

The Advisor



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ESTATE PLANNER'S TIP

Men and women over age 65 represent more than one-third of U.S. households occupied by people living alone. These clients may have special planning needs regarding end-of-life care. Advisors should alert singles and surviving spouses to the issues of assisted living, nursing home care and medical expenses. The clients may require someone to handle financial matters if they become disabled and should plan ahead in the event they are no longer able to live independently. These concerns are in addition to the usual estate planning issues facing all clients, such as the need for a living will and health care power of attorney. If the client has no close family members or friends who can perform these services, advisors can help by investigating services in the community that can assist clients.

IRA LOSSES NOT DEDUCTIBLE

Ronald Fish purchased shares of two master limited partnerships in his IRA. He received a 1099-R showing 2009 distributions of \$40,585, which he included on his tax form. Fish also received K-1s from the partnerships showing ordinary business losses totaling \$88,868, which he reported on his Schedule E. The IRS disallowed the deduction.

Fish claimed that an IRA has all the attributes of a grantor trust, making it a pass-through entity. The Tax Court disagreed, saying that a taxpayer may recognize a loss from an IRA only when

all amounts from IRA accounts have been distributed and the total distributions are less than the taxpayer's unrecovered bases in the accounts [Code §§72, 408(d), 7701(a)(37)]. Fish argued that requiring complete liquidation of an IRA in order to recognize a deductible loss is "unreasonable, arbitrary, capricious and completely unworkable for savers" dependent on the income for retirement.

The court denied the deductions, saying losses realized in Fish's IRA could not be used to offset income for the year (*Fish v. Comm'r.*, 110 TCM 260).

MORE PAPERWORK FOR EXECUTORS

Executors of estates subject to estate tax now have one more reporting requirement: the value of assets included in a decedent's gross estate. Under Code §6035, added as part of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, executors of estates required to file a return under Code §6018(a) must furnish to the IRS and to the person acquiring any interest in property included in the gross estate a statement identifying the value of the interests. The goal of Form 8971 is to prevent a beneficiary from using a basis exceeding the value as finally determined for federal estate tax purposes. This applies to executors required to file a return if the return is filed after July 31, 2015 (Notice 2016-19).

DEDUCTION LIMITED TO WHAT IRS ALLOWED

Terence and Lynn Barnes made multiple donations of clothing and household items to a resale shop, for which they received receipts. They claimed deductions of \$2,122 and \$2,510 respectively for 2010 and 2011. The IRS disallowed all but \$1,000 for each year.

The couple produced summary sheets for the

Tax Court showing the items donated, the purchase price and the value at the time of the donations. Some values were determined by the charity's donation value guide. The sheets detailed noncash items totaling \$5,030 and \$4,230 for the two years, although the couple's actual deductions were much less.

The court noted that some of the items purportedly contributed did not appear on any of the receipts. In general, donors lacking receipts from the charity are required to keep reliable written records that include the name and address of the donee organization, the date and location of the gift, a description of the property in reasonable detail, the fair market value at the time of the gift and the method for determining the value on the date of the gift.

There's "no doubt" that the couple made gifts, the court said, but they did not provide "adequate documentation" to establish the value of the gifts. They did not contemporaneously attach values to the items listed on the receipts and the list of donated items on the receipts did not corroborate the summary sheet the donors prepared. Therefore, ruled the court, they were not entitled to deductions in excess of what the IRS allowed (*Barnes v. Comm'r.*, T.C. Memo. 2016-79).

PHILANTHROPY PUZZLER

Geoff is the executor of his uncle's estate. The will included several specific bequests to his uncle's favorite charities. In compiling the inventory, Geoff discovered that the estate included nearly \$200,000 in U.S. savings bonds with unreported interest. The accountant mentioned that the interest is considered income in respect of a decedent and that family members who receive the bonds will owe income tax [Code §691(a)(1)]. Geoff asked whether he could instead satisfy the charitable bequests using the savings bonds (since charities are tax-exempt) and thereby allow family members to avoid the tax. Will this work?

DONOR LIST NEED NOT BE DISCLOSED

Americans for Prosperity Foundation (AFP), a 501(c)(3) organization, sought to permanently enjoin the Attorney General of California from requiring Schedule B of Form 990 in order to register in the state. Schedule B includes the names and addresses of donors giving more than \$5,000 during the year. Form 990 is available to the public, but Schedule B is not [Code §§6104(b), (d)(3)(A)]. From 2001 to 2010, AFP filed and the attorney general accepted Form 990 without Schedule B. In 2013, AFP was notified that its filing was incomplete because it did not include an unredacted Schedule B.

In February 2015, the U.S. District Court (CD CA) granted a preliminary injunction, finding that AFP had “raised serious questions.” AFP argued that the court was not bound by the Ninth Circuit Court of Appeals ruling in *Center for Competitive Politics v. Harris* [784 F.3d 1307] that the Schedule B requirement was not facially unconstitutional. The District Court, which agreed that the record before the court “is much denser now,” said it was focusing “solely on AFP’s as-applied challenge.”

