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ESTATE PLANNER'S TIP

Childless couples and individuals need to consider who they will rely on as they age to help make decisions regarding nursing care, housing, finances and end-of-life planning. This job generally falls on immediate family members for those with children and grandchildren, but for clients with no children, extended family may be the obvious choice. For those without children, estate planning documents such as living wills, health care powers of attorney and revocable trusts become even more important. There are professionals and companies providing this type of service, but it's important to have the arrangements in place before needed. A study by AARP estimates that by 2030, 16% of women ages 80 to 84 will be childless – pointing out the need for seniors to give consideration to how these issues will be addressed in their estate planning.

ESTATE VALUE DOESN'T INCLUDE WHAT DECEDENT DIDN'T OWN

John Pulling owned three small parcels of land in Florida at his death. He also held a 28% interest in a land trust that owned two larger parcels, contiguous to those he owned outright. The land – totaling about 131 acres – was zoned and used for agriculture. An appraiser put the value of Pulling's three parcels at \$940,000, noting that the dimensions of the land, lack of utilities and limited access made development "not economically feasible."

The IRS claimed that the land trust's holdings should be "assembled" with Pulling's in coming to a value for the property. The Tax Court noted

that a "reasonable likelihood" test was more appropriate. If a higher use of land is possible only when combined with other parcels, there must be a reasonable probability of the lands in question being combined with other tracts in the reasonably near future, the court explained.

The court noted that the land trust had rejected early offers to sell the land for development, making it highly unlikely that Pulling's parcels could be put to a higher use. The IRS's "assemblage" theory is "too speculative," said the court, which accepted the estate's valuation of the property (*Pulling v. Comm'r.*, T.C. Memo. 2015-134).

THE LETTER IS NOT IN THE MAIL

With estates up to \$5.43 million sheltered from tax in 2015, relatively few Forms 706 will have to be filed. For returns filed on or after June 1, 2015, the IRS has announced that it will no longer automatically issue closing letters. An executor may request that a closing letter be issued, however.

Letters will generally be issued within four to six months after the return is filed, provided the return is accepted as filed and has no errors. The IRS said letters could take longer if the return is selected for audit or is reviewed for statistical purposes.

RULES CAST IN STONE; DEDUCTION ISN'T

James Isaacs contributed four trilobite fossils to the California Academy of Sciences (CAS) in 2006; he gave eight more in 2007, claiming deductions of \$136,500 and \$108,900 respectively. He included letters from CAS acknowledging the gifts with his Forms 8283, although neither letter mentioned whether CAS had provided any goods or services in exchange for the gifts.

The Forms 8283 were both signed by Jeffrey Marshall, who was called as a witness before the Tax Court. The court acknowledged that Marshall was an expert on the valuation of fossils, but because he said he did not recall signing the forms and did not write or even recognize the letters purporting to appraise the trilobites, the court did not admit them.

Because Isaacs' deductions exceeded \$5,000, he needed to obtain a qualified appraisal [Code

§170(f)(11)(C)]. The court found Isaacs failed to satisfy the appraisal requirement, noting that Marshall disavowed any knowledge of the letters provided by Isaacs. However, even if Isaacs had a qualified appraisal, the court said, his deduction would be denied because he failed to satisfy the requirements for noncash gifts in excess of \$500. Code §§170(f)(11)(A) and (B) require the donor to maintain written records of the approximate date and manner of acquiring the property, a description of the property in reasonable detail, the cost or other basis, the fair market value at the time of the gift and the method by which the value was determined.

Finally, said the court, even if Isaacs had satisfied both the valuation requirements, he lacked a contemporaneous written acknowledgment, required for all gifts of \$250 or more. Although Isaacs received letters from CAS, they did not state that either no goods or services were provided in return for the gift or provide a good faith estimate of the value of any quid pro quo. Therefore, ruled the court, Isaacs was not entitled to any deductions (*Isaacs v. Comm'r.*, T.C. Memo. 2015-121).

WILL INCONSISTENCIES RESOLVED

Barbara Yetka-Eisenberg's will directed that 50% of the residue of her estate be used to fund a charitable remainder unitrust for her brother, sister and cousin. The trust was to pay the lesser of 5% of the annual value of the assets or the trust's net income. A savings clause appearing later in the will, provided that "in no event shall the unitrust amount be less than 5 percent." The estate asked the New York Surrogate's Court to construe the conflicting provisions of the will.

Generally, where two will clauses are inconsistent, the one that is posterior in position is considered "a subsequent intention" and prevails over the earlier clause. Here, however, the court found that the earlier definition of the unitrust amount met the requirements for a qualified charitable remainder unitrust and would entitle the estate to a charitable deduction. The later clause, which was included in the savings clause

PHILANTHROPY PUZZLER

Stella is the executor of her uncle's estate. The uncle, who supported numerous charities throughout his life, had unused excess income tax charitable deductions remaining at his death. Stella has asked whether the uncle's estate is entitled to deductions of any kind for the value of these unused income tax deductions.

due to a drafting error, was only meant to ensure the trust's tax status in the event of a question. The court said there was never any reason to consult the savings clause because the unitrust met the requirements of Code §664 (*Testament of Yetka-Eisenberg*, Kings County Docket No. 2011-4050/B).

