The Advisor

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ESTATE PLANNER'S TIP

One question facing retiring clients may be whether to leave 401(k) assets in the employer's plan, if allowed, or roll the savings over to an IRA. Fees, which can be higher in an IRA, are a consideration. The client should check the employer's fee disclosure statement to determine the charges, in order to compare with an IRA. IRAs generally have a broader range of investment options, including stocks, bonds and exchange traded funds. These may not be available in an actively managed 401(k), although the client may prefer to rely on the expertise of those administering the 401(k) to monitor mutual funds. Clients who are still working may have the option to take a loan from a 401(k), but not from an IRA. In addition, creditor protection may be stronger with 401(k) plans, which are subject to federal law. Beneficiary options are generally greater with an IRA. Under federal law, a surviving spouse is entitled to the 401(k) unless a waiver has been signed; an IRA, on the other hand, can be left to other family members who can stretch out IRA distributions over several decades.

IS THIS REALLY EASIER?

Code §170(f)(8)(A) requires donors to obtain a contemporaneous written acknowledgment to substantiate charitable gifts of $250 or more. To be contemporaneous, the acknowledgment must be in the donor's hands on or before the *earlier* of the date the taxpayer files a return on which the deduction is claimed or the due date (with extensions) for filing the return for the year of the gift [Code §170(f)(8)(C)]. The acknowledgment must include the amount of cash or a description of any noncash gift and either affirmatively state that no goods or services were provided by the charity in return for the gift or give a description and good faith estimate of the value of any quid pro quo.

An acknowledgment is not necessary if the donee organization files a return, on such form and in accordance with regulations the IRS may issue, that includes the information required in

Code §170(f)(8)(B) [Code §170(f)(8)(D)]. However, until now, the IRS had declined to issue regulations to permit donee reporting, saying the current system works with minimal burden on donors and charities and the IRS had received few requests for a donee reporting system. Some donors who lacked written acknowledgments claimed that the charity could salvage the deduction by filing an amended Form 990, even many years after the gift. The IRS takes the position that donee reporting cannot be done via Form 990 (Ltr. Rul. 201120022).

The IRS now says that it plans to issue an information return specifically for reporting donors' gifts. To protect donors from identity theft, information on the return will pertain only to a particular donor. Charity will have to include the same gift and quid pro quo information as a contemporaneous written acknowledgment, in addition to the donor's name, address and Social Security number. This form will be sent to both the IRS and the donor no later than February 28 of the year following the gift. Charities will not be required to use this reporting method, but if they do not, donors must obtain a written acknowledgment (NPRM REG-138344-13).

PHILANTHROPY PUZZLER

Earlier this year, Bob contributed a large block of stock that had grown only slightly in value. Bob mentioned this gift to his tax advisor when they met for his year-end review. The tax advisor informed Bob that his charitable deduction appears to exceed the 30%-of-AGI limit [Code §170(b)(1)(B)] for gifts of appreciated property. He can carry over the excess deduction to later years, but Bob is retiring at the end of 2015 and knows that his income in 2016 will be significantly lower than 2015, making it harder to claim the full deduction. Does Bob have any other options?

Note: The call for an alternative to the contemporaneous written acknowledgment came primarily from donors whose deductions were denied when they lacked the documentation. The denial of the deduction generally came when it was too late to correct the situation. This alternative to the written acknowledgment is not likely to salvage any deductions, however, since information returns filed after February 28 of the year following the gift will not qualify. In addition, this method requires charities to obtain the donor's Social Security number, which donors may be reluctant to provide.

CONSERVATORS CAN'T MAKE CHARITABLE DISTRIBUTIONS ON BEHALF OF WARD

Cody Wade lived with his paternal grandparents, Ronnie and Reba Wade. In 2007, when he was age 18, Cody was left permanently physically and mentally disabled as a result of improper medical treatment following an earlier auto accident. Cody's parents consented to the appointment of the grandparents as his co-conservators. Relations between the Wades and Cody's mother, Kimberly Casner, were "acrimonious," involving attempts on Casner's part to modify the court's conservatorship.

In early 2014, after settlement of a medical malpractice action, the Wades sought court approval of a supplemental needs trust (SNT) to be funded with the settlement proceeds. The SNT provided that, at Cody's death, remaining trust assets would be used to pay any taxes and administrative expenses and then to reimburse state agencies for amounts paid on Cody's behalf. Any assets remaining after the reimbursement would be distributed in equal shares to two charities selected by the Wades. Casner objected, saying the court did not have the authority to approve any distribution of the residue other than by intestate succession.

The trial court amended the SNT, providing that any distributable funds remaining at Cody's death were to pass under Tennessee's laws of

intestate succession. The Wades appealed.

The Court of Appeals of Tennessee said the Wades cited no statute or case law to support their argument that the trial court has authority to approve the remainder provisions in their proposed SNT. The court noted that the couple is not seeking to effectuate the provision of Cody's will, since he never executed a will prior to becoming disabled, but rather to change the character of his property and circumvent the laws of intestate succession through the remainder provisions of the irrevocable SNT. A comment in the Restatement (Third) of Trusts provides that the legal representative "may also make charitable and other inter-vivos gifts of the property of a minor or incompetent person" to the extent authorized by the appropriate court. The court noted, however, that the power of a court to dispose of an incompetent's estate "to persons to whom the incompetent was under no legal obligation" must be exercised with "great caution."

