

The Advisor



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ESTATE PLANNER'S TIP

Clients who receive restricted stock as compensation for services as an employee or independent contractor are not subject to income tax on the value of the stock until it becomes vested or transferable [Code §83(a)], at which time it is taxed as ordinary income. In some cases, however, it may be advisable to pay the tax earlier than required, thereby converting the property to a capital asset. Under Code §83(b), the client may elect to pay tax at ordinary income rates on the difference between the fair market value of the restricted property on the date of the grant over the cost basis. When the asset is later vested, all appreciation will be capital gain. The election, which may be revoked only with IRS approval, must be made within 30 days of the receipt of the stock. The election should be made only after considering the potential for forfeiture of the property. No loss deduction is allowed if the stock is later subject to forfeiture.

NOTHING RECEIVED IN EXCHANGE FOR NOTES

Paul established three irrevocable trusts for his benefit. At his death, principal and accumulated income were to be distributed to his children. The day before Paul died, he purchased the remainder interests in two of the trusts, using an unsecured promissory note.

Paul's executor filed a gift tax return, showing that Paul received adequate and full consideration in the form of the remainder interests. The executor also filed an estate tax return, including the value of the corpus of the trusts, but deducting the value of the outstanding promissory notes as claims against the estate.

The IRS noted that while Paul's liability on the promissory notes depleted his taxable estate, the receipt of the remainder did not increase the value of his taxable estate because the value of the entire property would already be included in his gross estate under Code §2036(a)(1). Therefore, there was no adequate and full consideration under Code §2512(b). Paul made a completed gift to the children in the amount of the value of the promissory notes, said the IRS, adding that no deduction is allowed for his liability outstanding on the notes (CCA 201745012).

CHARITABLE GIFTS NOT “WASTEFUL”

Sarah Melvin claimed that the \$1.5 million given to charity between 2011 and 2015 constituted marital waste. Her husband, Walter, asked the Appellate Division of the Supreme Court of New York to preclude her argument, noting that she had signed joint tax returns for those years.

Sarah did not deny that she signed the returns, or that the gifts were made to a bona fide charity or that the couple received a benefit in the form of a tax deduction. Instead, she claimed the gifts were made without her consent and were “inherently wasteful in their excess.”

The court noted that by signing the returns, she is presumed to have read and understood them, adding that a party to litigation cannot take a position contrary to a position taken in an income tax return. The court agreed that she is judicially estopped from claiming the donations were made without her consent (*Melvin v. Melvin*, 2017 NY Slip Op 7421).

UNSIGNED TRUST NOT ADMISSIBLE

In 2012, Merritt London revised his living trust, leaving much of his estate to six charities, friends and his housekeeper. In early 2013, he met with

his attorney about changes that would create a trust fund for a niece and nephew, while reducing the portion of his estate passing to the charities. Although the trust changes were made and delivered to London, he never signed the document prior to his death.

London’s niece and nephew sought to have the unsigned trust declared “valid and enforceable,” superceding the 2012 trust. The Superior Court of New Jersey dismissed the complaint and granted summary judgment for the charities.

The Appellate Division of the Superior Court of New Jersey affirmed the ruling, noting that for a writing to be admitted to probate, there must be a showing “by clear and convincing evidence” that the decedent actually reviewed the document and assented to it. The court found that the envelope containing the trust document was in the same condition as when it was delivered to London (*In re Trust of London*, Docket Nos. A-4693-14T4, A-4746-14T4).

2018 TAX NUMBERS . . . MAYBE

The IRS issued inflation-adjusted tax numbers for 2018, but some of these may be subject to change under the tax bills currently being considered in Congress (Rev. Proc. 2017-58). Among the changes announced by the IRS:

| | 2017 | 2018 |
|---|-------------|-------------|
| Gift, generation-skipping transfer and estate tax exclusion | \$5,490,000 | \$5,600,000 |
| IRA contribution limit | 5,500 | 5,500 |
| 401(k) contribution limit | 18,000 | 18,500 |
| 401(k) catch-up contribution limit | 6,000 | 6,000 |
| Personal and dependent exemption | 4,050 | 4,150 |

PHILANTHROPY PUZZLER

Sara established a charitable remainder unitrust, naming herself as the sole income beneficiary. Her brother, Edward, is having his will prepared and, as a strong supporter of the charity named as remainderman of Sara’s trust, wants to include a bequest for an additional contribution to Sara’s trust if he predeceases her. Sara’s unitrust allows additional contributions. Can he make a contribution to Sara’s trust through his estate?