HIGH PAYOUT, NO DEDUCTION

A year prior to his death in 2007, Arthur Schaefer established two net-income with make up charitable remainder unitrusts. Each trust paid to Schaefer for life and then to one of his two sons for life. The unitrusts were to make 11% and 10% payouts respectively. His estate did not claim a charitable deduction with relation to the unitrusts, but instead reduced the amount reported on Schedule G, Transfers During Decedent's Life, on the Form 706, by the charitable portion. The IRS said the estate was not entitled to a charitable deduction because the actuarial value of charity's remainder interest was not at least 10% of the value of the assets contributed to the trusts [Code §664(d)(2)(D)].

The estate argued that the trustee was required to distribute only the trust income each year, not the full 11% or 10%, except where the trustee is making up for prior years when less than the stated percentage was distributed [Code §664(d)(3)(B)]. The remainder interest should be valued using the §7520 rate, provided the rate is above 5% of the net fair market value of the assets, according to the estate. (The §7520 rate in effect for the month the trust was created was 5.2%.)

The IRS pointed to Rev. Rul. 72-395 and Rev. Proc. 2005-54, which hold that the remainder interest of a net-income with make up charitable remainder unitrust is to be valued using the fixed percentage, despite the fact that distributions are limited to net income.

The Tax Court found both calculation methods flawed, but said the remainder value under the estate's method "is possibly closer" to what charity will eventually receive. The court, finding Code §664(e) to be ambiguous, turned to legislative history to ascertain Congressional

intent. A report on the Senate amendment to the Tax Reform Act of 1969 stated that in valuing the charitable deduction, the remainder interest in a trust is to be determined on the basis that the income beneficiary will receive the "higher" of 5% or the payment provided in the trust. The payout rate set forth in the trust is to be used to value the remainder interest, said the court, even though distributions may be limited by net income (*Estate of Schaefer v. Comm'r.*, 145 T.C. No. 4).

NOT A VERY CHARITABLE PURPOSE

The IRS denied tax-exempt status to an organization that provides services for voluntary repatriation of undocumented aliens, finding that the group's activities did not further an exempt purpose under Reg. §1.501(c)(3)-1(b)(1)(i).

The organization purchases airline tickets, pays for transportation to the airport and gives small amounts of cash for meals to those who wish to return to their own countries but lack the resources to do so. This aids not only the undocumented aliens, said the group, but potentially improves the market in the U.S. for the services of American workers.

The IRS noted that undocumented aliens are not a charitable class per se, adding that the organization was "not concerned with identifying and assisting the poor and distressed among the undocumented aliens," but rather identifying those most likely to return home and not seek to re-enter the U.S. illegally (Ltr. Rul. 201527043).

PUZZLER SOLUTION

Carryover deductions may be claimed on the uncle's final income tax return for the year of death, subject to the 30%- or 50%-of-AGI deduction ceilings [Code §170(b)(1)]. Any excess deductions that are not claimed on this return are lost and may not be claimed on the estate's income tax return [see, generally, Reg. §1.170A-10(d)(4)(iii)].

STRATEGIES FOR CHARITABLE BEQUESTS

With the estate tax credit sheltering estates up to \$5.43 million in 2015, few clients have to worry about planning to reduce or avoid the estate tax. That doesn't mean charitable bequests won't still be a part of a thoughtful estate plan, but it does mean that the way clients remember charity may be different. Asking if clients would like to continue supporting worthwhile organizations through an estate gift should be a standard part of any estate planning review. What are some of the options for clients who wish to remember their favorite charities?

Outright or in trust?

An outright bequest can be a specific dollar amount or a particular asset. Keep in mind that if the client bequeaths a particular asset to charity, the organization receives nothing if the asset is not in the estate at death. Outright bequests can also be made in the form of a percentage of the value of the estate, the residue of the estate or a portion of the residue.

Bequests in trust, also known as deferred bequests or split-interest bequests, offer flexibility and estate tax savings. A bequest in trust produces a smaller charitable deduction than an outright bequest in which charity receives the funds immediately, without waiting for an intervening income interest to expire. But a split-interest bequest may be an ideal option for clients who need to provide continuing financial support for family members.

Split-interest bequests come in many forms: charitable remainder trusts, QTIP trusts, charitable gift annuities, charitable lead trusts and remainder interests in a farm or personal residence. Whatever the form of the bequest, it is important that the transfer satisfy the requirements of Code §2055(e)(2).

What assets are best?

In planning charitable bequests, certain assets make more sense from a tax standpoint. Property that would result in reduced deductions if given during the donor's life often makes the best bequest.

One example is ordinary income property. The charitable deduction for an inter vivos gift of ordinary income property, such as inventory or artwork in the hands of the artist, is limited to the donor's cost basis [Code §170(e)(1)(A)].

Tangible personal property that is not related to the donee organization's charitable mission is also more valuable as a bequest. For example, if a rare violin is given to a hospital during the donor's life, the income tax charitable deduction likely would be reduced by 100% of any long-term capital gain [Reg. §1.170A-4(b)(3)(i)]. The same violin bequeathed to the hospital will produce an estate tax charitable deduction equal to the full fair market value.

Clients should also consider bequests of income in respect of a decedent (IRD). This is income that the decedent earned prior to death that is paid to the estate after death. IRD may be taxed twice – in the decedent's gross estate and in the estate's (or recipient's) income. A bequest to charity of items of IRD can create both estate tax and income tax savings [Code §642(c)(1)], and because charities usually pay no income tax, the bequest will not be reduced. Items of IRD include qualified retirement plans, interest on U.S. savings bonds, accounts receivable of a cash-basis individual, annuities, renewal commissions of insurance agents, last salary check and a deceased partner's distributive share of partnership income up to the date of death.

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