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No Federal Tax Deduction Allowed for Single Trust Serving Both Charitable and Noncharitable Purposes

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Recent Cases

No Federal Tax Deduction Allowed for Single Trust Serving Both Charitable and Noncharitable Purposes

In *Estate of Johnson v. United States*, 941 F.2d 1318 (5th Cir. 1991), the Court of Appeals for the Fifth Circuit held that a single trust, created by a will, which served both charitable and unlimited noncharitable purposes resulted in a split interest trust which could not be reformed to satisfy the requirements for the federal estate tax charitable deduction.

Background

Forrest J. Johnson ("Johnson") died in January of 1984, leaving a will that created a multi-purpose trust. The trust allocated funds to support Johnson's three sisters, to maintain the family graves, and to establish a charitable trust to pay for religious education in certain Mississippi Catholic parishes.

In April of 1985, the estate filed its federal estate tax return taking no deduction for a charitable bequest. Almost two years later, the estate requested authority from the chancery court to create a nonprofit foundation in order to carry out Johnson's charitable bequests. Authority was granted in April of 1987, with the foundation being incorporated in June. In October of 1987, a set amount of funds was transferred to the foundation, and the Internal Revenue Service ("I.R.S."), relying on Section 501(c)(3) of the Internal Revenue Code, declared the foundation exempt from federal taxation.

In that same month, the executor of Johnson's estate claimed a refund of federal estate taxes previously paid, based on the funds subsequently transferred to the foundation as a charitable donation. The I.R.S. denied the claim.

In January of 1989, the chancery court granted the request made by the court-appointed representative of Johnson's only living sister to interpret the will as establishing three separate trusts, with each trust serving a separate purpose. The chancery court approved the establishment of a $100,000 trust in the name of Johnson's sister for her continuing care, with the funds remaining at the sister's death to be transferred to the charitable foundation. The remainder of the estate was not designated to either trust.

In February of 1989, the estate sued the I.R.S. in the United States District Court for the Southern District of Mississippi, seeking a refund of the estate taxes denied by the I.R.S. The district court granted the estate's motion for summary judgment, holding that Johnson's will created three separate trusts and, therefore, no split interest trust existed. The United States appealed to the Court of Appeals for the Fifth Circuit.

Will Created a Split Interest Bequest

The appellate court reversed and held that Johnson's will did intend to create a split interest bequest, citing the language of the will describing the purposes of the trust. The court also found that no basis existed for separating the non-charitable, open-ended bequests, regarding care for Johnson's sisters and family grave maintenance, from the charitable bequests. The court cited the case as a classic example of a split interest trust because both charitable and non-charitable beneficiaries were granted an interest in the same property.

The Fifth Circuit explained that estate tax deductions were disallowed under 26 U.S.C. Section 2055(e)(2) of the Internal Revenue Code where interests in the same property were passed to both charitable and non-charitable recipients. Congress enacted this section in 1969 to prevent abuse of the tax code by trusts with primarily noncharitable interests that bequest only residual amounts to charitable interests. Under that law, estates had to distinguish and assess the amounts designated to charitable beneficiaries separately from amounts designated to non-charitable beneficiaries. Johnson's trust did not make such a distinction.

Further, Johnson's trust failed to qualify under the limited exception found in Section 2055(e)(2)(A) of the Internal Revenue Code, which allows deductions for only three specific split remainder interests: charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds. The appellate court explained that in those specific instances, the I.R.S. was able to determine the total amount bequested to the noncharitable recipient and, therefore, could distinguish the charitable bequests.

No Charitable Deduction Allowed

The Fifth Circuit held that the estate's refund claim should have been denied because the trust was disallowed as a charitable deduction under Section 2055(e)(2), due to its split interest nature. It further failed to qualify under Section 2055(e)(3), which enables initially nondeductible charitable bequests to become deductible through the amending of the will to make the bequest fit one of the Section 2055(e)(2) qualified exceptions. The court held that Johnson's will could not be reformed to fit one of the three qualified interests under Section 2055(e)(2).

The appellate court distinguished the instant case from a case involving a split interest trust that paid three life interests of $100 a month to noncharitable beneficiaries. In the latter case, the noncharitable interests could be satisfied through the purchase of three annuities. Thus, the funds going toward the noncharitable beneficiaries could be limited, and thereby firmly separated from the funds designated for the charitable recipients; the trust could be reformed to qualify under Section

2055(e)(2) as a charitable annuity remainder trust.

