewing a Form 706, the important pages for tax exempt organizations are the first page which is a summary reflecting whether there is any state or federal estate tax due, Schedules J and K which lists expenses and Schedule O which shows bequests to charities. Those should give you the information you are seeking. Ideally you want to see a zero on Page 1 where the line indicates the amount of tax is due.

In addition to federal estate taxes, some states also assess state estate taxes which have a completely different set of rules. It is possible that your share will not be subject to federal estate taxes but is subject to state estate taxes. Again, ask for an explanation from the estate tax preparer as to why a charitable organization is paying estate taxes.

*The Incomprehensible 1041: Fiduciary Income Tax Return*

Each estate or trust is a separate taxable entity as of the death of the testator or grantor. That means that the estate or trust must have its own Tax ID# and file an income tax return annually until the estate or trust closes. That tax form is the Form 1041.

From a non-profit's standpoint, the 1041 is the easiest to review because it is much shorter than the Form 706. You mainly want to know if any income taxes were paid. If all of the residuary beneficiaries of the estate or trust are tax-exempt, there should be no tax due in any year that the estate or trust is open. The Internal Revenue Code allows the tax preparer to make an election informing the IRS that the ultimate beneficiaries of the estate/trust are tax-exempt and thereby pass the income (and the tax it generates) out to the charities, resulting in zero tax due. Unfortunately, this tax election is much more familiar to tax preparers who regularly deal with tax-exempt beneficiaries. One caveat: There are a few oddball exceptions to this rule, mostly involving income in respect of a decedent (IRD), annuities and possibly some IRAs. Begin with the

assumption that charities should not be paying income taxes from their share, show the Tax Code section to the estate attorney and ask why it does not apply if you see that there were fiduciary income taxes paid.

If you have a situation with mixed beneficiaries (tax-exempt and non-tax-exempt, otherwise known as regular folks), this election cannot be made and your share of the estate will indeed have to pay its share of the income taxes. But if the executor/trustee is diligent about distributing income or principal each year; he/she can reduce or eliminate the income taxes by passing the income out to the individual beneficiaries. And since tax-exempt organizations do not have to pay taxes on income passed out to them, your organization will benefit. Bringing up this issue is an excellent way to prompt a trustee or executor late in the fiscal or calendar year of an estate or trust to make a distribution. Remind him or her that making a distribution now could result in a tax savings to your organization and, in general, reduce the tax burden on all beneficiaries since the fiduciary income tax rate is generally higher than individual income tax rates. See Appendix C – 1041 Tax Citation for the Tax Code citation and an explanation.

One further note – each year that the estate or trust files a 1041, your organization will receive a Schedule K-1 form. You do not need to take any action other than keep a copy in your file. K-1s are used by individual beneficiaries to prepare their individual tax returns.

*Collection of IRAs, Life Insurance Policies & Payable on Death Accounts*

The collection of designated beneficiary accounts such as IRAs, life insurance policies, pension plans and payable on death (or P.O.D.) accounts is usually straightforward other than the voluminous forms that must be completed by an authorized signer of your organization. However, problems do arise:

i. The Patriot Act & How It Can Drive You Mad!

If you are the authorized signatory for your organization, you likely will be asked to supply your Social Security Number on the application for proceeds form (as well as your organization's Tax ID#). Obviously there is no problem supplying the Tax ID# but you should be uncomfortable giving out your Social Security Number unless absolutely necessary. Suggest instead that you provide the company with your Driver's License number and a copy of the license (assuming your state does not use SSN as the ID#). I once calculated that if I had not refused to supply my SSN when completing these forms, my number would have been handed over more than 5,000 times!

