The Advisor

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ESTATE PLANNER'S TIP

One of the largest assets for older couples going through a divorce may be retirement plan savings. Because different rules regarding the division of assets apply to different types of plans, it's important to consider the fair split of these assets as part of any divorce negotiations. For example, an IRA owned by a husband can be split upon divorce, with no tax consequences if the funds are rolled over into the wife's IRA. Assets in a 401(k) plan also may be split, although the plan may have rules governing when the division is made (e.g., when the employee leaves the company or reaches a certain age.) The Retirement Equity Act of 1985 introduced the qualified domestic relations order (QDRO), a judgment or decree by a state court regarding the division of retirement assets [Code §414(p)]. The QDRO must state the names and last known mailing addresses of the plan participant and the ex-spouse, the portion of the benefits to be paid to each and how long the payments are to continue. Without a QDRO, a qualified plan administrator might not be required to pay an ex-spouse's share, regardless of what the divorce decree or separation agreement provides. The QDRO prevents the participant spouse from withdrawing all funds in the account and makes sure each ex-spouse is taxed on the proper share of the distributions.

ADOPTED CHILDREN OUT IN TRUST CONSTRUCTION

Warren established an irrevocable trust prior to September 25, 1985, intended to benefit his lineal descendants. The trustees – one of Warren's sons, another individual and a bank – are to pay as much of the net income and principal as desirable to the group composed of Warren's children, their issue and descendants and the spouses of said beneficiaries.

Warren has three children. The oldest has three biological children and the youngest has no children. The middle child adopted two individuals as adults. The trust does not define whether the terms "issue," "descendants" and "children" include adopted individuals.

State law when the trust was created provided that in the absence of evidence of the grantor's intent, the terms "child" and "children" excluded adopted individuals. Sometime later, the state

common law was reversed to include adopted persons. Warren, who is still living, said he intended to benefit only blood descendants. The trustees obtained a court order, contingent on a favorable IRS ruling, that the trust is to include only "blood issue," "blood children" and genetic descendants.

The IRS ruled that the state court's construction of the trust does not affect the exempt status of the trust for generation-skipping transfer tax purposes and will not result in any transfers being subject to GST tax. The IRS also said the court's construction is not a transfer for gift tax purposes [Code §2501] and will not result in the realization of gain or loss under Code §§61 or 1001 (Ltr. Rul. 201814001).

"SURPRISE" CODICIL NOT VALID

Beginning with a 1987 will and continuing through his 2010 will, Earl Field and his wife left the bulk of their $20 million estate to Fort Hays State University (FHSU). In 2008, Wanda Oborny began working for Field as a part-time bookkeeper. Gradually she was given access to numerous bank accounts and the authority to sign checks for Field, who had become depressed following his wife's death.

After Field's death in 2013, Oborny said she found two typewritten letters in his office, dated a few weeks earlier. One envelope was addressed to her and the other to Field's attorney. The envelopes contained letters instructing that Oborny was to receive half of Field's estate, with the remaining half divided between Field's attorney and FHSU. Field's attorney informed Oborny that because the letters bore no witness signatures, they were invalid for passing property to her. Oborny consulted another attorney who advised the same.

Shortly thereafter, Steve and Kathy Little, friends of Oborny, notified Field's attorney that they had been asked by Field to witness a codicil just prior to Field's death. They said Field wanted to surprise Oborny with the bequest. The purported codicil bore the signatures of the Littles and Field.

The District Court denied Oborny's attempt to admit the document for probate, finding the codicil was neither typed nor signed by Field and that Oborny, or someone at her behest, had signed Field's name. Oborny's request for attorney fee was denied by the trial judge, but another judge granted her fees of $1 million. FHSU appealed the award of fees.

The Kansas Court of Appeals heard testimony from handwriting experts for both FHSU and Oborny. By the time of the trial, the Littles were dead by murder-suicide after being investigated by the FBI. The court said "abundant evidence" supported the conclusion that Field's signature on the codicil was forged. The court also noted Oborny had been terminated from a prior job for misuse of funds and that her testimony was inconsistent. Field's accountant testified that he was "tax-averse" and that under the 2010 will, there would be no estate tax, thanks to the charitable deduction. However, under the terms of the codicil, the estate tax would be about $4.4 million. The appeals court noted that Field had always used his attorney to draft his wills and that due to his advanced age and medical problems, was inca-

PHILANTHROPY PUZZLER

Darlene is reviewing her estate plan following the recent death of her husband. The couple's only child, Benjamin, is mentally incompetent. Darlene would like to include a bequest to charity, but wants to make sure Benjamin is properly cared for. She has considered a charitable remainder trust that would pay income for life to Benjamin. She's concerned that the payout would have to be made directly to Benjamin, even though he is incapable of handling his financial affairs. Darlene has asked whether there is any other way to structure the trust payout.

pable of typing the codicil or signing his name as on the document. Because Oborny did not act in good faith, the court reversed the fee award (*In re Estate of Field*, No. 116,456, No. 117079).

$10 PURCHASE PRICE ENOUGH FOR COURT

Shriners Hospital was named as the residuary beneficiary in L. G. Foster's 2008 will. In 2013, Foster executed a durable power of attorney giving Frederick Romo authority to sell his real property "under such terms and conditions" as Romo deemed appropriate.

