

The Advisor



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ESTATE PLANNER'S TIP

Surviving family members have numerous decisions to make in the days following the death of a loved one – including certain post-mortem estate planning elections. For example, the value of the estate is generally the fair market value of the assets on the date of death but, under Code §2032, the executor can elect to use the alternate valuation date that is six months after the date of death. This is generally used where the value of the assets has declined in the interim. The election to treat certain trust assets as qualified terminable interest property (QTIP) permits the use of the marital deduction while also directing how assets will pass at the death of the surviving spouse [Code §2056(b)(7)(B)]. Where a farm or closely held business represents more than 35% of the adjusted gross estate, favorable installment payments may be used [Code §6166]. Family members may also want to exercise disclaimers [Code §2518] to ensure that the surviving spouse has sufficient assets or that the credit shelter trust is fully funded. A surviving spouse may wish to claim the deceased spousal unused exclusion amount [Code §2010(c)(4)]. All of these options have special rules regarding the method of making the election and the date by which the election must be made.

POST-DEATH CHANGES DON'T ALTER DISTRIBUTIONS

Sam named Trust A as 50% beneficiary of his IRAs and Trusts B and C as 25% beneficiaries. The trusts qualified with the “look through” provisions of Reg. §1.401(a)(9)-4, Q&A-5(b). When his financial advisor joined another firm, Sam transferred the IRAs to a new custodian and signed a new beneficiary designation form naming his estate as the beneficiary.

Following Sam's death, the trustees of the three trusts claimed that, in signing the form, Sam meant only to move the IRAs, not to change the beneficiary designations. The court ordered the beneficiary

designation to be modified retroactively to carry out Sam's original intent. The estate asked the IRS to rule that the beneficiaries of Trusts A, B and C were able to take withdrawals over their own life expectancies [Reg. §1.401(a)(9)-9, Q&A-1], rather than over Sam's remaining life expectancy [Reg. §1.401(a)(9)-5, Q&A-5(c)(3)].

An estate cannot be a “designated beneficiary” for purposes of Code §401(a)(9). Therefore, said the IRS, there was no designated beneficiary for Sam's IRAs. Further, the IRS is not required to give effect to a local court order that alters a doc-

ument after the IRS has “acquired the rights to tax revenues.” Otherwise, said the IRS, there could be “considerable opportunity for ‘collusive’ state court actions” and federal tax liabilities would remain unsettled for years (Ltr. Ruls. 201628004 – 201628006).

NO TAX-DEFERRED EXCHANGE TREATMENT

Peter inherited an interest in an annuity from his father’s estate. He intended to exchange his portion for another annuity under Code §1035, but mistakenly signed a lump-sum payment form from the annuity company. The lump sum was deposited in Peter’s checking account. He then used the funds to pay for a separate annuity. When preparing Peter’s tax return, his accountant found the Form 1099-R showing the receipt of the lump-sum distribution.

Peter asked that the distribution from the annuity to his checking account and the subsequent purchase of an annuity be treated as a tax-deferred exchange. This would put Peter in the same position as if the distribution had not been made.

The IRS noted that amounts received under an annuity contract are generally included in gross income [Code §72(e)]. No gain or loss is recognized on the exchange of one annuity contract for another annuity [Code §1035(a)(3)], provided the

contracts relate to the same insured and the obligee under the contract received in the exchange is the same as those under the original contract. Code §1035 makes no provision for the purchase of an annuity contract with amounts distributed to the policyholder from another contract. Therefore, ruled the IRS, the distribution to Peter from the annuity will not be treated as a tax-deferred exchange (Ltr. Rul. 201625001).

