The Advisor

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ESTATE PLANNER'S TIP

Four states – Florida, Nebraska, Ohio and Tennessee – have recently begun offering tax-advantaged ABLE 529 plans to help parents of disabled children. Plans in other states are expected to be available in the coming months. Similar to 529 college plans, ABLE (Achieving a Better Life Experience) plans allow contributions up to the annual gift tax exclusion amount ($14,000 in 2016). Amounts contributed grow tax-free and can be withdrawn tax-free to cover qualified disability expenses of the beneficiary. Amounts in ABLE funds are not included in the $2,000 limit on personal assets used in determining eligibility for Medicaid and Supplemental Security Income benefits, although if the ABLE fund exceeds $100,000, SSI benefits will be suspended until the account drops below that amount. ABLE accounts can cover education, housing, transportation, healthcare, prevention and wellness, employment support, assistive technology and personal support. Eligible beneficiaries include any individual receiving SSI or disability benefits or certain individuals with a medically determined physical or mental impairment. ABLE plans will not eliminate the need for special needs trusts, which can be funded in larger amounts and can be used for a greater variety of personal expenses.

STATE COURT'S ORDER CAN'T CIRCUMVENT FEDERAL TAX LAW

George and Sybil lived in a community property state. Mike, the couple's son, was sole beneficiary of George's three IRAs. After George's death, Sybil filed a claim against the estate for her half interest in the community property. A court-approved settlement directed the IRA custodian to assign a portion to Sybil as a spousal rollover IRA.

The IRS declined to rule on whether the portion of Mike's inherited IRAs assigned to Sybil was classified as her community property interest, saying that was a matter of state law.

As to the assignment of the IRA, the IRS noted that Sybil was not the named beneficiary. Code §408(g) provides that the rollover rules of Code §408 must be applied without regard to any community property laws. Therefore, ruled the IRS, Sybil's community property interest is disregarded. She cannot be treated as a payee of the inherited IRA for Mike and may not rollover any amounts of the inherited IRA. Any assignment of an interest in Mike's inherited IRA to Sybil is treated as a taxable distribution to Mike. The IRS added that the state court's order "cannot be accomplished under federal tax law" (Ltr. Rul. 201623001).

POST-DEATH MOVES REDUCE DEDUCTION

Victoria Dieringer owned most of the shares of DPI, a closely held corporation, with the balance owned by her sons. The shares passed to a trust at her death. The trust provided for $600,000 in specific charitable bequests, with the remainder passing to her private foundation. Her children received no monetary bequests under the will or trust. The DPI shares were appraised at more than $14 million at her death.

Several months after Dieringer's death in 2009, her sons voted to elect S corporation status for DPI. Because of concerns about excess business holdings [Code §4943], DPI voted to redeem the foundation's shares in exchange for promissory notes. The sons, on behalf of DPI, executed a short-term promissory note for $2,250,000 and a long-term note for $3,776,558 (later amended to $2,968,462). The sons said the drop in market value between Dieringer's death and the appraisal was due to a poor business climate. On its tax return, the foundation reported receipt of a noncash contribution of DPI stock valued at $1,858,961 and the two promissory notes, along with significant capital losses on the stock sales. Dieringer's estate reported a charitable deduction of $18.8 million, based on the date of death value of the DPI stock. The IRS reduced the deduction to reflect the amount received by the foundation.

Property in an estate is generally valued at its date of death value [Code §2032]. An election can be made to use the alternate valuation method if doing so will decrease the value of the gross estate [Reg. §20.2032-1(b)]. The estate argued that because the alternate valuation date was not elected, the charitable deduction was the date of death value of the stock, not the amount received by the foundation. The Tax Court agreed with the IRS that Dieringer's sons "never intended to effect decedent's testamentary plan." The court said post-death events did not support the substantial decline in the value of DPI shares in just seven months. The sons "thwarted" Dieringer's plan by the redemption, and the estate therefore was not entitled to the full amount of the claimed charitable deduction (*Estate of Dieringer v. Comm'r.*, 146 TC 8).