The difficulty and misunderstanding arises from forms that did not take charitable entities into account when they were drafted. Providing a Delegation of Authority, Tax Letter and perhaps a Driver's License copy often serves to fill in the blanks that need to be filled even if they do not match up perfectly

If you need to supply a death certificates to collect life insurance and are finding the family uncooperative (or there is no family) you may need to use some ingenuity. An internet obituary search can help and once you have found a funeral home, a sympathetic funeral director can sometimes provide a copy of the death certificate (or contact information). This is a more common problem than you might expect and since you need an original death certificate to collect life insurance, IRAs, etc. knowing alternate ways of obtaining it can be helpful. Not every state allows a non-family member to obtain the death certificate but that information will be available on the state government site, usually under "Vital Records" or "public records".

ii. When You Are Stuck in No Man's Land

If after you have supplied multiple documents to the life insurance/IRA company, they still will not send you your money, ask to be referred to their legal department for a specific list of what they want. Life Insurance/IRA death benefit employees are working from a one-size-fits-all generic list of documents they insist you must provide. Each tax-exempt organization is structured differently and you may not be able to provide exactly what they want. You should be able to negotiate a replacement for the requested document if you explain your structure to someone other than the person handling the initial call – a supervisor or someone from the legal department will have more decision-making power. Sometimes a notarized, corporate-sealed affidavit attesting to one fact or another does the trick.

iii. "PLEASE Don't Withhold Taxes!"

Life insurance and IRA companies are notorious for withholding taxes even if you have dutifully checked the box for no withholding of federal or state taxes. To avoid this, include a cover letter with bold underlined language directing that no taxes be withheld. In addition, do not be bullied into opening a checking account for your life insurance or annuity proceeds. You are entitled to and should demand a check or wire transfer. If you receive a proceeds check and taxes were withheld **Do Not Bank It**! Instead, contact the issuing company and demand a new check and show them proof that you checked the "do not withhold" box.

IRAs are different in that under federal law, a conduit IRA account in your organization's name must be opened before you can liquidate your (new) account. In order to avoid having to wait for this two step process, be sure to explicitly state in your cover letter (in which you forward the death benefit application form) that you want a full liquidation of the entire account, including any conduit IRA. That way, even if the insurance/IRA custodian does not read your letter, you can call them up and direct their attention to that paragraph, saving you having to write them again and provide another complete set of documentation.

iv. *Additional Resources for Learning about Estate/Trust Administration*

For more information about all of the above, consider checking with your local community college or State Bar association for short courses in estate administration. They are usually cheap and effective and since many states follow the Uniform Probate Code, they will apply (generally) to most of the states. You should be aware, though, that there are differences in filing deadlines and how supervision of estates and trusts are handled. Nevertheless, the inventory, accounting and tax forms are remarkably similar from state to state.

## C. Problems, Problems, Problems

### I. Real Estate

Real estate in general carries its own special set of issues because of the potential liability associated with ownership and the need to avoid incurring liabilities. Many charitable groups do not accept real estate by policy but there are some ways to benefit from a gift of real estate without actually taking title.

If you are devised a piece of property by an estate or trust, first inquire if it can be sold by the estate or trust – even if the property is left to you directly. In some instances, an executor or trustee, for a fee, will undertake the sale on your behalf and your organization never enters into what is called the chain of title. Although you may pay a fee to the trustee or executor, as well as a real estate commission, the alternative is for your organization to receive nothing.

Another option is to request that your share of an estate or trust NOT include real estate. If the estate is large enough, this may be a possibility.

One important note about real estate devises (the term "devise" is generally used when referring to bequests of real estate but "real estate bequest" is fine to use as well) -- If your group is specifically devised a piece of property you MUST take action to disclaim it within nine months of the date of the donor's death (or in some instances, nine months from when you are notified about the gift) in order to be in compliance with state and federal law on disclaimers. If you know that you cannot accept a piece of property, promptly notify the estate attorney of that fact and request that he/she prepare a formal disclaimer for your organization to sign. That disclaimer becomes a part of the chain of title, just like a deed is a part of the chain of title. If you fail to formally sign and file a disclaimer of a devise and the estate is subject to estate tax, the IRS will presume the gift came to you for estate tax purposes, meaning a deduction is being taken. Your inaction can cause an estate to pay additional estate taxes or inadvertently file a fraudulent U.S. Estate Tax Return. The key here is to immediately ask questions of the estate attorney when you realize that your organization is named to receive a bequest of real estate. **Notification of a bequest of real estate should be a red flag to take action right away.** If the estate is not subject to estate taxes, the issue is still very important but not quite as urgent.

Another issue to watch out for is an executor/trustee who transfers the real estate into your group's name and informs you afterwards. Again, take immediate action when real estate is involved!