The Wades were asking permission "to make what effectively is a testamentary decision" on Cody's behalf. The court said it found no legal authority allowing a court to do so (*In re Wade*, No. W2014-01769-COA-R3-CV).

NO DEDUCTION WHERE CHARITY'S SHARE COULD VANISH

The entire residue of John Dimarco's estate was to pass to the church he regularly attended and the pastor was designated as executor of the estate. Because Dimarco had been attending two churches just prior to his death, both pastors agreed to serve as co-executors.

About five months after Dimarco's death in late 2008, several cousins retained a lawyer regarding their potential interests in his estate. The New York Attorney General's office also appeared on behalf of the charitable beneficiaries.

In April 2012, the parties reached the first settlement, which called for Dimarco's heirs at law to receive one-third of the gross probate estate, with the two churches each receiving one-third. Each share was worth approximately $173,250. The Surrogate's Court finally admitted the will to probate in May 2012. In December, 2012, after Dimarco's estate was liquidated, a further settlement was reached, calling for distributees to pay their attorney fees directly from their settlement shares.

The estate filed an untimely Form 1041 for the 2010 tax year in April 2012, reporting total income of $335,854 and claiming a charitable deduction under Code §642(c)(2) of $314,942, for amounts permanently set aside for charitable purposes. The IRS determined a deficiency, saying the estate was not entitled to the deduction because the possibility that the amount set aside for charity would pass to non-charitable beneficiaries was not "so remote as to be negligible" [Reg. §1.642(c)-2(d)].

The Tax Court found that during the tax year at issue, the estate "was in the midst of an ongoing legal controversy," adding that the dispute was not fully resolved at the time the tax return was filed. The court noted that the charity's funds were not set aside in a segregated account. All estate funds were held in a general account from which estate expenses were paid. It wasn't until late January 2013, when the court accepted the second settlement, that all issues were resolved, said the court (*Estate of Dimarco v. Comm'r.*, T.C. Memo. 2015-184).

PUZZLER SOLUTION

Bob may elect on his 2015 return to limit his deduction to the basis in the stock, rather than the fair market value. He will then be entitled to the more generous 50%-of-AGI limit [Code §170(b)(1)(C)(iii)]. However, the election would have to apply to *all* contributions of 30% capital gain property to charity for the year and to carried-over deductions from prior years [Reg. §1.170A-8(d)(2)(i)(a)].

A GIFT TO CHARITY OR TO A PERSON?

It's clear that a client's transfer of funds to a college to establish a scholarship for the client's child or grandchild is not a charitable gift. But at what point does a gift to charity cross the line and become a gift to an individual? The IRS and the courts have addressed this issue, and many charities wrestle with donors wishing to make gifts with strings attached.

In one of the foremost cases in this area – *S.E. Thomason v. Comm'r.*, 2 T.C. 441 (1943) – the court held that "charity begins where certainty in beneficiaries ends, for it is the uncertainty of the objects and not the mode of relieving them which forms the essential element of charity." In *Thomason*, the taxpayer made transfers to a boys' school on behalf of a student who was a ward of the Illinois Children's Home and Aid Society. The Tax Court found the payments were gifts for the benefit of a particular individual, not contributions to or for the use of charity. The IRS reached the same conclusion in Rev. Rul. 61-66 (1961-1 C.B. 19), in which it ruled that a payment to a university to fund the research of a particular professor was in fact a gift to the professor. The IRS found that the university was merely a conduit because it had no discretion over the use of the funds. Even where funds are paid directly to charity, if there is a reasonable expectation that the money will be used for a particular individual, no deduction is allowed (TAM 9405003).

The test, said the IRS in Rev. Rul. 62-113 (1962-2 C.B. 10), is whether the charity has control over the donated funds and the discretion as to their use, in order to ensure the contribution will be used to carry out the organization's mission. This ruling involved gifts to a missionary fund designed to reimburse missionaries for approved expenses above and beyond those covered by the missionaries' parents, families and friends. A gift to the fund by a missionary's parent was deductible if the funds are not earmarked only for their son's use. However, in *Peace v. Comm'r.* [43 T.C. 1 (1964)], the court allowed a deduction by a donor who listed the names of certain missionaries on checks sent to the missionary fund. The court said the donor's intent was to contribute to the common fund of the mission, to be used as the mission saw fit.

The U.S. Supreme Court also weighed in on the issue in *Davis v. U.S.*, 90-1 USTC ¶50,270 (1990), in a case involving transfers to cover missionaries' expenses. Parents claimed deductions for funds deposited in their sons' bank accounts, which the sons pledged to use in accordance with church restrictions. The court noted that, although there was no evidence the sons misspent the funds, allowing a deduction in such situations "would create an opportunity for tax evasion that others might be eager to exploit." The court found that the church had no right to the money or cause of action against missionaries who misused the funds.

In another ruling, the IRS permitted a charitable deduction where a couple's contribution to an organization was accompanied by a request that the funds be used to support the work of a particular individual (Ltr. Rul. 200250029). The charity supported the composition and performance of musical works by entering into agreements with professional arts institutions to commission works to be performed by the institutions. The charity did, in fact, enter into an agreement with an organization to commission and perform the composer's work, but the IRS found that the donors' gift was not impermissibly earmarked for the composer because they had no assurance the charity would use the funds to support the composer's work.

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