The Advisor

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ESTATE PLANNER'S TIP

Advisors already know that clients should have, at a minimum, a will and/or living trust. Durable powers of attorney and health care directives are also vital documents in a complete estate plan. But clients should be urged to prepare informal lists to help family members in the administration of the estate. Among these: (1) funeral instructions, including the type of service, burial or interment location, music to be played and possibly even obituary information for newspaper notices; (2) a list of financial accounts, including locations, account numbers, estimates of value and any special death beneficiary designations on the accounts; (3) the names, addresses, phone numbers and e-mail addresses of attorney, tax professional, financial advisor and others who are acquainted with the client's affairs; (4) screen names and passwords for electronic accounts and (5) the names, addresses and phone numbers of friends, associates and organizations to notify at the client's death. Copies of this information may be provided to the advisor to keep with the client's file. Clients should also be encouraged to discuss this information – as well as the contents of the will – with family members to avoid misunderstandings, disappointment or confusion when the estate is being distributed.

DOCUMENTS AT ODDS WITH DONOR'S INTENT

Harold created two grantor retained annuity trusts (GRATs) – one for four years and one for 15 years – funding them with shares of his company's stock. The remainder beneficiary of both GRATs was a trust for the benefit of Harold's four children.

Harold had the power to revoke, modify or amend the children's trust at any time. The accountant hired to file the gift tax return noted that, because the children's trust was revocable, the remainder interests in the GRATs would be included in Harold's estate, defeating the purpose of creating the GRATs. The drafting attorney disagreed.

Several years later, a financial planner informed Harold that for the transfers to the GRATs to be complete, Harold should not have the power to revoke the children's trust. Again, the drafting attorney disagreed.

A different attorney was retained to reform the children's trust, ab initio. The state court agreed, conditioned on a favorable IRS ruling. The IRS noted that a court may reform a trust, even if unambiguous, to conform to the grantor's intent. Affidavits from Harold, the drafting attorney, accountant, financial planner and the second attorney, along with their correspondence and memoranda, showed that the power to revoke did not conform to Harold's intent. The IRS ruled that the reformation to correct a scrivener's error

resulted in completed gifts at the time the GRATs were created (Ltr. Rul. 201442042).

PAYMENT OR DEPOSIT? ESTATE GETS COSTLY LESSON

When the tax return for Laura Bishop's estate was due in 2003, the executors could not precisely determine the estate's liabilities, due to on-going litigation in three states. The executors were advised to file Form 4768 Application for Extension of Time to File a Return. They attached a check for $230,884, along with a partially completed Form 706 on which the executors listed an "estimated tax." The check did not indicate whether it was a payment or a deposit.

In 2009, after the litigation was resolved, the estate filed a return seeking a refund of $136,268. The IRS disallowed the claim, saying that it fell outside the three-year statute of limitations [Code §6511(b)(2)(A)].

The District Court said the estate's good faith estimation of its tax liability, its failure to indicate that the remittance was a deposit and the submission of the check with a request for an extension lead to the conclusion that the check was a payment. The estate's claim for a refund was therefore barred by the statute of limitations. The U.S. Court of Appeals (5th Cir.) affirmed (*Winford v. U.S.*, 2014-2 USTC ¶60,685).

TRUST QUALIFIES AFTER JUDICIAL "REPAIR"

Victor created a revocable living trust and pour-over will. At his death, trust income was to be paid to Gloria for life, with the remainder passing to charity. The trust allowed the executor of Victor's estate to request funds from the trust to pay estate taxes and debts.

No payments, other than the specified annuity or unitrust amount, may be made to or for the use of any noncharitable beneficiary [Code §664(d)(2)]. Therefore, Victor's trust did not qualify as a charitable remainder trust under Code §§664(d)(1) or (d)(2), and his estate was not entitled to a charitable deduction under Code §2055(a).

The estate proposes to reform the trust to create a charitable remainder unitrust. A specified portion of the unitrust amount will be paid to Gloria, with the balance paid to charity. At Gloria's death, trust assets will be distributed outright to charity. A second trust will be created, from which payments will be made for estate taxes and expenses. At the completion of the estate administration, remaining assets will be added to the unitrust.

The IRS ruled that the charitable interest was reformable under Code §2055(e)(3)(C)(i) because the charitable interest was ascertainable and therefore severable from the noncharitable interest. Victor's estate will be entitled to a deduction for the value of both the remainder interest and the percentage amount payable to charity during the trust term (Ltr. Rul. 201450003).

PHILANTHROPY PUZZLER

Barney wishes to create a testamentary charitable remainder trust to benefit his niece. He plans to make several specific bequests and then use the residue of the estate to fund the trust. He wants his niece to receive $10,000 per year. Any drawbacks to Barney's plan? Special planning considerations?

GAS PRICES DOWN, MILEAGE RATE UP

Despite the lowest pump prices in years, the standard mileage rate for business use of a vehicle is up for 2015. The rate climbed to 57.5 cents per mile, compared with 56 cents in 2014. The standard mileage rate for medical and moving expenses dropped, however, from 23.5 cents to 23 cents. The rate for charitable use of a private vehicle remains set by statute at 14 cents per mile. The mileage rates are in addition to any expenses for tolls and parking (Notice 2014-79).

THE ANSWER'S STILL "NO"

Frank McDougal was surprised to learn when his aunt died in 1992 that he had been written out of her will in favor of a charitable foundation. In 2009, after storing many of the papers pertaining to his aunt's estate in his attic for years, McDougal took them to a handwriting expert who determined the signature on the trust agree-

ment creating the foundation had been forged. In 2011, McDougal filed suit against the foundation, claiming undue influence. The Court of Appeals of Ohio upheld the trial court, which had granted summary judgment for the foundation on the grounds that the statute of limitations had elapsed.

