

them are not *abusive*, in that they comply with the changes made to the statutory law in 1997. (This is reference to the maximum 50 percent annual payout rate and the 10 percent minimum remainder interest.) The IRS's riposte to this assertion is the Quote of the Month. [12]

## FINAL CHARITABLE LEAD TRUST REGULATIONS ISSUED

**T**he IRS, on January 4, issued final regulations concerning charitable lead trusts, in an effort to shut down the practice of using the lives of seriously ill individuals to move assets and income away from charitable beneficiaries prematurely and instead to other private beneficiaries (T.D. 8923). These trusts are sometimes referred to as *vulture trusts*. The effective date of the regulations is January 5, 2001.

A summary of these regulations, in proposed form, is in the June 2000 issue. Also there is a summary of the law and the abuse. The essence of all of this is that, under prior law, any individual's life could be used as the measuring life in determining the noncharitable interest in a lead trust. Promoters were using seriously ill individuals, unrelated to the donors, for this purpose, to generate a large charitable deduction (calculated as if the individuals were healthy) and to pass the property from the charity to private persons much earlier than should be the case. As the IRS nicely stated the matter, these regulations are "necessary to ensure that the amount the taxpayer claims as a charitable deduction reasonably correlates to the amount ultimately passing to the charitable organization."

The IRS proposed to limit the individuals whose lives could be measuring lives to the donor, the donor's spouse, and/or a lineal ancestor of all the remaining beneficiaries. The final regulations, however, expand the class of permissible measuring lives to include an individual who, with respect to all noncharitable remainder beneficiaries, is either a lineal ancestor or the spouse of a lineal ancestor of these beneficiaries (Reg. §§ 1.170A-6(c)(2)(i)(A), (ii)(A); 20.2055-2(e)(2)(vi)(a), (vii)(a); 25.2522(c)-3(c)(2)(vi)(a), (vii)(a)). Thus, these remainder beneficiaries can include stepchildren and stepgrandchildren of the individual who is the measuring life, as well as charitable organizations.

These regulations also provide that a trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15 percent probability that individuals who are not lineal descendants will receive any trust corpus

(*id.*). This probability must be computed at the date of transfer to the trust, taking into consideration the interests of all individuals living at that time.

The IRS wrote that this change "will afford drafters the flexibility to provide for alternative remainder beneficiaries in the event the primary remainder beneficiary and his or her descendants predecease the individual who is the measuring life for the term of the charitable interest."

The Treasury Department and IRS conceded that there may be situations in which the grantor, for a valid estate planning objective, may desire to use an individual as a measuring life who does not satisfy the criteria in the regulations. It was suggested, however, that "other permissible estate planning techniques" be utilized. [16]

## IRS: WE WON'T ACCEPT RETURNS FILED BY EXEMPT ORGANIZATIONS THAT LACK RECOGNITION OF EXEMPTION

**I**n an information letter, the IRS has taken the stance that it will not accept annual information returns (usually, Form 990) filed by exempt organizations that have not filed an application for recognition of tax exemption (usually, Form 1023 or 1024) (INFO 2000-0260). The IRS wrote that the statutory authorization for the returns (IRC § 6033) does not require the IRS to accept such a filing.

The particular matter concerned an organization that is claiming tax exemption as a social welfare organization (an IRC § 501(c)(4) entity). It has not, however, filed an application for recognition of exemption. It filed an annual information return. The IRS responded by instructing the organization to either file the application or begin filing income tax returns (Form 1120 or 1041). [12, 23, 24.3]

**Commentary:** *One of two things has happened here. This is either an egregious abuse of administrative discretion by the IRS or the individual who wrote the letter (or at least signed it), Mr. Joseph J. Urban, acting chief, Projects Branch, Exempt Organizations, simply does not understand the law on this point.*

*It is crystal clear that only most charitable organizations and certain employee benefit funds are required to file applications for recognition of exemption (IRC §§ 508(a), 505(c)). Other organizations, including social welfare organizations, can be tax-exempt without filing such an application. Yet, nonetheless, these organizations are generally mandated to file annual information returns (IRC § 6033(a)). There is nothing in the Internal Revenue Code linking the requirement of filing annual returns with any requirement for seeking recognition of tax exemption.*

