The Advisor

BALL STATE UNIVERSITY FOUNDATION
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ESTATE PLANNER'S TIP

"Domicile" probably isn't a concern of most clients. In fact, many may not even realize that they can inadvertently change their domicile, thereby creating new estate planning considerations. However, there may be clients who want to establish a new domicile while retaining contacts with their current home state. Some steps a client should take to establish a new domicile: register to vote in the new location and notify the voter registrar in the old state to remove his or her name from the rolls; file a federal income tax return from the new state and notify the IRS of the change of address; transfer the bulk of checking and other financial accounts to local banks, keeping only modest amounts in institutions close to the old home; register vehicles in the new location; have estate planning documents drafted under the laws of the new state. Before making a break from one location to the other, clients should review the effect on both income and estate taxes that the move will make.

IRS DISREGARDS TRUST

Vince designated his estate as the beneficiary of his IRA. At his death, the IRA became part of his residuary, which passed to a trust. The trust directed that his wife, Sally, receive all income, as well as principal as needed for her health, support and maintenance. At Sally's death, 5% of the principal was to pass to Vince's church, with the rest distributed to his living heirs.

Normally, the balance of Vince's IRA would have to be paid out within five years of his death. However, state law permits termination of a trust under certain circumstances. At the estate's request, the court terminated the trust and ordered the executor to pay all probate funds to Sally.

The IRS ruled that the proceeds of the IRA received by Sally would be treated as paid directly to her and would not be considered an inherited IRA. As a result, she will be able to roll the distribution over to an IRA maintained in her own name and take distributions over her lifetime, the IRS ruled (Ltr. Rul. 201736018).

SOCIAL SECURITY GIVING MORE, TAKING MORE

The Social Security Administration announced the largest cost-of-living adjustment since 2012. The 2% increase means the average monthly benefit for all retired workers will rise from $1,377 to $1,404. For all disabled workers, the adjustment will mean an extra $24, from $1,173 to $1,197.

Social Security recipients who have not reached full retirement age (age 66 and two months for those born in 1955) but who are working can earn up to $17,040 in 2018, compared to $16,920 in 2017, before benefits are reduced. The reduction is $1 in benefits for every $2 in earnings above the $17,040 limit. No reduction applies to beneficiaries who have reached full retirement age and continue to work.

Current employees will pay into the Social Security portion (OASDI) until earnings reach $128,700 in 2018, versus $127,200 in 2017. The 1.45% withholding on the Medicare portion applies to all earnings.

TRUST CORRECTION GETS IRS APPROVAL

Curt created an irrevocable trust to benefit his wife, Colleen, and the couple's children. One section of the trust, titled "Special Power of Appointment," gave Colleen the testamentary power to direct principal and income to persons, charities and estates. When Curt realized that the power of appointment did not preclude Colleen from appointing to her estate, her creditors or the creditors of her estate, he sought to reform the trust.

Under state law, an irrevocable trust can be amended to correct a scrivener's error. The court granted Curt's request to retroactively reform the trust to give Colleen a limited power of appointment. He then asked the IRS to rule that, as a result of the reformation, trust assets would not be included in Colleen's gross estate under Code §2041(b) and that the reformation was not an exercise or release of the general power of appointment that would constitute a gift under Code §2514.

The IRS noted that Curt did not intend for Colleen to have a general power of appointment over trust assets and that, due to the judicial reformation, the value of assets would not be included in her gross estate (Ltr. Rul. 201737008).

PHILANTHROPY PUZZLER

The shareholders of a small pharmaceutical company are considering making a corporate gift to a medical school. The company owns highly appreciated, undeveloped real estate and the shareholders want to know if the land is a good gift choice. Also, can the corporation transfer the real estate to a charitable remainder trust and retain payments?

A COPY IS GOOD ENOUGH

When Salvatore Esposito's will could not be found at his death, his friends, who had been named executors, sought to probate a copy obtained from the drafting attorney. Esposito was survived by five distant nieces and nephews who did not object to the will. His estate was left to two charities.

In general, where a will known to have been in the possession of a testator cannot be found, there is a strong presumption that the testator destroyed the will with the intent to revoke it. In order to admit a copy of the will to probate, the court must be satisfied that the will had not been revoked and that it had been executed in the manner required for probating an existing will.

At no time between the will's execution and Esposito's death did he indicate to his attorney that he was revoking it. Two long-time friends of Esposito stated that they assisted him with his personal affairs and he never indicated he was revoking his will. The Surrogate's Court of New York concluded that Esposito's will was lost, not revoked. Because the will contained an attestation clause, the court said the statutory requirement presumption was satisfied (*In re Will of Esposito*, 2017 NY Slip Op 31994(U)).

DEED CONSTITUTES CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT

Big River Development (BRD) contributed a facade easement to the Pittsburgh History and Landmarks Foundation (PHLF) in 2005. Based on an appraisal, BRD claimed a charitable deduction of $7.14 million.

In 2009, the IRS told BRD it proposed to disallow the deduction, based on its lack of a contemporaneous written acknowledgment from PHLF. The deed of easement stated that "in consideration of Ten Dollars," and also that the deed reflected the entire agreement of the parties. It did not, however, expressly state that no goods or services were provided to BRD in exchange for the gift.