## II. Uh-Oh, The Family Wants the Money Back…

Out of the blue you receive a tearful phone call or heart-rending letter from a family member who was not included in a Will or Trust because, at the time of creation, they had no need for money or perhaps were not even born. Circumstances have changed and they would like your organization to give up all or a part of your share to help them.

These are tough situations and the first thing to do is to hear the caller out and let them know you will need to consult with others in your department. You certainly want to sympathize with their situation but let them know that, in general, a charitable organization may risk their tax-exempt status by returning funds unnecessarily. Suggest that you write them shortly with an answer.

a. The tax code section that will help is attached – see Appendix D – Private Inurement. The magic words are "private inurement". To summarize, charities may not enrich individuals with funds intended for the charity. To do so could put your organization at risk for losing its tax exempt status. These can be terribly guilt-inducing situations but remember that the private inurement argument is not an excuse. It is an absolutely legitimate legal issue and one that you have the responsibility to consider in these circumstances.

b. The polite and apologetic letter of refusal. See Appendix E – Private Inurement Letter for a sample letter that may help you strike the right note.

c: On very rare occasions, there may be an instance where there is good evidence that the decedent wished to give to someone but neglected to change their document. Finding a way for that person to receive some dollars in the form of an expense is possible. For example, a cleaning person who worked for the donor for many, many years usually received a bonus annually in lieu of a pay raise but the employer passed away a month before the usual bonus time. If you agree that these funds are owed to the employee, ask the executor or trustee to pay that amount to him or her and include it as deferred salary. Do insist that some type of documentation of why the payment is being made be supplied to you for your own organization's protection.

## III. Oops …Your Bequest Was Calculated Incorrectly or Worse, Paid to the Wrong Organization

This is always an unwelcome surprise but it happens – to large organizations and small. Calculating the distributions should be simple but mathematical mistakes can happen, as can errors such as not realizing that there has been an amendment or codicil that changed the original version or the trust or will. It is possible that the wrong percentages and/or the wrong parties have been paid throughout the course of the administration.

When you receive a notification that your bequest was calculated incorrectly or even paid to your organization in error, you need a full and detailed explanation of what went wrong before you act. Confirm with the attorney or executor that the estate/trust will not be charged professional fees to correct this error. Documentation needed should include numbers, not just a general statement that there was a mathematical error or that you are the wrong group.

Is there room for negotiation? My own experience is that once you have received adequate documentation that a mathematical error is legitimate, an organization should repay the money promptly as it is highly unlikely that any court will rule otherwise and you are wasting your money hiring an attorney to fight the inevitable. However, if the error is egregious, you may want to try to negotiate a reduction in the attorneys/executor/trustee fees to compensate the beneficiaries for poor performance. It is worth asking but only in cases where the amount is large and error outrageous.

Most often, the person who committed the error is horrified at his/her error, embarrassed and terrified that you will not return the monies (or that you will be difficult about doing so).

However, if you believe that your group is, in fact, the "right" beneficiary, this is the time to hire outside counsel unless the amount is small. But before doing so, marshal your evidence – such as records of gifts from this donor, mailings to him/her, evidence of visits, etc.

## IV. Litigation – do I need a lawyer?

Do you need a lawyer every time your share of an estate is or could be involved in litigation? The short answer is "YES" if you want to be 100% sure of protecting your interest to the extent available. But deciding whether to participate in a lawsuit is usually a cost/benefit analysis although donor intent issues may also come into play.

a. Assess your risk

If you have access to any attorney (estate or not), ask for help in assessing your risk. Often, hiring an attorney specifically to assess your case is a good use of funds and should not be expensive. You will need to be clear with the attorney that you are only retaining him or her at this point to assess the case, not to take action.

In the case of smaller amounts, factors you should take into consideration include the size of your bequest, whether it is specific or residual, the projected cost of representation, your organization's tolerance for litigation, any possible public relations fallout and whether you may be able to negotiate better on your own. ***In general, any serious/complex litigation requires an attorney so as to ensure that you are not inadvertently assessed a portion of costs/attorneys fees.***

Be aware that there are generally very tight timelines in which to answer a lawsuit. Twenty-one days from the date of service of the lawsuit on your organization is

very common. Be certain there is a system in place to ensure legal pleadings do not sit on someone's desk unopened or not responded to because of indecision or vacation.

b. Pro Se – Acting as your own counsel

If you choose to do so, your organization may attempt to enter an appearance or be heard by the court pro se (without an attorney). Obviously this is not a wise idea other than in VERY small matters.