In 2013, McDougal filed suit in probate court, contesting the validity of the 1985 amended trust. These documents were kept separate from the estate planning documents and were not located until 2011, when produced by the foundation during discovery in the first case, McDougal claimed. He argued that the two-year statute of limitations began running at the time he discovered the trust documents. The trial court ruled that res judicata barred relitigation of the matter, adding that it was also untimely.

The Court of Appeals of Ohio again upheld the lower court, finding that the nature of a complaint, not the label, determines whether an issue has already been litigated. The common law claim of tortious interference with an expectancy of inheritance and a statutory claim contesting the validity of a will raise essentially the same claim, said the court (*McDougal v. Vecchio*, 2014 Ohio 4472).

IMPLIED PLEDGE SURVIVES DEATH

Louise Thomas had discussed the establishment of a scholarship in her name with her alma mater. She planned to fund an endowment in the amount of $1.19 million with proceeds from the sale of real estate. Negotiations between Thomas and East Carolina University Foundation were memorialized in writing, which Thomas acknowledged.

Representatives from the Foundation were to meet with Thomas at her home on February 14, 2013, to pick up the check. However, Thomas was hospitalized on February 9 and died in the hospital on February 17, without having transferred funds for the scholarship.

The Foundation's claim against the estate was denied by the bank executor. The Foundation sued, alleging that the bank breached the contract by failing to honor Thomas' intent. The court granted the bank's motion to dismiss, agreeing that there was no meeting of the minds to form an enforceable agreement.

The Foundation appealed, claiming that Thomas' actions manifested an intent to deliver the proceeds of the sale of real property to the Foundation. But for Thomas' death, she would have consummated the pledge to establish a scholarship in her name, the Foundation argued. The North Carolina Court of Appeals ruled that the lower court erred in dismissing the Foundation's complaint. The steps that Thomas is alleged to have taken show her "offer to exchange monies for the designation of an endowment" and the Foundation's acceptance of this offer, said the court.

An implied contract exists where the intent is not expressed, but an agreement creating an obligation is implied or presumed from the parties' actions. An implied contract is just as enforceable as an express contract. The North Carolina Supreme Court had held that an exchange of a pledge and a promise to designate funds as directed constitutes sufficient consideration to support a contract [*Rutherford College, Inc. v. Payne*, 209 N.C. 792 (1936)], noted the court (*East Carolina University Foundation, Inc. v. First Citizens Bank & Trust Co.*, No. COA14-465).

PUZZLER SOLUTION

In order to pay his niece exactly $10,000 per year, Barney would have to use a charitable remainder annuity trust. Because the trust is to be funded with the residue of the estate, it will not be known until Barney's death whether the trust will meet the 5% minimum payout requirement [Code §664(d)(1)(A)] or violate the 5% probability test (Rev. Rul. 77-374). Barney's will should allow the personal representative to modify the trust to assure that it qualifies and entitles the estate to a charitable deduction. This could involve reducing the $10,000 payout if the residue is too small or, if the residue of the estate is too large, funding the trust with only that portion of the residue needed to meet the minimum 5% payout and still give the niece $10,000, with the remaining residue passing outright to charity.

CHARITABLE GIFT PLANNING AND S CORPORATIONS

S corporations differ from C corporations primarily in their tax treatment. An S corporation is a hybrid business organization in which profits are taxed only once – directly to the shareholders in proportion to their ownership interests, similar to a partnership, proprietorship or limited liability company (Code §§1361 - 1379).

Deductions and profits pass through to the shareholders. Charitable contributions are deductible up to the donors' bases in their stock [Code §1366(d)(1)] and are subject to the 50%/30% contribution ceilings that apply to individuals [Code §170(b)(1)]. Treatment is the same for partnerships and LLCs.

A real estate developer who owned 95% of the stock in his corporation proposed that his corporation give charity a golf course and clubhouse. The charity's name was to be changed to honor the donor, who was also to become a member of the charity's board. The IRS ruled that the donor would not be considered to have received a dividend as a result of these "perks" (Ltr. Rul. 9151031). He was entitled to a charitable deduction on his individual return for his proportional share of the fair market value of the golf course. His deduction was limited to his basis in the company [Code §1366(d)(1)(A)]. *Note:* Through 2014, a shareholder's basis in S corporation stock was reduced by an amount equal to the shareholder's pro rata share of the *adjusted basis* of the contributed property. Previously, the basis reduction was equal to the pro rata share of the deduction claimed [Code §1367(a)(2)(B)]. Renewal of this provision has been included in extender bills.

S corporations, partnerships and LLCs can be grantors of charitable remainder trusts that benefit the corporation (term-of-years trusts only) or a shareholder (for life or a term of years).

S corporations can also establish charitable lead trusts. Such trusts may be an effective way for a family corporation to benefit charity and pass valuable appreciating assets to a child of the shareholders – at little or no transfer tax cost (Ltr. Rul. 9512002).

Gifts of S corporation shares to charity – Since 1998, charities have been eligible S corporation shareholders [Code §1361(c)(6)], however items of income, loss, credit or deduction, and any gain on the sale or disposition of the shares, flows through to the charity and is included in computing unrelated business income tax.

Gifts of S corporation shares to charitable remainder trusts – Transferring S corporation stock to an irrevocable charitable remainder trust voids the corporation's S status. However, gifts to *revocable* trusts, including revocable charitable remainder trusts of which the donor is the owner, do not terminate S status [Code §1361(c)(2)(A)(i)].

Bequests under the S corporation owner's will to a lead trust or charitable remainder trust will not void the corporation's S status. However, the trustee must dispose of the stock within two years of the day on which the stock is transferred to the trust [Code §1361(c)(2)(A)(iii)].

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