| | 2017 | 2018 | | 2017 | 2018 |
|---------------------------|---------|---------|---------------------------|-----------|-----------|
| Standard deduction | | | Head of household | \$444,550 | \$453,350 |
| Single | \$6,350 | \$6,500 | Married filing separately | 235,350 | 240,025 |
| Joint | 12,700 | 13,000 | Alternative minimum | | |
| Head of household | 9,350 | 9,550 | tax exemptions | | |
| Married filing separately | 6,350 | 6,500 | Single, head of household | 54,300 | 55,400 |
| Cutbacks on itemized | | | Joint | 84,500 | 86,200 |
| deductions and personal | | | Married filing separately | 42,250 | 43,100 |
| exemptions begin | | | Kiddie tax | 2,100 | 2,100 |
| Single | 261,500 | 266,700 | Nanny tax | 2,000 | 2,100 |
| Joint | 313,800 | 320,000 | Annual gift tax exclusion | 14,000 | 15,000 |
| Head of household | 287,650 | 293,350 | Annual gift tax exclusion | | |
| Married filing separately | 156,900 | 160,000 | for non-citizen spouse | 149,000 | 152,000 |
| Tax brackets | | | Special use valuation for | | |
| 25% bracket starts | | | real property devoted to | | |
| Single | 37,950 | 38,700 | farming or closely held | | |
| Joint | 75,900 | 77,400 | business use | 1,120,000 | 1,140,000 |
| Head of household | 50,800 | 51,850 | Savings bond interest | | |
| Married filing separately | 37,950 | 38,700 | exclusion phased out | | |
| 28% bracket starts | | | Single, head of household | 93,150 | 94,700 |
| Single | 91,900 | 93,700 | Joint | 147,250 | 149,550 |
| Joint | 153,100 | 156,150 | | | |
| Head of household | 131,200 | 133,850 | | | |
| Married filing separately | 76,550 | 78,075 | | | |
| 33% bracket starts | | | | | |
| Single | 191,650 | 195,450 | | | |
| Joint | 233,350 | 237,950 | | | |
| Head of household | 212,500 | 216,700 | | | |
| Married filing separately | 116,675 | 118,975 | | | |
| 35% bracket starts | | | | | |
| Single, joint, head of | | | | | |
| household | 416,700 | 424,950 | | | |
| Married filing separately | 208,350 | 212,475 | | | |
| 39.6% bracket starts | | | | | |
| Single | 418,400 | 426,700 | | | |
| Joint | 470,700 | 480,050 | | | |

PUZZLER SOLUTION

In the annotations for the IRS sample charitable remainder unitrust documents, the IRS indicates that “only the donor or a donor’s estate may make an additional contribution” to a unitrust. Contributions by others may cause the disqualification of the trust under Rev. Procs. 2005-52 through 2005-59. Edward could, instead, leave a bequest in a separate charitable remainder unitrust to benefit Sara and then their favorite charity.

A WILL IS NOT THE ONLY WAY

As every estate planner knows, not everyone has a will, and even many clients who do have wills don't review them regularly. But for philanthropic clients, there are other ways to provide for charities that don't involve wills or codicils. When reviewing a client's estate plans, it's a good idea to coordinate the will or living trust with beneficiary designations that generally pass outside probate. What are some of the ways available to benefit charities beyond bequests in wills?

Life insurance

Clients can name a charity as beneficiary of a life insurance policy, while retaining the right to change the beneficiary or surrender the policy at any time. Charity can also be named a co-beneficiary with family members, or a contingent beneficiary, to take the proceeds only if the primary beneficiary dies before the insured. The full amount passing to charity qualifies for an estate tax charitable deduction.

Naming charity as beneficiary does not give rise to an income tax deduction, although a deduction is available if charity is named the owner of the policy. A deduction is available for the fair market value of the policy or cost basis, whichever is less [Code §170(e)(1)(A)], and future premium payments would be tax deductible. The value of the policy is removed from the insured's gross estate, and even if the donor dies within three years, the value of the insurance is offset by the charitable deduction.

Life insurance can also be used to fund a testamentary charitable remainder trust or charitable gift annuity, providing payments for life for family members. An estate tax deduction would be available for the value of the charitable interest.

Retirement accounts

IRAs, 401(k)s and other qualified retirement accounts are subject to the tax on income in

respect of a decedent [Code §691]. Naming charity as the death beneficiary of part or all of a retirement account avoids the tax on IRD and generates an estate tax charitable deduction [Code §2055(a)(2)].

The IRS has ruled that retirement accounts can be used to fund charitable remainder trusts that make payments to family members before passing to charity (Ltr. Ruls. 9253038, 9237020), resulting in payments – and taxes – spread over the beneficiary's life. The IRS also ruled favorably on an arrangement in which a donor would create a testamentary charitable gift annuity using IRA assets, with the payout rate based on the recommended rates in effect at the donor's death for a person the age of the named annuitant.

Financial/brokerage accounts

Clients can name beneficiaries for just about any financial arrangement. These are commonly referred to as payable on death (POD) or transfer on death (TOD) accounts. Similar arrangements may be possible for vehicles or real estate in some states.

Donor advised funds

More than \$85 billion is held in donor advised funds. Distributions from DAFs are subject to tax if the person advising receives, directly or indirectly, "a more than incidental benefit" [Code §4967(a)(1)]. Therefore, DAFs cannot be used to create inter vivos or testamentary life-income gifts.

Clients should, however, consider how the funds in their DAFs will be distributed after their deaths. Some DAFs might allow the donor to name a successor to advise gifts. Other plans might continue distributions to the same charities the donor had named during his or her lifetime. If the DAF allows the donor to name one or more charities to receive the funds at death, this should be part of the client's estate planning.

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