Foster indicated to Romo that he wanted his personal residence to pass to his church, but Foster became ill and moved to a nursing home before the arrangements could be completed. Because the power of attorney did not give Romo the authority to make a gift of the property, but did allow him to sell it, Romo sold the residence to the church for $10. Foster endorsed the sale.

Following Foster's death, Shriners Hospital challenged the sale, saying the church was not a "good-faith purchaser for value." The Circuit Court granted the church's motion for summary judgment.

Shriners appealed, claiming the transaction was a gift, which was not permitted under the power of attorney. The Arkansas Court of Appeals noted that Romo had the legal authority to sell the home under any terms he deemed appropriate. In the absence of "accident, mistake or fraud," the court said it would not question how the disposition was made. Inadequacy of consideration is not enough to set aside the conveyance, the court said (*Shriners Hospital for Children v. First United Methodist Church of Ozark*, 2018 Ark. App. 216).

KEEPING LAWYERS HONEST THROUGH UNAUTHORIZED PRACTICE OF LAW

Joan Farr organized the Association for Honest Attorneys (AHA) as a nonprofit corporation in Kansas. In seeking exempt status under Code §501(c)(3), she said AHA would help to "create public awareness/seek donations to discourage litigation, improve our legal system, keep attorneys honest, save people money, reduce their stress and seek 'justice for all.'" The IRS recognized AHA as exempt in 2003.

The state of Kansas found that Farr, who was not an attorney, was engaging in the unlawful practice of law. The IRS notified Farr that AHA's activities were to be examined. The IRS found she had used AHA funds to make numerous personal purchases, pay her son's tuition and pay for the exhumation and DNA testing of her father's remains.

In February 2015, AHA's exempt status was revoked, retroactive to 2010. The IRS found that because AHA was operated primarily for Farr's benefit, the organization no longer operated in accordance with Code §501(c)(3). Farr appealed, but the Tax Court agreed that more than an insubstantial part of AHA's activities furthered a nonexempt, private purpose (*Association for Honest Attorneys v. Comm'r.*, T.C. Memo. 2018-41).

PUZZLER SOLUTION

Normally, a charitable remainder trust must be payable to or for the use of one or more named "persons." Code §7701(a)(1) defines person to include a trust, although if a noncharitable trust is the beneficiary, the charitable remainder trust must be for a term of years (not more than 20). However, where the life income beneficiary is an incompetent and the only function of the noncharitable trust is to receive and administer payments from the charitable remainder trust, the payments will be deemed as received directly by the beneficiary (Rev. Rul. 76-270). Darlene could have payments from the remainder trust pass to a special needs trust established for Benjamin.

NONQUALIFIED TRUSTS NOT NECESSARILY A BAD THING

Most donors who create split-interest trusts are intent on qualifying for an income tax deduction. But it is possible to realize tax benefits even from a nonqualifying charitable remainder trust.

Split-interest charitable gifts must be in the form of either a charitable remainder annuity trust [Code §664(d)(1)], a charitable remainder unitrust [Code §664(d)(2)] or a pooled income fund [Code §642(c)(5)] to qualify for an immediate income or estate tax charitable deduction. And unless the instrument meets every requirement, it will fail. If that happens, not only could the donor lose the tax deduction, but the IRS could impose a gift tax on the charitable contribution.

Donors can amend defective charitable remainder trusts, but there are situations in which the donor might not want to qualify. Consider a donor, Phil, who creates a trust that will pay him all the income for his life. At his death, the trustees are to pay the corpus to certain charitable organizations that he names in his will, or in default of designating the charities, to charities selected by the trustees. Phil also retains the right to accelerate the transfer of any or all of the corpus to charity during his lifetime.

The IRS has ruled that in such a situation, Phil is not the owner of the trust for purposes of the grantor trust rules of Code §673 (dealing with reversionary interests), §674 (dealing with the power to control beneficial enjoyment) or §676 (dealing with the power to revoke) (Ltr. Rul. 8738044). Phil is, however, considered the owner of the ordinary income interest portion of the trust and owes income tax on the amount he realizes each year.

Assuming that proceeds from the sale of trust assets are allocable to corpus and are not income under state law or trust language, income from the sale of trust assets would not be included in Phil's gross income. Nor would the exercise of his right to accelerate the distribution of corpus result in taxable income to him. These amounts would instead be taxable to the trust, which would be able to take advantage of the unlimited charitable deduction under Code §642(c)(1).

Phil manages to reserve for himself all the income from the trust, remove from his gross income the proceeds from the sale of trust corpus and make charitable gifts for which the trust may take a deduction. Nor is Phil liable for gift tax on his transfer of assets into the trust. Reg. §25.2511-2(b) imposes a gift tax only where the transfer is completed. By retaining the right to name charities, no gift has been completed and no tax is owed. If Phil designates a charity to receive trust corpus during his lifetime, the gift will be complete and a tax becomes due. At that time, a gift tax charitable deduction would be available under Code §2522(a).

There are other ways Phil could achieve the same goals of providing himself with all the income and still contributing to charity. One would involve creating a revocable trust. This trust also would be unqualified and would allow Phil to take a charitable deduction when distributions are made to charity. But it has a major drawback: In addition to being taxed on all trust income, Phil would be taxed on all the income allocable to trust corpus, such as capital gains.

Another option is a qualified net-income charitable remainder unitrust. To ensure that he receives all the income, Phil would have to use the highest payout rate that still provides a 10% charitable remainder. The higher rate would result in lower actual value for the charitable share, meaning a reduced charitable deduction.

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