The Advisor

BALL STATE UNIVERSITY FOUNDATION
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ESTATE PLANNER'S TIP

Many people think that only the elderly need to be concerned with a durable power of attorney or a medical power of attorney. The elderly certainly should make known their wishes regarding end-of-life care and consider who they would want making medical decisions on their behalf if they are unable to do so. However, these documents are equally important, or possibly even more important, to younger individuals. The Health Insurance Portability and Accountability Act of 1996 (HIPAA) protects the privacy of health care information for those ages 18 and older. The parents of college students, especially those paying for college expenses, may be surprised to discover that they are not entitled to information on a child's condition in the event of a hospitalization. Parents should have adult children sign release forms authorizing medical professionals to share information on a son's or daughter's diagnoses and treatment. When the child signs the HIPAA form, it may also be time for the parents to sign forms allowing children to access information in the event of an emergency.

GETTING AN IRS SIGN-OFF

Executors and their advisors have long relied on estate tax closing letters to confirm that the IRS's examination of the return is complete and the file has been closed. However, for estate tax returns filed on or after June 1, 2015, the IRS no longer automatically issues closing letters, except for returns filed solely for the purpose of electing portability where the portability election was denied.

Estate tax closing letters generally confirm that the estate tax return has been accepted by the IRS as filed or has been accepted after an IRS adjustment to which the estate has agreed. The letters continue to be available if requested by an estate at least four months after the estate tax return has been filed.

A recently issued notice indicates that an account transcript, issued at no charge by the IRS, can substitute for an estate closing letter. The estate must file Form 4506-T, Request for Transcript of Tax Return. If the computer-generated report includes transaction code "421," along with an explanation of "Closed examination of

tax return," the transcript confirms that the IRS's examination of the return has been completed. Neither the issuance of an estate tax closing letter nor the account transcript prevents the IRS from reopening an estate tax return if there is evidence of fraud, malfeasance, collusion, concealment or misrepresentation of a material fact; a clearly defined, substantial error based on an established IRS position; or an other circumstance where a failure to reopen the case would be a serious administrative omission, the IRS notes (Notice 2017-12).

ADJACENT LANDOWNER LACKS STANDING TO ENFORCE EASEMENT

Chebeague & Cumberland Land Trust owns a conservation easement originally granted over roughly 100 acres of land. The goal was to retain the land in its "scenic, natural and open space condition for conservation purposes." The deed specifically noted the easement was primarily to benefit the general public in the Town and County of Cumberland, ME.

The Town of Cumberland purchased a portion of the land subject to the easement and has received approval to use the property for a public beach. It will require the construction of a parking lot, resurfacing of an access road, relocation of a bath house and addition of portable toilets. The Land Trust determined this to be a permitted use under the terms of the easement.

PHILANTHROPY PUZZLER

Camille read an article in her alma mater's alumni newsletter about a classmate who deeded a vacation home to the school while retaining the right to use the home for the rest of his life. Not one to be outdone, Camille is now considering this remainder interest gift technique using an apartment building that she owns in a nearby town. She has asked your thoughts about her gift idea.

The Estate of Robbins, which owns the remaining land subject to the easement, believes the plan is a violation of the easement and that the Land Trust is obligated to enforce the conditions. The estate sought a declaratory judgment, injunctive relief and damages for a breach of contract against the Land Trust. The Superior Court dismissed the complaint, saying the estate lacked standing to initiate an action to enforce the easement on the town's property.

The Maine Supreme Judicial Court agreed, noting that the estate, in essence, seeks to enforce the easement for its own benefit. While the estate could not compel the Land Trust to bar the proposed access to the town's land, the court did remand the matter on whether the estate has a claim for breach of contract action against the Land Trust as "affecting a conservation easement" (*Estate of Robbins v. Chebeague & Cumberland Land Trust*, 2017 ME 17).

DEDUCTION FAILS TO LIFT OFF

Joe Izen originally claimed the standard deduction on his 2010 income taxes, but when the IRS disallowed certain Schedules C and E deductions, the Tax Court allowed him to file an amended petition in which he claimed a $338,080 charitable deduction. Izen said he donated his 50% interest in a private jet to the Houston Aeronautical Heritage Society's museum.

Izen and an LLP had purchased the aircraft in 2007 for $42,000. The jet remained in storage for three years prior to the gift. Along with the amended return, Izen included an acknowledgment letter signed by the Society's president; a Form 8283 signed by a director of the Society, dated April 13, 2016; a copy of a donation agreement signed by the Society president and an appraisal dated April 7, 2011. The IRS refused to process the amended return, saying it failed to satisfy the substantiation requirements of Code §170(f)(12).

Both Izen and the IRS filed motions for summary judgment. The court denied Izen's motion, noting there was a dispute of material fact as to whether his 50% interest was worth $338,080. The court found no question of fact as to the IRS's claim that Izen had not satisfied the substantiation requirements.

Code §170(f)(12) sets forth more stringent requirements for contributions of used vehicles, including airplanes, when the claimed deduction exceeds $500. The donor must obtain, and include with the income tax return, a contemporaneous written acknowledgment from the charity. If the charity is not selling the vehicle, the acknowledgment must include a certification of the intended use and a statement that the vehicle will not be transferred during the period of use. The charity must complete Form 1098-C, Contributions of Motor Vehicles, Boats and Airplanes. The court said the requirement is "a strict one," adding that the doctrine of substantial compliance does not apply.

