The Advisor

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ESTATE PLANNER'S TIP

As clients prepare to file their 2015 income tax returns, they should watch for signs that their identity might have been stolen and fraudulent returns filed in their name. An IRS notice about a tax return the client did not file, income not received or an unknown employer might be a red flag. Clients should review their credit reports annually from the three reporting services and also review their Social Security records to determine if any unknown income has been reported. Statements from a health insurance carrier showing claims for care never received might be another indication of identity theft. Clients should use this time of year to examine credit card and bank statements for any irregularities. Signing up for direct deposit of Social Security benefits and income tax returns from the IRS are also recommended. Both advisors and their clients should shred documents with personal and financial information, such as past tax returns, bank and brokerage statements and credit card bills, rather than throwing these in the trash.

IRS HAS SECOND THOUGHTS

In late 2015, the IRS issued proposed regulations (NPRM REG-138344-13) giving charities an alternative to contemporaneous written acknowledgments to substantiate gifts of $250 or more. Code §170(f)(8)(A) requires donors to obtain a written acknowledgment including the amount of cash or a description of other property and either affirmatively stating that no goods or services were provided by the charity or describing any quid pro quo, along with a good faith estimate of the value.

Donors need not obtain the acknowledgment if the charity files a return, on such form and in accordance with regulations the IRS may issue, that includes the required information [Code §170(f)(8)(D)]. In Ltr. Rul. 201120022, the IRS indicated that it had not issued such an acknowledgment form and that the charity could not provide the information on Form 990.

Under the proposed regulations, charities would have to issue a separate information return for each donor, to avoid identity theft. The form would have to be provided to both the donor and the IRS no later than February 28 of the year after the gift, and would have to include the donor's name, address and Social Security number. Charities would not be required to use this form, but if they did not, donors would be responsible for obtaining a written acknowledgment.

The proposed regulations were withdrawn in early 2016, after the IRS received numerous public comments expressing "significant concerns" about charities collecting and maintaining donor Social Security numbers. The IRS determined that this method would not lessen the reporting burden imposed on charities.

TAXES COME BEFORE FUNDING, COURT SAYS

Hillsdale College was to receive $1 million outright from the estate of Mitzi Olson, and was also the remainder beneficiary of two testamentary charitable remainder unitrusts established for Olson's children.

The will directed that expenses, debts and estate taxes were to be paid from the estate residue, and expressly provided that no federal or state estate taxes were to be allocated to or recoverable from the trusts. In a later section of the will, Olson acknowledged that substantial taxes would be owed by her estate, but the will "completely and accurately reflects my personal wishes." No taxes were to be apportioned against any property qualifying for the charitable deduction.

The estate set aside a reserve of $5.75 million for state and federal estate taxes, but noted that there were insufficient funds after allocating for distributions to Hillsdale, the two unitrusts and the specific bequest to Olson's friend. Hillsdale argued that estate taxes should not be paid out of the residue, but instead be allocated to the noncharitable bequests. This would result in more money being placed in the unitrusts, although Olson's friend would receive nothing under the will. The executor said the will unambiguously directed that estate taxes were to come from the residue. The district court agreed.

Hillsdale appealed, saying that Olson intended two-thirds of the residue to be distributed to the unitrusts and that estate taxes should be apportioned to the noncharitable bequests. The Minnesota Court of Appeals noted that Olson was aware that she could have avoided some taxes by using a different distribution plan, but opted not to do so. The portion of the estate left after special bequests is to be placed into the unitrusts only after expenses and taxes are paid. Payment of the specific bequests to the unitrusts is to be made only if a residue remains after these payments, the court determined (*In the Matter of the Estate of Olson*, A15-0539).

PHILANTHROPY PUZZLER

Larry has been discussing the possibility of creating a charitable remainder trust with a representative of his favorite charity. He was presented with several options, including one that allowed trust payments to terminate either at his date of death or with the last regular payment prior to his death. He isn't sure if one termination date is better than the other. What are the tax consequences of his decision?

EASEMENTS AREN'T "NATIVE" OR "ACCESSIBLE"

A limited liability company contributed conservation easements in 2003 and 2005 to the North American Land Trust. The 2003 property consisted of 79 acres in six noncontiguous tracts in and around a golf course bordered by residential lots. The 2005 property was 90 acres in three noncontiguous tracts, also on a golf course and bordered by residential lots. In both cases, the conservation purpose was to preserve a relatively natural habitat and open space. The LLC retained the rights to create golf cart paths, build rain shelters and food concession stands over the easement land and to use chemicals for the golf courses.

The IRS disallowed the deductions claimed by the members of the LLC, arguing that the rights retained negated any conservation purposes. The Tax Court said it did not need to decide whether operating a golf course is "inherently inconsistent with conservation purposes of preserving a relatively natural habitat under Code

§170(h)." Instead, in both cases the court found that the LLC did not meet the threshold requirement of qualifying for a conservation purpose.

The easements were not for the scenic enjoyment of the general public, since access to the golf courses, and therefore the easement areas, was limited to members and invited guests. The court also found that the areas had been altered from their natural state in order to establish the golf courses. The use of chemicals further promotes the maintenance of nonnative flora, and the original landscape of the easement area has been replaced with nonnative grasses. Native wildlife and plants do not "normally live" on the easement, the court determined (*Atkinson et al. v. Comm'r.*, T.C. Memo. 2015-236).