The Tax Court noted that the Form 8283 executed by PHLF's president was contemporaneous, but did not include a quid pro quo statement. A letter PHLF provided in 2007 included the statement, but was not contemporaneous. However, the court found that the deed of easement, which was properly executed by PHLF's president and recorded with the county, contained all the necessary information and was contemporaneous. The court added that it was "unclear" whether PHLF's continued monitoring of the easement should be considered a "service" to BRD, since PHLF would merely be discharging its own enforcement responsibilities and could "generate no upside" for BRD (*Big River Development v. Comm'r.*, T.C. Memo. 2017-166).

OVERREACH BY ATTORNEY-IN-FACT

William Colon bequeathed his entire estate to charities. Anthony Marenghi, Colon's attorney-in-fact, appointed Catherine Fletcher as adjunct attorney-in-fact to execute an annuity policy payable to Marenghi and his wife.

The executor of Colon's estate sought the nearly $250,000 annuity as part of the estate, claiming that Marenghi acted for his own benefit and, since Colon never signed the contract, the annuity was unenforceable. Marenghi's widow said she was entitled to the annuity and that he had exercised his authority under the power of attorney.

The power of attorney gave Marenghi the authority to make gifts to Colon's parents, spouse, children and some remote descendants. The Surrogate's Court of New York found that neither Marenghi nor his wife were members of this class. While the purchase of an annuity might have been appropriate for Colon's financial planning, the naming of Marenghi and his wife as beneficiaries exceeded his authority. It was, instead, an unauthorized gift and therefore void, said the court. Although Marenghi himself did not execute the annuity contract, Fletcher did so under the power granted by Marenghi. However, Marenghi could not grant a power he did not himself possess.

The court found no consideration given by Marenghi or his widow for being named beneficiaries of the annuity. Because the "presumption of impropriety" exists, the beneficiary designation is invalid and the funds are to be delivered to the executor, the court ruled (*In re Marenghi*, 2017 NY Slip Op 31993(U)).

PUZZLER SOLUTION

Long-term capital gain property such as realty or marketable securities can be contributed and deducted by C corporations at fair market value (subject to a 10%-of-taxable income ceiling with a five year carryover for excess deductions) [Code §170(c)(2)]. Corporations can also be grantors and income beneficiaries of charitable remainder trusts, provided the trust lasts for a term of no more than 20 years [Reg. §§1.664-2(a)(5), 1.664-3(a)(5)].

MAINTAINING TRUST QUALIFICATION REQUIRES ONGOING VIGILANCE

IRS sample documents for charitable remainder annuity trusts (Rev. Procs. 2003-53 to 2003-60) and charitable remainder unitrusts (Rev. Procs. 2005-52 to 2005-59) provide guidance on drafting documents. Trusts that substantially comply with these samples or incorporate sample alternative provisions will be qualified trusts. But that does not mean that there aren't ways to run afoul of rules governing the trusts.

Guilt by association

The IRS has ruled that an 11% charitable remainder trust that was to be funded with a $1 million contribution from a married couple and $1 million from their six grandchildren and last for the joint lives of the eight donors was an association with a business purpose (Ltr. Rul. 9547004). The trust could not be classified as a trust for income tax purposes. (This trust predated Code §§664(d)(1)(D) and (d)(2)(D), which require at least a 10% remainder interest.)

The IRS reached the same conclusion where an S corporation proposed to fund a charitable remainder unitrust. The corporation would receive unitrust payments for 19 years, after which payments would be made to the sole shareholder and spouse for their joint lives (Ltr. Rul. 200203034). The IRS said that both the corporation and the shareholder would be grantors, and because the trustee would have the power to invest and reinvest trust assets, it couldn't be classified as a trust or meet the definition of a charitable remainder trust.

Failure to pay

A trust must meet the definition of and function exclusively as a charitable remainder trust from inception [Reg. §1.664-1(a)(4)]. One requirement is that payments be made at least annually [Code §§664(d)(1)(A), (d)(2)(A)], although there are special exceptions in the case of a unitrust. The U.S. Court of Appeals (11th Cir.) upheld a Tax Court ruling that denied an estate tax charitable deduction for the remainder interest from an inter vivos annuity trust because payments had never been made to the donor during her lifetime. The estate argued that the donor had no need for the funds, which would have served only to reduce the amount passing to the charity. The court held that the 5% payment requirement was to prevent charitable remainder trusts from being used to circumvent the current income distribution requirements of private foundations [*Est. of Atkinson v. Comm'r.*, 2002-2 USTC ¶60,449].

UBTI concerns

A charitable remainder trust's continued tax exemption is dependent upon it having no unrelated business taxable income for the year [Code §664(c)]. A trust that has UBTI will be taxed as a complex trust. There is a $1,000 UBTI deduction that applies, however [Code §512]. A trust with UBTI loses its exemption only for that year, but if that happens to be a year when significant capital gain income is realized, the result could be financially expensive.

Self-dealing cautions

Charitable remainder trusts are subject to the private foundation rules that prohibit acts of self-dealing [Code §4941(d)], excess business holdings [Code §4943(c)], jeopardizing investments [Code §4944] and taxable expenditures [Code §4945(d)]. Penalties for self-dealing can reach up to 200% of the amount involved for the disqualified person and 50% for the trust [Code §4941(e)(4)]. Self-dealing is a concern, especially, where an unsophisticated donor attempts to save on fees by acting as the trustee and subsequently has any financial transactions with the trust.

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