The attorney general cited a “compelling interest in enforcing the law and protecting the public,” adding that there was no actual burden on First Amendment rights. Having the information from Schedule B allows the attorney general “to determine whether an organization has violated the law, including laws against self-dealing, improper loans, interested persons, or illegal or unfair business practices.” The court found, however, that the attorney general was “hard pressed” to pinpoint a single witness to corroborate the necessity of the Schedule B in conjunction with the office’s investigations. Even if the office could, the court found the disclosure demand “more burdensome than necessary.”

Trial testimony indicated that auditors “seldom use Schedule B” when investigating charities, noting only five instances in 540 investigations over the prior decade. Relevant information could be obtained from other sources, according to the testimony.

The court said that while the Ninth Circuit “foreclosed any facial challenge to the Schedule B requirement,” it left open the possibility that a charity could show “a reasonable probability” that the compelled disclosure of names will subject the organization’s donors to threats, harassment or reprisal that would warrant relief on an as-applied challenge. The court said it was “more than satisfied” that such a showing was made, with evidence presented that AFP employees, supporters and donors faced public

threats, harassment, intimidation and retaliation once their support became publicly known.

Although the attorney general claimed that Schedule B was not available for public viewing, the court found the office “has systematically failed to maintain the confidentiality of Schedule B forms,” with staff members testifying that in separating confidential information from public filings, “there is room for errors to be made.” In fact, AFP pointed to more than 1,400 Schedule Bs posted for viewing on the attorney general’s public website. The court found this disclosure “irreconcilable” with the assurance of confidentiality. AFP has “suffered irreparable harm,” said the court, noting that the attorney general’s threat to cancel the organization’s charitable registration would “preclude it from exercising its First Amendment right to solicit funds in California.” The attorney general’s office does not review Schedule Bs upon collection and virtually never uses them to investigate wrongdoing, said the court. The disclosure requirement burden on First Amendment rights outweighs any “negligible burden” of an injunction on the attorney general (*Americans for Prosperity Foundation v. Harris*, Case No. CV 14-9448-R).

PUZZLER SOLUTION

Where charity receives U.S. savings bonds at death, the income tax generally can be avoided. However, if savings bonds are used to satisfy pecuniary bequests, it is considered a sale or exchange of the property [*Keegan v. Comm’r.*, 114 F.2d 217]. The estate would recognize the unreported increment in the redemption price and pay income tax. There is an exception if the bonds are included in the residue and the entire residue passes to charity [Reg. §1.691(a)-4(a)]. If the will had directed that the charitable bequests were to be satisfied using the bonds, the tax could have been avoided.

HIS, HERS AND CHARITY'S

Second spouse or kids from the first marriage? That is often the dilemma facing IRA owners when naming beneficiaries. Naming a spouse allows the survivor to set up a new IRA in his or her own name and take distributions according to IRS tables.

Drawbacks: There's no guarantee the survivor will name the deceased spouse's children at his or her death or that funds in the IRA will not have been depleted during the surviving spouse's lifetime.

Naming children as the designated beneficiaries allows them to establish inherited IRAs, spreading out the payments over their life expectancies. **Drawbacks:** While the children can establish inherited IRAs, there's nothing to stop them from withdrawing the funds immediately, even if they have to pay the tax. This option also provides no security for the surviving, second spouse.

What are some more reliable options in the case of second marriages?

- Leave the entire IRA to the surviving spouse and purchase life insurance to replace the assets for children.

- Create two IRAs – one for the spouse and one for children. While this works for IRAs, it may not be an option for 401(k) plans which automatically pass to the surviving spouse under federal law unless the spouse has executed a waiver.

Clients who are charitably inclined might want to consider a plan that provides income for life to the surviving spouse, followed by income to children and then a gift to charity. Normally, spouses with children from a previous marriage will use a QTIP trust to assure that assets pass to named beneficiaries at the death of the survivor

[Code §2056(b)(7)]. The survivor receives all trust income for life and remaining assets pass outright to children.

A QTIP charitable remainder trust [Code §2056(b)(8)(A)] differs from a standard QTIP, since it provides only an annuity or unitrust payment (minimum 5%) to the surviving spouse, who must be the only noncharitable beneficiary. The trust cannot pay income to children following the death of the surviving spouse, prior to passing to the charitable remainderman. It is possible, however, to establish a QTIP trust, with trust assets passing to a charitable remainder trust at the death of the survivor (Ltr. Rul. 9122029).

What advantage is there to funding the trust with retirement assets? The biggest may be the flexibility in taking withdrawals. Normally, a surviving spouse can roll assets from a deceased spouse's estate into an IRA and continue to defer income tax [Code §402(a)(7)]. But distributions prior to age 59½ are generally subject to a 10% penalty in addition to any income tax owed, making distributions to a young widow or widower more expensive. Older surviving spouses may also have a problem. Distributions from IRAs must begin by April 1 of the year following the year when the owner turns age 70½, whether the money is needed or not. Mandatory payouts, based on the life expectancy of the surviving spouse, can become extremely large for an IRA owner in his or her mid- to late-80s. And again, there is no guarantee that the survivor will name the children from the deceased spouse's first marriage or that a significant portion of the IRA will remain at the survivor's death. Like the IRA, a qualified charitable remainder trust is tax-exempt.

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