The Society did not complete or file the Form 1098-C. In addition, the letter from the Society's president expressed thanks for the gift, but did not include Izen's name and taxpayer identification number. It also failed to state that no goods or services were provided in consideration for the gift. While a deed of gift can serve as a de facto acknowledgment, the court noted that it must contain all the information required under Code §170(f)(8)(B). The Society's agreement did not include the signatures of the donors, their taxpayer identification numbers and did not state the intended use of the jet. The Tax Court granted the IRS's motion for summary judgment (*Izen v. Comm'r.*, 148 T.C. No. 5).

Note: For gifts of used vehicles that are sold by the charity, the donor's deduction is limited to the gross proceeds received by charity upon a sale [Code §170(f)(12)(A)(i)]. A qualified appraisal is not required.

GAIN OR LOSS FROM GIFTS OF MORTGAGED PROPERTY

An S corporation plans to have several of its qualified subchapter S subsidiaries contribute business properties to charity. A few of these parcels are subject to mortgages. If property subject to an indebtedness is transferred, the amount of the indebtedness is treated as an amount realized for purposes of determining whether there is a sale or exchange in determining gain or loss [Reg. §1.1011-2(a)(3)]. This is true, even if the transferee does not agree to assume or pay the indebtedness.

The IRS was asked to rule that the computation of basis under the bargain sale rules of Code §1011(b) will be determined on a property-by-property basis.

Under Code §1011(b), if a charitable deduction is allowed by reason of a sale, the adjusted basis for determining gain shall be that portion of the adjusted basis that bears the same ratio to the adjusted basis as the amount realized bears to the fair market value of the property. The IRS ruled that the computation of basis is determined on a property-by-property basis for property subject to mortgage indebtedness that the corporation contributes to charity (Ltr. Rul. 201709001).

PUZZLER SOLUTION

The exception to the partial interest rule for a gift of a remainder interest in a home or farm applies only to an interest in a personal residence [Code §170(f)(3)(B)(i)], defined as any property used by the taxpayer as his or her personal residence, even though it is not used as a principal residence [Reg. §1.170A-7(b)(3)]. Because Camille does not live in the apartment building, it would not qualify for an income tax or gift tax charitable deduction. She could, instead, use the apartment building to fund a charitable remainder trust from which she could retain a stream of payments for her lifetime.

MAKING THE MOST OF DEDUCTION CARRYOVERS

A major concern of aging clients is that they will outlive their savings or fall victim to inflation or an economic downturn. Even though an individual's income may be sufficient for current needs, the future is a question mark that affects many philanthropic decisions. Charitable bequests are popular because many donors feel that "once I'm gone, I'll no longer need the money." But there are donors who would make lifetime gifts if they felt more secure about what the future holds.

Charitable remainder trusts are popular with many older donors precisely because they allow current gifts without a loss of income. One drawback to a charitable remainder trust – whether an annuity trust that pays a fixed amount for life or a unitrust that pays a percentage of the annual value of the trust assets – is that the percentage amount chosen when the trust is created cannot be increased at a later date.

One way to overcome this problem is to select a unitrust with the highest payout level possible when the trust is created. The remainder must be at least 10% of the value of the assets contributed to the trust [Code §§664(d)(1)(D), (d)(2)(D)] and the payout rate cannot exceed 50% [Code §§664(d)(1)(A), (d)(2)(A)]. However, as the payout rate increases, the charitable deduction allowed for the gift of the remainder interest drops. That may not be a negative if the donor would be unable to use the entire deduction at a lower rate.

Consider Mike, age 55, who has adjusted gross income of $50,000. He owns a parcel of vacant land worth $850,000 that currently earns no income. If he needs money in the future, he could sell the property, but would pay capital gains tax of 15%, leaving him with only $737,500 to reinvest.

Mike could fund a charitable remainder unitrust with the property, let the trustee sell the land and avoid the capital gains tax. If he chose a 5% payout, Mike's income the first year would jump from zero to $42,500. His income in later years would remain a constant 5% of the changing value of the trust assets. Mike's charitable deduction would be $271,771 (assuming quarterly payments and the use of a 2.6% §7520 rate).

In the year he creates the trust, Mike could deduct up to 30% of AGI [Reg. §1.170A-8(d)(3)], carrying over the excess for up to five years [Code §170(b)(1)(B)]. His AGI is now $92,500 with the additional trust income, making his allowable deduction $27,750. Assuming Mike's AGI remains at $92,500 for the next five years, he will be able to deduct a total over the six years of only $166,500. He will "lose" more than $105,000 of his deduction.

There is another possibility that will enable Mike to satisfy his philanthropic goals, increase his income and take full advantage of his allowable deduction. By electing a higher payout from a unitrust, he can arrive at a deduction equal to the maximum allowable. Here are the deductions – all of which satisfy the 10% remainder requirement – at various payout levels:

Payout rate	Deduction
6%	$223,159
7	185,241
8	155,440

By selecting an 8% payout rate, Mike would reduce his deduction to an amount that could be fully deducted over six years, in part because his income will also rise, allowing him to use his carryover deductions faster. Mike might instead establish a net-income with makeup unitrust [Reg. §1.664-3(a)(1)(i)(b)] or a flip unitrust [Reg. §1.664-3(a)(1)(c)] that would begin as a net-income trust but switch to a standard unitrust at a triggering event such as the sale of the property or Mike reaching a particular age.

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