Most large charities have a policy which requires that they be represented by an attorney if they are filing motions, answers or other pleadings. It is possible, however, to simply write the court (and cc all of the other parties or their attorneys) and indicate that that you will not be retaining counsel and state your reasons. Most commonly, the reason is that your bequest is smaller than the amount of money you would need to spend on legal fees. I always also respectfully request that our letter be included as a part of the court file. That way, if a settlement of some kind is worked out, the judge may (or **may not**) determine that your organization should be a part of any agreement. At a minimum, you have been courteous and let the other parties know where you stand.

c. An attorney is not in the budget

If you feel you need to hire an attorney but do not have funds budgeted, consider canvassing your board for pro bono assistance or your local law school and determine if you can obtain assistance. Another option would be to cultivate an experienced trust officer or estate paralegal who can help assess the case and perhaps provide an introduction to an attorney who will either reduce his or her usual fees or do the work pro bono.

Another useful tool is to utilize an attorney you may have hired in the past and ask if he or she would be willing to handle the occasional smaller issue either pro bono or at a reduced rate.

d. Joining forces

Another, extremely effective and cost-efficient method of obtaining legal counsel (or helping you decide whether you want to do so) is to contact your fellow charitable beneficiaries and consider cost-sharing or a joint negotiation. Larger organizations will have more resources and, hopefully, would be willing to share their thinking on an issue. Of course, you should only choose a fellow beneficiary whose interests are aligned with yours.

e. Don't be an ostrich and lose everything

Learning that your organization's share of an estate might be in jeopardy is a stressful event. But taking no action (i.e., burying your head in the sand like an ostrich) and hoping for the best can keep you from having a seat at the settlement table.

At a minimum, even if you cannot afford or do not want to hire an attorney, you should respond to the documents you receive and indicate in writing that you want to be a part of any settlement negotiations. If an organization chooses not to become involved, an executor/trustee can still settle with the beneficiaries who do participate and leave your organization out in the cold. Something is better than nothing!

f. Mention donor intent …a lot……

Legitimate issues often arise in conjunction with estate and trust administration in which each side has a valid point. In these cases, learning to negotiate a reasonable settlement is critical. Attending a seminar on negotiating skills would be an excellent part of training for estate and trust administration. Most executors/trustees would prefer to settle and you need to use your strongest weapon – which may be donor intent. Continue to remind the executor/trustee that your donor clearly intended your organization to receive a share of this estate (presuming that is not at issue) and that the donor's intent ought to permeate any settlement. Frequent references to the donor's wishes as being paramount are both truthful and good strategy. The majority of estate disputes that have arisen during my years in this field have been settled by negotiation.

g. How to find a good estate attorney

Referrals from other attorneys, board members and other charities are a good place to start. If you are literally starting from scratch in finding an estate litigation attorney in a particular region, you can consult Martindale Hubbell (martindalehubbell.com) which is the "bible" of rated attorney listings in the US.

Once you have identified potential candidates, determine whether they belong to the American College of Trust and Estate Counsel (ACTEC) and/or are members of the Probate or Trust/Estate section of their state bar association, as well as the sections of their state bar to which they belong (i.e., Probate, Trusts and Estates, etc). It is also helpful to look at their rating on the Martindale site (A.V. is the best) and how long they have been practicing.

If you see that their client base includes tax-exempt organizations, that is a plus as they are likely to understand the financial pressures we all face to keep legal expenses low and our valid concerns about bad publicity resulting from a potential lawsuit. It is a good practice to keep a list of attorneys all over the U.S. with whom you have worked or had recommended to you. In a time-sensitive situation, this can be invaluable!

Be warned, however, that full-blown estate litigation (such as a will contest) is not cheap. Ask in advance for an estimate of going to trial and for a realistic assessment expressed as a percentage of your chances of winning. If the answer is less than 70%, do

think long and hard before proceeding. It is also good to ask upfront if the same attorney will handle the court appearances. Some cases require two attorneys – one for the research and writing aspect and one for the court litigation. This can get very expensive but may be necessary in very large estate matters.

