

# The Advisor



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## ESTATE PLANNER'S TIP

Spouses, children, other family members and even charities are generally the primary beneficiaries named in wills and living trusts. But clients may want to remember others in their estate planning. For instance, if a client has a long-time housekeeper, gardener or caregiver, he or she may want to provide some type of severance pay through the estate plan – possibly based on the amount the person had been receiving and the length of employment. If the client is especially close to the employee, consider establishing a retirement income, for life or a term of years, with a charitable gift annuity funded through the estate. When including a bequest to employees, it's important to consider state laws on the client's testamentary capacity and the presumption of undue influence for certain individuals who may have had the ability to exert control over the client.

## DECEASED SPOUSE'S IRA NOT TREATED AS INHERITED

At Marvin's death, his two IRAs passed to a trust he had created with his wife, Sally. She was the sole trustee and had the power to allocate assets to the survivor's trust or the exemption trust. She allocated both IRAs to the survivor's trust and combined the IRAs into a single account.

Sally was entitled to all the income from the exemption trust and as much principal as the trustee determined for her health, support and maintenance. She was the sole beneficiary of the survivor's trust and had the right to receive all the income and principal. She planned to create a spousal rollover under Code §408(d)(3).

Generally, an IRA passing through a third party such as a trust or estate and then distributed to the

surviving spouse is treated as being from the third party, not from the deceased spouse. As a result, the surviving spouse is not eligible to roll over the distribution to his or her own IRA. The general rule does not apply where the IRA has not yet been distributed and the survivor has the sole discretion to pay the IRA to himself or herself. When the IRA is distributed, the survivor has 60 days in which to roll over the amounts into an IRA set up under his or her own name.

The IRS said that no third party could prevent Sally from receiving a distribution of Marvin's IRA and rolling over the amount into an IRA in her own name. Once that is done, Sally can begin taking required minimum distributions calculated under Code §401(a)(9) as owner (Ltr. Rul. 201632015).

### IRS PUTS TRUST IN TAXPAYERS

The IRS, finding that too many taxpayers are missing the 60-day limit on IRA rollovers, has issued a self-certification procedure to help avoid the income tax that would otherwise be due. In general, amounts distributed from a qualified plan or IRA are excluded from income if transferred to an eligible retirement plan no later than the 60<sup>th</sup> day following the day of receipt. The IRS has the authority to waive the 60-day requirement where the failure to waive would be against equity or good conscience, for reasons of casualty, disaster or events beyond the reasonable control of the taxpayer [Code §§402(c)(3)(B), 408(f)(3)(I)]. There is an automatic waiver procedure where the failure of a rollover is due to an error on the part of a financial institution [Rev. Proc. 2003-16].

The new procedure requires the taxpayer to present a written certification to the plan administrator or IRA trustee indicating that the missed 60-day deadline was due to one of several enumerated reasons, including a misplaced check that was never cashed, a mistaken deposit into an ineligible account, damage to the taxpayer's principal residence, serious illness of the taxpayer or family member, death of a family member, the taxpayer's incarceration or a postal error.

### PHILANTHROPY PUZZLER

Jack had farmed for 45 years and hoped that one of his children would take over the operation when he retired. However, his children have all moved away from the area and are not interested in keeping the farm in the family. Jack has more than \$120,000 in farm equipment that he plans to sell, but his accountant told him that he would recognize significant income on a sale, since the machinery has been depreciated. A friend suggested that Jack use the machinery to fund a charitable remainder trust that would provide income to Jack and his wife for life and then benefit their favorite charity. Will this plan work?

After providing the certification to the IRA custodian, the taxpayer must make the contribution to the IRA "as soon as practicable" or within 30 days after the reason preventing the taxpayer from making the contribution has passed. A plan administrator or IRA trustee may generally rely on the certification that the taxpayer has satisfied the conditions for a waiver of the 60-day rollover (Rev. Proc. 2016-47).