The court held that Johnson's trust could not be reformed to meet one of the Section 2055(e)(2) exceptions while still complying with the terms of the will. Even though a contract could have been bought to satisfy the family grave maintenance, no upward limit existed on the amount required to support Johnson's remaining sister due to the unpredictable costs of medical care. Therefore, the amount of funds needed to fulfill the noncharitable bequests could not be accurately assessed until after all of Johnson's sisters had passed away. As a result, the funds to the charitable beneficiaries could only be assessed after all the sisters were deceased.

Lastly, the Fifth Circuit held that the statutory language of the Internal Revenue Code was clear, and no express Congressional intent supported an exception in this case.

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New Jersey Supreme Court Finds County Board's Itemized Phone Bills Are Not Public Records

In *North Jersey Newspapers Co. v. Passaic County Board of Chosen Freeholders*, 601 A.2d 693 (N.J. 1992), the Supreme Court of New Jersey held that the state's Right-to-Know statute did not create an unqualified right of access to a public body's itemized telephone billing records that disclosed the identity of the parties called. Furthermore, the telephone bills were not accessible under New Jersey common law because the public's need for the identity of the parties called did not outweigh the governmental policies of confidentiality in telephone communications and executive privilege.

Background

To uncover possible misuse of public funds, the North Jersey Newspapers Company ("Newspaper"), in July 1990, requested copies of itemized phone bills for the office and car-phone lines of the Passaic County Board of Chosen Freeholders' ("Board"). Some of these bills included date, time, length of call, amount of charge, and phone number called. The Newspaper made its request pursuant to New Jersey's Right-to-Know Law, N.J.Stat.Ann. 47:1A-1 to -4, and a parallel right of access to public records under New Jersey common law.

The Board denied the Newspaper's request on both grounds. First, the Board claimed that the Right-to-Know Law allowed access to the total amounts of a phone bill but not to the entire itemized document. Second, the Board argued that the public's interest in reviewing the itemized phone bills did not outweigh the governmental need for confidentiality; therefore, the Board denied the Newspaper's request for access under the common law as well. Consequently, the Newspaper sued in the Superior Court, Law Division, Passaic County, seeking access to the requested records.

Proceedings in the Lower Courts

The trial court granted the Newspaper unlimited access to the itemized phone bills. The court concluded that because itemized phone bills are not specifically exempted from the Right-to-Know Law, the Newspaper should have access to the records it sought. The court also found that common-law standards required accessibility because the constitutional and privacy interests of persons telephoned by Board officials did not outweigh the public's interest in reviewing the phone bills. The Board appealed to the Superior Court, Appellate Division.

The appellate court agreed that the phone bills were public records accessible under the Right-to-Know Law. However, the appellate court reversed the trial court, finding that the Board's privacy interests not only were protected by the New Jersey Constitution but also outweighed the public's interest in reviewing the phone bills. Therefore, the appellate court ruled, the Newspaper should not have unlimited access to the requested records. The Newspaper appealed to the Supreme Court of New Jersey.

Right-to-Know Law Does Not Apply

The supreme court disagreed with the appellate court's statutory analysis and found that the Right-to-Know Law did not apply to itemized phone bills. The appellate court's judgement was modified accordingly.

In finding that the Right-to-Know Law did not apply to itemized phone bills, the supreme court distinguished public records accessible under the Right-to-Know Law from public records accessible under the common law. Under the Right-to-Know Law, the public has an unqualified right to inspect public documents only if the documents are records "required by law to be made, maintained or kept on file." In contrast, records accessible under New Jersey common law are records made by public officers in the exercise of their public functions. The public's right to inspect common-law records depends on whether the public's need for the records outweighs the government's need for confidentiality.

The Newspaper claimed the itemized phone bills were covered by the Right-to-Know Law because the Board was required to record all the details of its telephone bills under the Local Fiscal Affairs Law. The Local Fiscal Affairs Law requires public agencies submitting requests for anticipated expenses to make available a detailed bill of items on demand. Furthermore, the Newspaper claimed, the standard of "detailed" in the Local Fiscal Affairs Law was meant to grow with the times and included information that was routinely available. Modern technology allows telephone companies to routinely provide customers with information such as date, time, length of a call, number called, and charge for a call. Therefore, the Newspaper argued, because such information was routinely available, public agencies such as the Board were required to make itemized phone bills available to the

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