## D. True Stories from the trenches

With happy endings

I. A charity was named as one of several beneficiaries of a CA estate administered by two nephews. The nephews unilaterally decided to apportion ALL of the estate taxes to the charitable beneficiaries. The accounting reflected that family members were paying none of the taxes and the charities were paying more than $100k despite no such instructions in the Will. I wrote the attorney who admitted that the nephews had no legal grounds upon which to apportion the taxes but they intended to do so anyway, despite the CA statute to the contrary. In this instance, one phone call from our attorney to theirs and one letter from her advising that we would be filing a motion asking for the court to rule and for our attorneys' fees resulted in the $100k being swiftly repaid to the charities. Total cost to the charities: $200. Lessons learned: Read those accountings!

II. A charity was named as the sole beneficiary of a donor who owned property in Italy and the U.S. His nephew was named as executor. He and his mother, (the donor's sister) were most unhappy that the real estate was not coming to them. They visited the properties and convinced the court in Milan that no valid Will existed and that, therefore, the property belonged to the family. The charity hired an English-speaking law firm in Milan to assess the situation. They reported that the U.S. Will was indeed valid in Italy. The notario (court official) in Milan was furious to find out that he had been misled and promptly rescinded his order that the property pass to the family. The case was challenging due to the need to protect interests quickly by finding an Italian (and English-speaking) attorney and then to grasp Italian probate law. However, in the end the matter was very straightforward and the family completely capitulated within days of the charitable attorney entering the picture. Lessons learned: Be wary of executors with an inherent conflict of interest. If your interest is large or complex, get an attorney and do not negotiate or give up until you know all the facts.

III. A charity was named to receive a significant portion of the residue of a large trust at the donor's death. However, immediately after the donor's death, her estranged daughter entered her home and later informed the court that no Will or Trust was to be found. As her only heir, the estranged daughter would then inherit as an intestate heir. The charity was notified by one of the other trust beneficiaries that they had a copy of the trust document in their file. The trust was very large and soon the charity was bombarded with phone calls from friends of the deceased

donor who stated categorically that this donor never intended her trust to go to her daughter. Proceeding gingerly the charity retained an attorney to investigate. The other trust beneficiaries decided not to join with us. Eventually the charity negotiated a large settlement paid by the daughter. The other trust beneficiaries received nothing. Lessons learned: Sometimes the cost/benefit analysis is not just about numbers but is also about ensuring that a donor's intent is carried out when he/she no longer has a voice.

Without happy endings

I. A charity was named to receive the remainder of an RLT upon the death of both husband and wife. The husband died leaving a very lonely spouse. Because the trust was not properly funded (assets not retitled), when the spouse quickly remarried a man she did not know well (but was a good dancer…true quotation), he gained access to his wife's finances and trust and determined that there were dollars to be gained. In this very sad case, the wife was physically and emotionally abused by the new spouse and then, upon her death, he claimed a very large marital share of her estate. The charity, which had been named as a trust beneficiary by the wife and her first husband of many years, had to engage in a contentious and expensive fight. Thus assets gained through hard work and frugal living by the first husband and wife become available to a second spouse of a few years' duration. The wife did not consult an attorney after her husband died (only her CPA) and never realized her assets were exposed by not being in the trust. Eventually mediation ensued but the best settlement the charity could receive was still many many thousands of dollars less than it should have been. If the original spouses had correctly titled all assets in the family trust, none would have been available to the second spouse to claim. And of course, a prenuptial agreement would have also been a good idea.

II. Eleven charities were named as the beneficiaries of two trusts in Texas. A nephew was the trustee. Each trust was over $1m and it took five years to distribute the trusts. The trustee did not file tax returns and when he did finally file them, they were incorrect and penalties and interest were due. Eventually the charities received the bulk of their share but there were still outstanding issues. However, it was no longer cost-effective to continue to hire outside counsel to collect the final dollars. This trustee had absolutely no sense of fiduciary responsibility to the beneficiaries or to his aunt. It was very difficult to walk away from collecting every last dollar but it was, in the end, a good business decision. Lessons learned: Resist the urge to become so outraged at bad behavior that you lose your sense of proportion. Sometimes getting what you can and throwing in the towel IS the right thing to do….as Kenny Rogers says……you've got to know when to hold 'em and when to fold 'em!