A LESSON IN WHAT NOT TO DO

Among the charitable deductions that Brent and Lynette Mcminn claimed on their 2004 and 2005 income tax returns were (1) a \$2,600 gift to Kayit’s Children’s Home; (2) gifts to Children’s Research Foundation (CRF) that were reported on Form 1099-MISC received from Juice Plus, a business Lynette operated; (3) gifts totaling \$11,435 to R.L. Montgomery Ministries; (4) office equipment and furniture they valued at \$6,950 to the Faith Family Worship Center; (5) a 2002 van also given to the Faith Family Worship Center and (6) Brent’s unreimbursed travel expenses of \$3,013 to accompany their pastor to Jamaica to visit church missions and find a location for a children’s home. Many of these were disallowed by the IRS. The Tax Court determined that:

(1) Kayit’s Children’s Home, located in Mexico, is not a charity within the U.S. Under Code §170(c)(2), a deduction is allowed only if the donee is organized in the U.S.

(2) The donors made several gifts to CRF but had no contemporaneous written acknowledgments, as required by Code §170(f)(8)(a). The gifts for less than \$250 – which do not require contemporaneous written acknowledgments – were allowed, because the information was included on the Forms 1099. The deductions for \$250 or more were disallowed.

(3) R.L. Montgomery Ministries is not a registered exempt organization in the U.S., but is an individual who claims to be an agent of Ranch House Ministries. Because the Mcminns did not show that the funds were given to Ranch House Ministries, and because the couple lacked contemporaneous written acknowledgments, their deductions were denied.

PHILANTHROPY PUZZLER

Glen made a significant cash gift to his favorite charity in 2010. He claimed the maximum charitable deduction that year (50% of adjusted gross income), but was unable to deduct the entire amount due to the deduction limits of Code §170(b)(1)(A). He took charitable deductions for the excess in 2011, 2012 and 2013. In 2014 and 2015, Glen did not itemize, instead taking the standard deduction. He expects his itemized deductions to exceed the standard deduction of \$6,300 for single filers this year and has asked if he can use the remaining carryover from his 2010 gift.

(4) The donors included a Form 8283 for the office equipment and furnishings, along with a contemporaneous written acknowledgment from Faith Family Worship, but they failed to provide a description of the items “in detail reasonably sufficient” to inform the IRS of the type of property, as required under Reg. §1.170A-13(b)(1)(ii). Their deduction was therefore denied.

(5) Instead of a qualified appraisal, the donors provided a page from the website of Kelly Blue Book to establish the value of the van. The court limited the couple’s deduction to \$5,000 due to the lack of an appraisal [Code §170(f)(11)(E)(i); Reg. §1.170A-13(c)(3)].

(6) No deduction was allowed for the Jamaican trip expenses, because the couple lacked a contemporaneous written acknowledgment and did not comply with recordkeeping requirements [Reg. §1.170A-13(f)(10)]. Code §170(j) provides that no charitable deduction is allowed for traveling expenses while away from home unless there is no significant element of personal pleasure, recreation or vacation (*Mcminn v. Comm’r.*, T.C. Memo. 2016-136).

FRAUD NOT A FIRST AMENDMENT RIGHT

Carolyn Cohen and Randi Wax were involved in activities at Kabbalah Centre in San Diego. Both had been asked to donate to a building fund to either purchase or build a permanent home for the Centre. Cohen gave more than \$450,000 and Wax gave more than \$300,000.

In 2013, the Centre informed some of its building fund donors – but not Cohen or Wax – that it would not be buying or building a facility, and asked that the donors approve the use of funds for other purposes. When Cohen learned that no facility would be bought or built, she asked for her money back. The Centre refused.

Cohen and Wax eventually filed suits, alleging breach of contract and breach of the implied covenant of good faith and fair dealing. They also said that since the Centre’s promise was false when made, it was guilty of fraud, unfair

business practices and obtaining property under false pretenses.

Shortly after, the Centre filed anti-SLAPP motions in each case. The Centre would have to show that its actions “arose from an act in furtherance of its protected speech in connection with a public issue.” The Centre claimed that, in soliciting funds, it was engaged in a furtherance of its exercise of protected speech. Cohen and Wax argued that their causes of action arose from the Centre’s breach of contract and fraud, neither of which is protected speech. The trial courts in the cases denied the Centre’s anti-SLAPP motions.