### TWO-WITNESS REQUIREMENT NARROWED

Isabel Wilner's niece and intestate heir, Dana Wilner, argued that when the original copy of Wilner's will could not be found, she must have destroyed it with the intent to revoke it. The will left most of Wilner's \$250,000 estate to her church. Because Wilner was confined to a hospital bed and blind, her executor and attorney argued that she would have needed help to access the will in order to destroy it, suggesting instead that the will had been removed by someone else. They attempted to prove the will by presenting a conformed copy. The Orphan's Court admitted the copy, but the Superior Court of Pennsylvania reluctantly agreed with Dana that state law requires two witnesses to testify not only to the execution of the will, but also to its contents. The court urged the Pennsylvania Supreme Court to determine whether an exception is appropriate where charity is to receive the estate and the will's proponents stand to gain nothing under its provisions (*In re Wilner*, 2014 PA Super. 94).

The Supreme Court of Pennsylvania did review the case, agreeing with Dana that state statute requires all wills – including lost ones – to be "proved" by two witnesses. However, the court said the legislation seemed principally concerned with the signature requirement of the testator, not the contents of the will, "lost or otherwise." The phrase "prove a will" addresses the need to verify that a document is a valid testamentary instrument, said the court, adding that it's unlikely anyone besides the testator and drafting attorney is aware of the contents when a will is witnessed. Nor is there any need for witnesses to know the contents when fulfilling their role in confirming the

validity of the testator's signature, the court said. The requirement for two witnesses to be familiar with the contents would then apply even if the original, executed will were available for probate.

The contents of a lost will can be proven in other ways. Imposing "overly burdensome proof requirements" may frustrate the testator's intent where a conformed copy is available, said the court. Allowing the terms of a lost will to be established by clear and convincing evidence, as is the case in several other states, is an "appropriate standard of proof." The court found that standard had been met with Wilner's will. The Superior Court's ruling was reversed and the case remanded for reinstatement of the Orphan's Court order (*In re Estate of Wilner*, J-18-2016, No. 136 MAP 2014).

#### DRAFTING ATTORNEY LIABLE TO BENEFICIARY

Alice Dumville wanted her estate to pass to her mother, if alive, but if not, to the Richmond Society for the Prevention of Cruelty to Animals (RSPCA). Dumville's mother did predecease her, but the title company said the will as written left the RSPCA only the tangible personal property – worth about \$72,000; the real property – worth about \$600,000 – passed by intestacy.

The attorney, as co-executor of the estate, sought to correct his "scrivener's error," based on Dumville's intent. The court found the language unambiguous and ruled that the real property passed to Dumville's intestate heirs.

The RSPCA as a third-party beneficiary of the contract between Dumville and her attorney, sued, alleging breach of contract and professional negligence. The circuit court admitted the attorney's testimony from the action seeking to correct the scrivener's error and awarded damages of more than \$600,000 to the RSPCA.

Beneficiaries under testamentary instruments are an exception to the general rule that third-parties may not enforce contracts. An intended beneficiary is "an integral part" of the obligations assumed by the parties. The attorney knew Dumville sought to benefit the RSPCA and

specifically agreed to draft the will to accomplish that goal. The RSPCA became the intended beneficiary of both Dumville's will and of her contract of employment with the attorney, said the Supreme Court of Appeals of Virginia (*Thorsen v. Richmond Society for the Prevention of Cruelty to Animals*, Record No. 150528).

#### ARTIST'S WORKS WORTHLESS – FOR DEDUCTION PURPOSES

Artist Karen Kaplan claimed a charitable deduction of \$4,638 for noncash gifts to various organizations in 2011. Among the gift items were postcards that she created. She arbitrarily assigned a value of \$1 to each card.

The amount allowed as a charitable deduction for property that would produce ordinary income to the donor if sold at fair market value is limited to the donor's cost or basis [Reg. §1.170A-4(b)(1)]. The postcards included Kaplan's name and a copyright symbol, making them similar to inventory, said the Tax Court. The deduction was disallowed, with the court noting that Kaplan was given the opportunity to present evidence of her cost or basis in the postcards but failed to do so (*Kaplan v. Comm'r.*, T.C. Memo. 2016-149).