*The IRS is having difficulties posting annual returns by tax-exempt organizations that have not filed recognition applications (see the January issue). While this correlation is understandably troublesome for the agency, it is no excuse for this outrageous position, where legitimate returns are turned away or exempt organizations are told they must file tax returns (and pay tax?). What a spectacle: tax-exempt organizations timely complying with their legal reporting responsibilities—and the IRS audaciously and arbitrarily refusing to accept the documents! The IRS needs to correct this bungle quickly, before unsuspecting tax-exempt organizations begin to comply with it.* □

### **IRS STEPPING UP EDUCATION, OUTREACH, VOLUNTARY COMPLIANCE EFFORTS**

The Exempt Organizations component of the Tax Exempt and Government Entities Division of the IRS is in the process of increasing its emphasis on enhancing voluntary compliance. Thus, a Customer Education and Outreach office has been created. This office will be responsible for coordinating and redesigning the means by which Exempt Organizations interacts with its community. Also, the establishment of an office of voluntary compliance is being contemplated.

The IRS has requested comments and suggestions as to areas within the jurisdiction of these two offices (Ann. 2000-14). Suggestions are being solicited for new initiatives in the areas of outreach and education. The Exempt Organizations office wants help in connection with the development of a web page for use in communicating with its customers. This includes assistance concerning design of the page and its content.

Exempt Organizations also intends to aggressively pursue the issuance of plain-language publications. Help is being solicited as to this project as well, including suggestions for topics for these publications. Indeed, the IRS has asked for drafts of proposed plain-language publications.

Further, the IRS is planning on establishing voluntary compliance programs. Exempt Organizations has invited comments and drafts as to these programs as well.

These initiatives are also reflected in the Exempt Organizations workplan for fiscal year 2001, which was made public by the IRS late last year. There it is stated that the new customer education and outreach function will focus on helping exempt organizations “understand their tax responsibilities” by developing a “tailored education program focused on customer sub-

segments.” Also, the IRS will be monitoring trends of noncompliance and designing products for exempt organizations to address noncompliance.

The workplan emphasizes IRS participation at conferences, seminars, and workshops, by means of the delivery of speeches and participation in panels. Being developed is a “Speaker Mentor Cadre” to mentor IRS employees making speeches or other presentations, and a “Speakers Cadre,” consisting of “frontline employees who will deliver effective speeches and presentations, and represent TE/GE within their local customer community.” [2.3] □

### **OTHER DEVELOPMENTS**

■ On January 20, White House Chief of Staff Andrew Card ordered the heads of federal departments and agencies to refrain from sending proposed and final regulations for publication in the Federal Register “unless and until a department or agency head appointed by the president after noon on Jan. 20, 2001, reviews and approves the regulatory action.”

■ The case styled *Peters v. Commissioner* (see the December issue) has been settled. He agreed to an assessment, the amount of which is unknown. Concurrently, Mr. Peters and the other former trustees of the Kamehameha Schools/Bishop Estate have settled with the school; they have agreed to pay \$14 million pursuant to a settlement agreement that has been approved by the probate court in Hawaii and agreed to by the IRS. [19.11]

■ A publicly supported charitable organization and a trade association operate in tandem, with the charity entity the controlling organization. The trade association wishes to establish a political action committee (PAC). The association will control the PAC. Contributions to the PAC will be solicited from members of the association, who are also members of the public charity. The PAC will maintain separate books and records, and will engage an unrelated party as its financial manager. Convinced that the political activities of the PAC will be “sufficiently segregated and insulated by safeguards” implemented by the public charity and the association, the IRS ruled that the activities of the PAC will not be attributed to either organization (Priv. Ltr. Rul. 200103084). [17, 21, 30]

■ A husband and wife established a charitable remainder unitrust, funding it with stock. The trust document provides that no additional contributions may be made to it. Unaware of this provision, the donors made an additional contribution of stock to the trust, which the trust sold. This difficulty was subsequently detected; the parties are to be paid the sales proceeds and will personally report the capital gain and dividend income