The Court of Appeals of California rejected the Centre’s argument that, because all of the claims arose out of the Centre’s charitable solicitations, the wrongful conduct was protected activity. In general, charitable solicitations are within the protection of the First Amendment, and neither Cohen nor Wax seek to enjoin the Centre from soliciting funds, the court noted. The donors contend that the wrongful act was the failure to either use the funds to buy or build a facility or to return the contributions. Both argue that if the Centre makes a promise about the use of the solicited funds, it must use the funds in that manner or return them. The court agreed with the denial of the anti-SLAPP motions, saying that while charitable solicitation is protected by the First Amendment, “alleged fraud is not” (*Cohen v. Kabbalah Centre International, Inc.*, B258226; *Wax v. Kabbalah Centre International, Inc.*, B258231).

PUZZLER SOLUTION

Under Code §170(b)(1)(B), Glen can claim excess deductions in each of the five years succeeding the year of the gift. The five-year period does not refer only to years in which the donor itemized. Excess deductions not claimed within the five tax years following the gift are lost. Clients should consider their future tax situation when making gifts involving carryovers.

MANY HAPPY RETURNS FOR CHARITABLE GIFTS

Ann puts \$100,000 in a trust that will pay her income for life, remainder to her daughter. Barbara puts \$100,000 in a qualified charitable remainder trust that will pay a unitrust amount to her nephew for life, with the remainder (valued at \$35,000) to her church. Cynthia gives appreciated stock in her closely held business to her college. Which of these three women must file a gift tax return? Which should file?

The answer is that Ann and Barbara must file, and Cynthia should. Ann's gift of a remainder interest in trust to her daughter is a gift of a future interest, which does not qualify for the annual exclusion [Code §2503(b)]. Barbara's gift to her nephew, although it is a present interest, is worth more than the \$14,000 annual exclusion amount. Moreover, Code §6019(a)(3) requires gift tax returns for all split-interest gifts, even where the only gift is to charity. Both women are required to file gift tax returns under Code §6019.

But why should Cynthia need to file a gift tax return for an outright gift to charity? Technically, no gift tax return is required for gifts to charity, provided the transfer is of the donor's entire interest in the property and no other interest in the property has been transferred for a noncharitable use (e.g., a charitable remainder trust).

Cynthia gets two deductions for her one gift to charity. She receives an income tax charitable deduction [Code §170] and an unlimited gift tax charitable deduction [Code §2522]. The gift tax return must be filed no later than the due date of the income tax return, with extensions.

Cynthia should file a gift tax return, even though it's not required, because filing Form 709 creates a "paper trail." It's important for a tax-

payer who might face an audit to be able to demonstrate that gifts were made and returns properly filed to account for any gaps in income. The return also may assist the executor of an estate in attempting to account for all the decedent's assets.

Filing a gift tax return also starts the clock running on the statute of limitations and limits the time in which the IRS can challenge the value or deductibility of a charitable gift. This is especially important where, as in Cynthia's case, the gift is closely held stock or some other hard-to-value asset. Otherwise, the donor could be faced years later with the difficult task of reconstructing the paperwork documenting the gift.

All split-interest charitable gifts require that a gift tax return be filed where a private interest is reserved, either for the donor or for a beneficiary named by the donor. Even where the noncharitable portion is sheltered by the \$14,000 annual exclusion or the unlimited marital deduction, the donor is required to file a return to declare the charitable gift. In certain situations a donor may, in fact, owe a gift tax on a charitable gift. A donor who creates a charitable trust that does not qualify as a unitrust or annuity trust will not be entitled to a gift tax deduction [Code §2522(c)]. A trust that pays all income to the noncharitable beneficiary or a trust that allows the grantor to invade trust principal to pay medical expenses, for example, does not qualify for the charitable deduction. In those cases, the donor could be open to both tax and a fine for failure to file when gift tax is owed.

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