The Advisor

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ESTATE PLANNER'S TIP

The vast majority of Americans no longer need to worry about estate taxes. That may make annual exclusion gifts less important as a means of reducing a client's gross estate, but there is another reason that clients may want to continue a program of giving to younger family members [Code §2503(c)]. Gifts can be an incentive for children or grandchildren with summer and part-time jobs to establish IRAs. Those with earned income are eligible to contribute up to $5,500 to an IRA in 2015 [Code §408]. If the grandchild does not need the deduction available for funding a traditional IRA, the Roth IRA might be an attractive option. All qualified withdrawals in the future are tax free. How much can a grandchild save? If $5,500 is contributed annually for five years, starting at age 16, the account will be about $452,364 (assuming 6% interest, compounded annually) when the grandchild reaches the full retirement age of 67, even if no further contributions are made. If the grandchild continues putting $5,500 annually into an IRA, the fund will grow to about $1.8 million by the age of 67.

EX-SPOUSE SHARES IN ESTATE TAX

Thomas Smoot, the executor of his father's estate, initially claimed that the estate was not subject to tax, later agreeing with the IRS that the estate owed more than $1.4 million in taxes and interest. The will provided that beneficiaries would be responsible for a pro-rata share of any taxes assessed on the estate for the assets they received. The elder Smoot's ex-wife, Dianne, had received life insurance proceeds, an IRA, a 401(k), an annuity and certain financial assets worth about $5.4 million, which represented nearly 70% of the total estate.

Dianne initially refused to contribute to the taxes, saying that Thomas had taken the position that no taxes were owed. He was precluded from relitigating his contribution claim against her because the parties had signed a settlement agreement resolving "all remaining claims," she argued. The U.S. District Court (S.D. GA) ruled that Thomas could bring the contribution action.

In order for her to be liable for taxes on the proceeds of life insurance policies, the elder Smoot had to have had incidents of ownership over the policies at the time of his death, Dianne claimed.

She argued that Thomas had produced no evidence of such incidents of ownership. Thomas produced affidavits from representatives of the various life insurance companies, which the court ruled were admissible to authenticate the policies.

The court said the policies themselves reflected the incidents in various ways and that Thomas had established the incidents for the policies for which Dianne received proceeds. Dianne was responsible for a pro-rata share of the estate tax, along with the interest [Code §6601(e)(1)], ruled the court (*Smoot v. Smoot*, 2015-1 USTC ¶60,688).

COURT FINDS QUID PRO QUO, NOT GIFT

When David and Barbara Costello granted a land preservation easement to the county over their farm in Maryland, they became entitled to sell their development rights to a developer to use on a different parcel. The couple received $2.56 million for transferring their right to build 16 units elsewhere.

Initially, the county refused to sign the couple's Form 8283, Noncash Charitable Contributions, on which they claimed a deduction of more than $5.5 million. The county's attorney questioned whether they were entitled to a charitable deduction. The Form 8283 was signed after an appraiser reduced the value of the easement to $3.03 million, to account for the money received for the development rights.

The Costellos deducted about $1.06 million on their 2006 return, carrying over the balance to their 2007 and 2008 returns. The IRS disallowed the charitable deduction, saying that the appraisal was not "qualified" under Reg. §1.170A-13(c)(3)(ii)(A); there was no valid appraisal summary accompanying the Form 8283 and there was no donative intent because the arrangement with the county was part of a quid pro quo exchange.

The Tax Court found that the appraisal failed to mention that the sale of the development rights was conditioned on the conveyance of the easement, thereby depriving the IRS of "salient terms of the agreement." Likewise, the appraisal summary was deficient because it did not include the amount of consideration received from the county. The IRS was not apprised of the quid pro quo the couple received from the county nor the $2.56 million received from the sale of the development rights. The court also declined to term the transaction a bargain sale, finding that the couple sold and received money for all the development rights they owned (*Costello v. Comm'r*., T.C. Memo. 2015-87).

PHILANTHROPY PUZZLER

Morris wants to create a charitable remainder trust that will pay him income for life. He's concerned, however, that he might be hit by a cement truck shortly after funding the trust and never receive any income. He has asked whether payments can be guaranteed to continue for the benefit of someone else, should he meet with disaster.

CHARITY MUST DISCLOSE DONORS' NAMES

Charitable organizations that solicit contributions in California are required to register and file an annual report with the state's Registry of Charitable Trusts. An organization's IRS Form 990 Schedule B must be included. The Center for Competitive Politics (CCP) is a 501(c)(3) organization, with a mission of defending "First Amendment rights of free political speech, assembly, association and petition, through research, education and strategic litigation." CCP, which first registered with the state in 2008, had filed redacted Form 990s, omitting the names of significant donors (those giving more than $5,000 in a single year). In 2014, the attorney general's office required CCP to submit an unredacted Form 990.

CCP sued, seeking to prevent the attorney general from enforcing the disclosure requirement. Disclosure infringes on CCP's and its supporters' First Amendment right to freedom of association, CCP argued. The attorney general noted that while documents filed in the Registry are open to public inspection, the Schedule B of Form 990 is confidential, accessible only by in-house staff. The information was necessary to "determine whether a charity is actually engaged in a charitable purpose, or is instead violating California law."

The attorney general should be permitted to demand the names of significant donors only if a subpoena is issued, CCP claimed. The attorney general countered that there is a "compelling law enforcement interest" in the disclosure of the names and that having the information immediately available enables the office to identify "suspicious behavior."