**E. Questions?**

# Appendix A

**APPENDIX A – INITIAL LETER**

DATE

Address

RE: Estate/Trust

Dear M.:

Thank you for notifying [name of charity] that we are a beneficiary of the Estate of ____/beneficiary under the Trust of _____. *Please note that all correspondence and distributions should be sent to this address: _____ and directed to my attention.* You may be assured, however, that we will allocate this bequest/gift according to Ms._____'s wishes.

We are very thankful that Ms._____ remembered the [name of charity] in her estate plans and would like the opportunity to contact people important to her to express our thanks. Do you know of anyone who might appreciate this gesture?

In order for us to maintain complete estate files and allocate this gift as Ms._____ intended, we request a copy of that portion of the Will/Trust that identifies our interest. If (Because) our organization is a residuary beneficiary of the estate, we would appreciate receiving a copy of the inventory and all accountings for the estate/trust when they are prepared OR [informal trust accounting at the conclusion of the trust administration]

If [name of charity] is likely to receive any portion of its distribution in the form of real estate, please notify me immediately. We will need to visit the property and prepare an environmental assessment before taking title. Please do not automatically transfer ownership of any assets, including real estate and securities, without first notifying me.

It is the strong preference of [name of charity] that, wherever possible, the Executor/Trustee immediately liquidate assets, particularly securities, in order to preserve the principal of the trust during these very difficult and uncertain economic times.

We would like to include Ms. _____'s name in our annual report. Only her name would be listed, not the amount of any bequest/gift. I would appreciate your informing me if you have any objection to the inclusion; otherwise the listing will appear in the first annual report issued after the bequest/gift is received. If you would like a copy of that annual report, please let me know.

We would encourage you, wherever practical and allowable, to correspond with us by email. Please do not feel that you need to follow up those emails with a hard copy unless required by law or your own policies.

Thank you for your assistance in this matter. We look forward to working with you on this estate/trust. Enclosed are our W-9 and an IRS Determination Letter.

## APPENDIX B - ACCOUNTING

### SUMMARY OF ACCOUNT
### CHARGES

| | |
|---|---|
| Inventory and Appraisement (Schedule 1): | $ 721,913.64 |
| Receipts During Accounting Period (Schedule 2): | 135,664.35 |
| Gain on Sale (Schedule 3): | 51,569.39 |
| **TOTAL CHARGES:** | **$ 909,147.38** |

### CREDITS

| | |
|---|---|
| Disbursements During Accounting Period (Schedule 4) | $ 55,817.90 |
| Loss on Sale (Schedule 5) | $15,198.81 |
| Preliminary Distributions (Schedule 6) | $74,742.75 |
| Property on Hand (Schedule 7): | $763,525.70 |
| **TOTAL CREDITS:** | **$ 909,285.16** |

### INVENTORY AND APPRAISEMENT
### (Schedule 1)

| | |
|---|---|
| Partial No. One, filed 02/27/02 | $ 371,000.00 |
| Partial No. Two, filed 01/08/04 | 362,848.02 |
| Final, filed 08/15/05 | 3,872.75 |
| Supplemental, filed 09/25/05 | 4,195.71 |
| Corrected, filed 08/07/06 | < 20,002.84 > |
| **TOTAL INVENTORY AND APPRAISEMENT:** | **$ 721,913.64** |

**APPENDIX B - CONTINUED**
**(Schedule 2)**
**RECEIPTS**

PUTNAM INVESTMENTS
High Yield Trust Cl-A

| DATE | DESCRIPTION | AMOUNT |
|---|---|---|
| 09/25/01 | Dividend paid | 650.01 |
| 10/25/01 | Dividend paid | 650.01 |
| 11/26/01 | Dividend paid | 650.01 |
| 12/26/01 | Dividend paid | 586.26 |