PHILANTHROPY PUZZLER

Gloria created a testamentary charitable remainder trust for her daughter, Gwen, funding it with rental property. Gwen would prefer to receive the full value of her share immediately. She suggested, and the remainderman agreed, that the building be sold and the proceeds be distributed according to the parties' actuarial interests. Gwen has asked what the tax consequences of the transaction will be.

NO RELIANCE, NO CLAIM

The Educational Institute Torah-Oholei Menachem filed a Surrogate's Court petition in 2011 to determine the validity of its claim against the estate of Isaac Kramer. The Institute was seeking $1.8 million, based on a pledge card and promissory note Kramer signed in 2006. The court granted cross motions by several cousins to dismiss the Institute's motion for summary judgment.

The Supreme Court of the State of New York, Appellate Division, noted that charitable pledges have been upheld on the general theory that they constitute a unilateral offer of a donor to make a future gift. The donee charity is assumed to have accepted the gift by the incurring of a liability or detriment. Once accepted, a binding contractual obligation is enforceable against the donor.

The Institute failed to show that it had incurred a liability in reliance on Kramer's pledge. Therefore, ruled the court, the Institute's motion for summary judgment was properly denied (*In re Kramer*, 2016 NY Slip Op 4221).

REFORMATION REQUEST FOR TAX PURPOSES ONLY DENIED

Charles Sukenik's inter vivos trust provided that upon his death, his wife, Vivian, would receive certain real property, with the balance of the trust passing to the couple's private founda-

tion. In 2009, he executed an IRA beneficiary designation form naming Vivian as the death beneficiary.

Following Charles' death in 2013, Vivian asked the Surrogate's Court of New York to reform the trust to add a pecuniary bequest to Vivian in an amount equal to the balance in Charles' IRA ($3.2 million) and reform the IRA beneficiary designation form to name the foundation. This reformation would allow Vivian to avoid the receipt of income in respect of a decedent, resulting in a more "tax efficient" distribution.

Courts have the power to reform an instrument when needed to achieve a decedent's intent. They will rarely use this power to correct a mistake, unless required to prevent the testator's intent from being subverted. Reformations generally are not done simply to maximize available tax exemptions or deductions. The change Vivian requested is not prompted by a drafting error or subsequent change in the law, said the court, noting that Charles himself "thwarted the tax efficiency of his own estate plan" by making Vivian the beneficiary of the IRA.

Vivian's arguments rest on the assumption that those executing testamentary instruments intend to minimize taxes, but nothing points to Charles' intent to reduce taxes. The court found no authority to reform a "clear and unambiguous instrument" in order to remedy the adverse tax consequences of poor estate planning. Doing so "would open the flood gates to reformation proceedings aimed at curing any and all kinds of inefficient tax planning," said the court, which denied the reformation petition (*In re Reformation Proceedings in the Estate of Sukenik*, 2016 NY Slip Op 31217(U)).

DONOR TAKES WRONG TURN WITH CAR DONATION

Jamshed Chaudry contributed a car to charity in 2010, for which he claimed a charitable deduction of $6,231. He claimed a $4,000 deduction for noncash gifts in 2011, along with $200 for cash contributions. The IRS allowed a deduction of $1,469 for the car and disallowed his entire 2011 deduction.

Chaudry told the Tax Court that the average value for the car provided by several car dealers he approached was $3,000. The court allowed an additional deduction of $1,531 – the difference between what the IRS allowed and the $3,000 valuation. Because Chaudry had nothing to support the contributions he claimed in 2011, the IRS's disallowance was sustained (*Chaudry v. Comm'r.*, T.C. Summ. Op. 2015-74).

Note: Since 2004, the deduction for a gift of a vehicle (cars, boats, airplanes) is generally limited to the gross proceeds received by the charity upon a sale [Code §170(f)(12)(A)(i)]. Charities must report the sale to the IRS using Form 1098-C, Contributions of Motor Vehicles, Boats and Airplanes, which may also be used to provide the donor with contemporaneous written acknowledgment of the gift.