POWER OF ATTORNEY REVOKED FOR EXCEEDING AUTHORITY

The family trust executed by Sylvia and Hyman Fishbein became "irrevocable and nonamendable" at Hyman's death in 1998. The trust called for various distributions to family members in sums ranging from $2,500 to $5,000, with the balance going to specific charities in Israel or with Jewish affiliations.

In 2005, Sylvia named her stepdaughter as her health care representative and her nephew her attorney-in-fact. Sylvia was later adjudicated to be mentally incapacitated. The nephew began making distributions from Sylvia's estate, with the goal of making her eligible for Medicaid. Many of the distributions benefitted the nephew or charities he chose. At the request of Sylvia's stepdaughter, a court revoked the nephew's authority, demanded an accounting and imposed a constructive trust on assets the nephew transferred to himself.

The Superior Court of New Jersey Appellate Division agreed with the lower court that the nephew had exceeded the scope of his authority and it was not necessary to find that he acted dishonestly or in bad faith in order to remove him. The discretion granted to the nephew was "not unfettered," and required him to make distributions that were in Sylvia's best interests and consistent with her expressed intent, the court held (*In re Fishbein*, Docket No. A-3538-13T4).

DONORS GET COSTLY LESSON IN APPRAISALS

A couple who owned a home built in 1898 and certified by the National Park Service as a "certified historic structure" contributed a facade easement in 2007 to the Landmarks Preservation Council of Illinois. They obtained an appraisal putting the value at $108,000, which they claimed on their 2007 and 2008 tax returns.

Code §170(h)(4)(B)(iii)(l) provides that a taxpayer claiming a deduction for a use restriction on a historic structure must include a qualified appraisal. The Tax Court, referring to the report of the Joint Committee on Taxation explanation in the Pension Protection Act of 2006, noted that failure to obtain and attach an appraisal results in a disallowance of the deduction.

The couple admitted that they did not include the full appraisal with their 2007 return. In 2010, they submitted a corrected Form 8283. The court ruled that because the original return did not include a qualified appraisal, the couple's charitable deduction was properly denied and they were subject to penalties under Code §§6662(a), (b)(1) and (b)(3) for underpayment of tax and substantial valuation misstatement (*Gemperle v. Comm'r.*, T.C. Memo. 2016-0001).

PUZZLER SOLUTION

How the final payment is handled makes no difference in computing Larry's charitable deduction [Reg. §§1.664-2(a)(5)(i), -3(a)(5)(i)]. If he chooses to have the trust payments end on the date of his death, the partial payment for the period between the last regular payment prior to his death and his date of death will be paid to his estate and will be considered income in respect of a decedent (Code §691), subject to both income and estate tax.

PLAN EARLY FOR IRA ROLLOVER GIFTS

Now that qualified charitable distributions (QCDs) from IRAs are permanent, advisers should determine which clients could benefit from making the gifts and plan these early in 2016, before required minimum distributions have been made. How can clients help themselves while assisting their favorite organizations? Here are a few examples:

Taxpayers who make charitable gifts but don't itemize – Only about 35% of taxpayers itemize their deductions, with the majority relying on the standard deduction. As a result, many generous taxpayers get no added tax benefit from their gifts. But with QCDs, even taxpayers who don't itemize save taxes, since amounts sent to charity (up to $100,000 annually) pass free of the tax that would ordinarily be owed on a required minimum distribution.

Retirees who are taxed on a portion of their Social Security benefits – Up to one-half of a recipient's Social Security benefits can be taxed when provisional AGI exceeds $25,000 (single taxpayers) or $32,000 (joint filers). Up to 85% of Social Security benefits are taxed when provisional AGI exceeds $34,000 or $44,000 respectively. Required minimum distributions may increase a retiree's income enough to put him or her above these AGI levels. For certain clients, making a QCD may reduce the tax on Social Security benefits.

Clients who want to reduce their gross estates – Only estates in excess of $5.45 million are subject to estate tax in 2016. Because the value of IRAs is included in the gross estate, making QCDs, even in excess of a taxpayer's required minimum distribution, may enable the client to keep his or her estate below the applicable exclusion amount. Keep in mind that IRAs left to charity at death avoid both the estate tax and the tax on income in respect of a decedent.

Taxpayers already at the deduction limit – Very generous donors may find they can't claim all their deductions and must carry over the excess to future years. In general, cash gifts are deductible up to 50% of a donor's AGI, while deductions for gifts of appreciated property are limited to 30% of AGI, with a five-year carryover. QCDs do not count toward these deduction limits.

Clients whose AGI makes them subject to cutbacks or penalties – There are several AGI "triggers" that can result in higher taxes for certain clients. For example:

- 3.8% net-investment income tax applies to taxpayers with AGI of $200,000 (single filers) or $250,000 (joint filers).
- Taxpayers reach the top 39.6% income tax bracket and are also subject to a 20% rate on long-term capital gains and dividends when AGI reaches $415,050 (single) or $466,950 (joint) in 2016.
- Certain itemized deductions and personal exemptions are reduced when AGI exceeds $259,400 (singles) or $311,300 (joint) in 2016.

Some eligible clients may benefit by making QCD gifts that will help reduce their AGI below these levels.

Clients who want to see their gifts put to use during their lifetimes – Instead of making a bequest through a will or living trust, clients could contribute a similar amount through QCDs, in a single year or over several years, and see the good their generosity can do while they are alive.

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