The district court denied CCP's motion for a preliminary injunction, saying the organization was unlikely to succeed on the merits of its claim and could not show that it would suffer irreparable harm. The U.S. Court of Appeals, Ninth Circuit, affirmed, noting that CCP produced no evidence to suggest that significant donors would "experience threats, harassment, or other potentially chilling conduct" as a result of the disclosure. The disclosure requirement bears a substantial relation to a significantly important government interest, said the court, leaving open the possibility that CCP could show "a reasonable probability" that forcing the disclosure of contributors' names will subject them to threats, harassment or reprisals from government officials or private parties (*Center for Competitive Politics v. Harris*, 2015-1 USTC¶50,295).

MOTHER KNEW WHAT SHE WAS DOING

Violet Quirin executed wills in 2005 and 2007 in which her estate was divided equally between her two daughters. In 2010, Quirin contacted an attorney about drafting a new will, saying she had become estranged from the daughters. She wanted to leave her house to her church, her bank accounts to another charity and her personal property to friends. The attorney advised that a will contest might ensue, but Quirin was insistent that the daughters be excluded from receiving under the will. In the will, Quirin acknowledged her "love and respect" for her daughters, but stated that she was making no provision for them.

The attorney and the two paralegals who witnessed Quirin signing the will said they found nothing to suggest that she lacked testamentary capacity. In the months following the execution of her will, Quirin discussed her plan with the person named as executrix, indicating that she was "adamant" about leaving it as written.

The 2010 will was admitted to probate following Quirin's 2011 death, but one of her daughters petitioned to have the 2007 will probated instead, claiming Quirin lacked testamentary capacity. The district court confirmed the probate of the 2010 will.

The Supreme Court of Montana noted that, in general, testamentary capacity requires that the testator be aware of the nature and act to be performed, the nature and extent of the property to be disposed of and the objects of his or her bounty. The district court did not err in granting summary judgment based on its finding of Quirin's awareness of these three elements, ruled the Supreme Court (*In re Estate of Quirin*, 2015 MT 132).

PUZZLER SOLUTION

One way to guarantee that payments last for a minimum length of time is to use a term-of-years trust, with Morris receiving income for up to 20 years. He would name another beneficiary to receive payments in the event he died within the 20-year term of the trust (Rev. Rul. 74-39, 1974-1 C.B. 156). Or he could create a trust that lasts for his life and then pays income to another beneficiary for the shorter of the beneficiary's life or a term of years (up to 20) [Reg. §§1.664-2(a)(5)(i), 1.664-3(a)(5)(i)].

CASH ISN'T ALWAYS KING WHEN IT COMES TO GIVING

The number of taxpayers claiming charitable deductions for noncash gifts increased in 2012, according to the IRS's latest *Statistics of Income Bulletin*. In total, taxpayers who itemized their deductions claimed $49 billion on 22.2 million returns. About one-third of those returns included Form 8283, which is required when noncash deductions exceed $500.

Gifts of stock were the largest share of the noncash gifts, totaling $16.8 billion. Clothing and household items represented $9.3 billion and $3.7 billion respectively. Despite the disparity in total dollars, only 118,600 returns included stock donations, versus 8.7 million returns with clothing and household item donations. The average stock donation was $141,448 per return.

Other categories of noncash gifts include mutual funds (15,528 returns, $110,607 average per return), real estate (4,961 returns, $163,134 average per return), easements (1,114 returns, $872,250 average per return), art and collectibles (100,293 returns, $11,799 average per return), food (229,908 returns, $523 average per return), cars and other motor vehicles (154,093 returns, $1,930 average per return), planes, boats and other vehicles (5,574 returns, $30,000 average per return) and airline tickets and miles (2,065 returns, $1,369 average per return).

Who gave the most? Taxpayers ages 65 and older who filed Form 8283 gave the most in terms of the total amount of both cash and noncash contributions – $14.2 billion in cash contributions and $15.8 billion in noncash contributions. The average noncash donation for this age group was $12,418 per return.

Clients considering noncash gifts to charity should be aware of some of the special rules that apply:

- Donors who give noncash gifts valued at more than $500 must obtain a receipt from the charity and file Form 8283.

- A qualified appraisal is required if the value of noncash gifts exceeds $5,000. No appraisal is required for gifts of publicly traded securities or for gifts of closely held stock worth less than $10,000.

- The deduction for a gift of a car, boat, plane or other vehicle is generally limited to the gross proceeds received by the charity upon a sale [Code §170(f)(12)(A)(i)]. Charity must provide the donor with the amount of the sale price on Form 1098-C, Contributions of Motor Vehicles, Boats and Airplanes.

- The deduction for a gift of tangible personal property (artwork, antiques, collectibles) is limited to the lower of the donor's basis or fair market value if the gift is not put to a related use by the charity [Code §170(e)]. If the item is related to charity's exempt purposes, the donor may deduct up to the fair market value.

- The deduction limit for long-term capital gain property given to a public charity is 30% of the donor's adjusted taxable income for the year [Reg. §1.170A-8(d)(3)]. Excess deductions may be carried over for up to five additional years.

- A gift of stock is considered complete on the date the shares reach the charity's account, where an electronic transfer is used. The value of the gift is the average between the high and low selling price on the date of the gift. The mailbox rule applies if the donor mails stock certificates and stock power forms.

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