#### PUZZLER SOLUTION

Jack can fund a charitable remainder trust with the farm machinery, although he will likely have no charitable deduction. Under Code §170(e)(1)(B)(i), the deduction for a gift of tangible personal property that is unrelated to charity's exempt purpose is limited to the donor's basis, rather than the fair market value of the property, and Jack's basis is virtually zero (Ltr. Rul. 9413020). However, because the trust will make payments based on the fair market value of the machinery, without any loss to taxes, the payments may actually be higher than if the equipment was sold and the after-tax proceeds were invested for income.

### IRS EXTENDS ANNUITY TRUSTS A LIFELINE

Section 7520 rates have been below 5% since the beginning of 2008, currently hovering at 1.4%. That's bad news for donors wishing to fund charitable remainder annuity trusts. Not only are annuity trusts subject to the same 10% remainder requirement as charitable remainder unitrusts [Code §§664(d)(1)(D), (d)(2)(D)], they are also subject to a 5% probability test [Rev. Ruls. 70-452 and 77-374]. No deduction is allowed for a charitable remainder annuity trust if the probability exceeds 5% that a noncharitable beneficiary of the trust will survive to the exhaustion of the trust fund. An annuity trust for which a deduction is not available is not a qualified charitable remainder trust [Letter Ruling 9532006].

The 5% probability test is not really an issue when §7520 rates exceed 5% and the trust provides for the minimum 5% payout, but the lower the rates, the more difficult it is for annuity trusts to satisfy the probability test. For example, a 5% one-life annuity trust, assuming quarterly payments and a 1.4% §7520 rate, does not qualify for a donor age 74, although the charitable deduction of more than 47% easily satisfies the 10% remainder requirement. For a two-life annuity trust, both income beneficiaries would have to be at least age 77 to pass the 5% test.

Recently released Revenue Procedure 2016-42 offers a possible solution for younger donors seeking the fixed payments of an annuity trust. Annuity trusts created on or after August 8 that include the exact language of the sample provision will not be subject to the 5% probability test. The provision calls for the early termination of the annuity trust and an outright distribution of trust assets to the charitable remainderman prior to the date on which an annuity payment would be made, if that payment would result in the value of the trust corpus falling below 10% of the

value of the initial trust corpus. The early termination is considered a qualified contingency under Code §664(f). Language is included for both inter vivos and testamentary annuity trusts.

The Revenue Procedure includes an example in which the donor, on January 1, transfers \$1 million to a 5% annuity trust, with \$50,000 payments to be made each December 31 and using a §7520 rate of 3%. Each year, the trustee is required to determine whether the value of the trust corpus, minus the \$50,000 payment multiplied by a specified discount factor, is greater than \$100,000 (10% of the initial value of the trust). The computation qualifies in each of the first 17 years. The value of the trust corpus as of December 30 in year 18 is \$210,000. The computation is as follows:

1.  $\$1,000,000 \times 10\% = \$100,000$
2.  $(\$210,000 - \$50,000) \times [1 / (1 + .03)]^{18}$   
 $\$160,000 \times (1 / 1.03)^{18}$   
 $\$160,000 \times 0.970874^{18}$   
 $\$160,000 \times 0.587397 = \$93,984$

Because the value of the trust corpus minus the \$50,000 payment, multiplied by the discount factor, is less than \$100,000, the trust terminates on December 30 of year 18 and the principal and income – including the annuity payment that would otherwise have been payable to the income beneficiary – is distributed outright to charity.

Should donors be concerned about their annuity trusts ending early? While that is a possibility, trustees are likely to be able to get returns higher than what is presumed under current §7520 rates. Therefore, it may not be necessary to dip into corpus to the point where the 10% remainder value is reached.

**Cherí E. O'Neill**  
President and CEO

**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](http://www.bsu.edu/bsufoundation)

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