Only a portion of detail included in this example

TOTAL: $ 16,365.59

**GAIN ON SALE**
**(Schedule 3)**

**GAIN FROM INVENTORY VALUE TO SALE VALUE:**

| ASSET | INVENTORY VALUE | SALE VALUE | GAIN |
|---|---|---|---|
| CAL FED INVESTMENTS | | | |
| Calvert Soc Inv Bal, Class A | 55,053.75 | 63,231.33 | **8,177.58** |
| CITICORP INVESTMENT #79C-00576-12 X23 | | | |
| ING Intl Value Fund, Class A | | | |
| (Pilgrim on I & A) | 61,380.20 | 101,233.70 | **39,853.50** |

Only a portion of detail included in this example

**GAIN ON REINVESTED INCOME:**

FRANKLIN TEMPLETON INVESTMENTS
Tax-Free Income Fund Class A
Account #112-11202738483

| DATE | SHARES PURCHASED @ PRICE | COST BASIS | SOLD @ 7.27 | GAIN <LOSS> |
|---|---|---|---|---|
| 04/01/02 | 27.800 @ 7.04 | 195.71 | 202.11 | 6.40 |
| 05/01/02 | 27.605 @ 7.12 | 196.55 | 200.69 | 4.14 |
| 06/03/02 | 27.231 @ 7.13 | 194.16 | 197.97 | 3.81 |

TOTAL COST BASIS,
SHARES PURCHASED

**APPENDIX B - CONTINUED**

| | | | |
|---|---|---|---|
| THROUGH REINVESTMENT | $ 11,095.75 | 11,181.94 | **86.19** |

Only a portion of detail included in this example

TOTAL GAIN **$ 51,569.39**

**(Schedule 4)**
**DISBURSEMENTS DURING ACCOUNTING PERIOD**

| Date | Description | | Amount |
|---|---|---|---|
| 11/13/01 | H.O. Insurance Premium | $ | 599.00 |
| 11/30/01 | Superior Court Filing Fee | | 196.00 |
| 11/01/01 | HOA Dues | | 166.00 |
| 12/03/01 | Real Property Tax, San Diego County | | 1,077.75 |
| 12/07/01 | City of Carlsbad Water, 10/4-11/06 | | 174.37 |
| 01/04/02 | Coast News, Publication, Notice of Admin | | 145.00 |
| 01/07/02 | Alfred Reyes, Yard Cleanup, Sale Prep. | | 80.00 |
| 01/14/02 | Six certified copies, Ltrs Testamentary | | 36.00 |
| 02/21/02 | Pacific Bell, Final Bill | | 53.42 |
| 02/15/02 | Frank D. Real, Probate Referee, Inventory & Appraisal, Partial #1 | | 385.00 |
| 02/28/04 | Miller & Willits Accountants, Inc., Prep 2001 Fed & Cal Income Tax Returns | | 790.00 |

Only a portion of detail included in this example

Total: $ 55,817.90

**LOSS ON SALE**
**(Schedule 5)**

**LOSS FROM INVENTORY VALUE TO SALE VALUE:**

| ASSET | INVENTORY VALUE | SALE VALUE | LOSS |
|---|---|---|---|
| FRANKLIN TEMPLETON U.S. Gov Sec Fund – Class A | 6,949.233 @ 6.85 | 6,949.233 @ 6.35 | |
| | 47,602.25 | 44,127.63 | **<3,474.62>** |

Only a portion of detail included in this example

TOTAL LOSS **$ 15,198.81**

**APPENDIX B - CONTINUED**

**PRELIMINARY DISTRIBUTIONS**
**(Schedule 6)**

| | | |
|---|---|---|
| PATRICIA R | | |
| 1998 Volvo C70 VIN YV1NK5376WJ001026 | 21,000.00 | |
| 10/08/03Vivian R……., cash | 40,000.00 | |
| 12/29/03Vivian R……, cash | 10,000.00 | |
| Coin collection | 3,742.75 | |
| **TOTAL:** | | **$ 74,742.75** |

**PROPERTY ON HAND**
**(Schedule 7)**

| | | |
|---|---|---|
| US BANK ACCOUNT NO. xxx | $ 2,730.83 | |
| REAL PROPERTY | 4,000.00 | |
| EDWARD JONES ACCOUNT NO.xxxx | 756,794.87 | |
| **TOTAL:** | | **$ 763,525.70** |

## APPENDIX C – 1041 TAX CITATION

**Question: What is the citation relating to taxable income from an estate/trust eventually passed out to a tax exempt organization?**