FORM 990 NOW ONLINE

The information provided on Form 990, Return of Organization Exempt from Income Tax, includes data that can be of use to donors making decisions about their charitable contributions. The IRS recently announced that electronically filed forms are available online in machine readable format through Amazon Web Services. Forms from 2011 to the present may be downloaded. Form 990-N, filed by some small exempt organizations, is not yet available, but can be accessed at IRS.gov. Donor information is not included (IR-2016-87).

PUZZLER SOLUTION

The funds Gwen will receive are not considered unitrust payments and therefore are not taxed under the four-tier system. Instead, the payment is in exchange for Gwen's life interest and she will recognize capital gains to the extent the income received exceeds her basis [Code §1001(a)]. She is not entitled to the usual step-up in basis for property acquired from a decedent, however. Under Code §1001(e)(1), the general rule does not apply where the beneficiary is disposing of a life interest acquired from a decedent (Ltr. Rul. 8948023).

HIDDEN TRAPS LURKING WHEN CREATING CHARITABLE REMAINDER TRUSTS

Clients come to your office for estate planning advice, saying they wish to benefit a favorite charity. After they leave, you review Code §664 and related regulations, dealing with charitable remainder trusts, but that might not be enough to avoid estate planning disasters.

Ruby and Pearl, two elderly sisters, own farm land inherited from their parents. They have been renting the acreage to a farmer, but now want to increase their income. They've heard about charitable remainder trusts and want to use the land to fund a trust that would make distributions for their lifetimes before the assets would pass to several favorite organizations.

At first glance, a unitrust appears to be an ideal solution to selling the land and reinvesting for greater income. And nothing in Code §664 would seem to prevent the arrangement. However, the IRS has ruled on two occasions that a trust with multiple grantors constitutes an "association," not a charitable remainder trust (Ltr. Ruls. 9547004, 200203034). The issue is not a problem where spouses are involved. In Ltr. Rul. 9547004, grandparents and their six grandchildren proposed to contribute to a unitrust for their joint benefit. The IRS said the grantors were associates who "pooled their assets with an object to carry on business and divide the gains therefrom."

Each sister could, instead, contribute her 50% undivided interest in the land to an individual, two-life trust. By retaining the right to revoke the other's interest at death [Reg. §§1.664-2(a), 3(a)(4)], the survivorship benefits would be incomplete gifts for gift tax purposes.

Leon wants to create a net-income with make up charitable remainder unitrust paying to him for his life and then to his daughter, Sally, for her life.

Again, Code §664 doesn't seem to present any obstacles to the plan. However, in valuing Sally's interest for gift tax purposes, Leon's income interest would be zero, making the entire income interest subject to gift tax. And because Sally does not have a present interest, the annual exclusion would not apply. Under Reg. §25.2702-1(b), the value of the gift in trust is determined by subtracting the value of the interest retained by the transferor, unless the retained interest is a qualified interest. There is an exception in the case of a charitable remainder trust, but only if the survivor beneficiary is the grantor or the grantor's spouse [Reg. §25.2702-1(c)(3)]. Leon could opt to use a standard unitrust or a net-income unitrust without a make up provision, both of which also fall under the exception.

Genevieve, who recently remarried, wants to include a testamentary charitable remainder annuity trust in her estate plan. She wants the annuity to be paid to her husband for his life and then to her son for his life.

The estate tax marital deduction is available where the decedent transfers a qualified income interest for life, but the surviving spouse must be entitled to all income [Code §2056(b)(7)]. Because Genevieve's husband would receive only the annuity amount, it might appear that his interest would not qualify for the marital deduction. A special exception exists, however, for an income interest in a charitable remainder trust [Code §2056(b)(8)], provided the surviving spouse is the only noncharitable income beneficiary. By including her son, the marital deduction would be lost.

Genevieve could create a QTIP trust that, at her husband's death, would pour into a charitable remainder trust with her son as the sole income beneficiary. This preserves the marital deduction and the benefits to her son and charity.

BALL STATE UNIVERSITY FOUNDATION
P.O. Box 672, Muncie, IN 47308
(765) 285-8312 • (765) 285-7060 FAX
Toll Free (888) 235-0058
www.bsu.edu/bsufoundation

Cherí E. O'Neill
President and CEO

Philip M. Purcell, J.D.
Vice President for Planned Giving and Endowment Stewardship

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