The citation you want in Internal Revenue Code section 642(c)(2) about amounts to be used exclusively for religious, charitable, scientific, literary, or educational purposes. Since the income from the estate is to be distributed to four charities in all events, the income should be considered to be used exclusively for a charitable purpose and qualify for the section 642(c)(2) deduction. The Treasury regulations under section 1.642(c)-2 confirm this and allow a charitable income tax deduction to an estate for "any part of the gross income of an estate which pursuant to the terms of the will ... is to be used (within or without the United States or any of its possessions) exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals

**Question: does this apply to trusts as well? A fiduciary countered our earlier assertion that no tax was due by saying that since this wasn't an estate, the section wasn't "germane". I've read Sec. 1.642(c)-2(b) Certain Trusts but am having trouble deducing whether this would apply to a trust which was created as a regular living trust during the donor's lifetime?**

Answer: While by its terms, section 642(c)(2) applies to estates (and certain old trusts), section 645 of the Internal Revenue Code allows revocable trusts during their administration period to elect, with the consent of the executor of an estate, to be subject to income tax as part of the decedent's estate. The election can even be made if there is no executor of an estate appointed. Generally that election is beneficial, but not all revocable trusts make that election. By making the election, the income tax rules of section 642(c)(2) of the Internal Revenue Code should apply to the revocable trust. Treasury Regulation section 1.645-1(e)(2)(i) (if there is an executor) and -1(e)(3)(i) (if there is no executor) specifically requires this result. I know that it is requesting a level of detail from the trustee of the revocable trust, but I think that it is a reasonable request to make. And if the election was not made, because of this issue, I would wonder why the election was not made.

## APPENDIX D – PRIVATE INUREMENT

**Private inurement tax citation – drawn**
**http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Inurement-Private-Benefit-Charitable-Organizations**

**Life Cycle of a Public Charity - Jeopardizing Exemption**

A section 501(c)(3) organization will jeopardize its exemption if ceases to be operated exclusively for exempt purposes. An organization will be operated exclusively for exempt purposes only if it engages primarily in activities that accomplish the exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities does not further an exempt purpose. A 501(c)(3) organization:

- must absolutely refrain from participating in the political campaigns of candidates for local, state, or federal office
- must restrict its lobbying activities to an insubstantial part of its total activities
- must ensure that its earnings do not inure to the benefit of any private shareholder or individual
- must not operate for the benefit of private interests such as those of its founder, the founder's family, its shareholders or persons controlled by such interests
- must not operate for the primary purpose of conducting a trade or business that is not related to its exempt purpose, such as a school's operation of a factory
- may not provide commercial-type insurance as a substantial part of its activities
- may not have purposes or activities that are illegal or violate fundamental public policy
- must satisfy annual filing requirements

In addition to loss of the organization's section 501(c)(3) exempt status, activities constituting inurement may result in the imposition of penalty excise taxes on individuals benefiting from excess benefit transactions.

**Inurement/Private Benefit - Charitable Organizations**

A section 501(c)(3) organization must not be organized or operated for the benefit of private interests, such as the creator or the creator's family, shareholders of the organization, other designated individuals, or persons controlled directly or indirectly by such private interests. No part of the net earnings of a section 501(c)(3) organization may inure to the benefit of any private shareholder or individual. A private shareholder or individual is a person having a personal and private interest in the activities of the organization.

## APPENDIX E – PRIVATE INUREMENT LETTER

Date

RE: Estate of

Dear Ms.

Thank you for your email/letter/phone call of _____.

In response to your request to allocate a portion of our share of the estate to you, we must regretfully decline. As a nonprofit public charity, [name of charity] has a fiduciary duty to its members to ensure that corporate assets are adequately protected and managed and do not inure to the benefit of any private individual. Unfortunately, voluntarily giving up part of a bequest, in the absence of any legal requirement to do so, would violate our fiduciary duty and jeopardize our non-profit status. While we are most sympathetic to your family history and current difficulties, we are unable to assist you without creating problems for our own organization.

We are very grateful to have been named in Mr./Ms. estate planning documents and hope that the knowledge that this gift is living legacy to Mr./Ms. will provide some comfort as you remember him/her.

Sincerely yours,