

# The Advisor



March 2017

## ESTATE PLANNER'S TIP

Elderly clients sometimes wish to make a son or daughter joint owner of financial accounts, allowing the child to handle financial matters in the event of the parent's incapacity. But clients should be aware that adding a child's name to an account could create estate distribution problems. Consider the situation where a parent's intention, reflected in the will, is to divide the estate equally among three children. One child, however, has been named joint owner of several bank accounts. At the parent's death, assets in the accounts pass by right of survivorship to the child named as joint owner. The remaining estate is then divided equally among the three children, resulting in one child receiving a disproportionate share. If so inclined, that child might be able to equalize the shares by executing a qualified disclaimer (Code §2518) as to part of his or her distribution (assuming the disclaimed interest will pass to the siblings). The child also could give bank account proceeds to the others, although there could be gift tax consequences. A better alternative is for the parent to execute a durable power of attorney giving the child control of the accounts in the event of incapacity, or to make the accounts part of a revocable living trust with a trustee empowered to act in the event of incapacity.

## "DONATIONS" WERE INCOME TO PASTORS

Fredric and Elizabeth Gardner established the Bethel Aram Ministries (BAM) in 1993. In 1999, they transferred all their assets to BAM and took vows of poverty, with the understanding that BAM would provide for their needs as pastors. From 2002 to 2004, the couple assisted others in setting up corporations and LLCs. Promotional material claimed that the government "was not able to interfere in any way," church workers were ministers and not employees, there were no

filing requirements and no withholding, self-employment or income taxes. The Gardners helped establish more than 300 corporations and 18 LLCs.

When the couple refused to provide the records and books of BAM, the IRS reconstructed their income, determining that they had gross bank deposits of \$101,722, \$219,481 and \$281,232 for the three years. The Tax Court determined that payments deposited into BAM bank accounts

constituted taxable income to the Gardners. The couple argued that the deposits were gifts or donations to a legitimate church, that they had taken vows of poverty and that they were acting as agents of BAM. The court ruled that the deposits were compensation to the Gardners for the services they provided setting up the corporations, LLCs and trusts. The Tax Court found that the Gardners had no personal bank accounts, used the BAM accounts as their own, paid for their personal expenses from the BAM accounts and “exercised complete dominion and control” over BAM funds. The couple also owed self-employment tax on the funds, the Tax Court held.

The U.S. Court of Appeals (9th Cir.) agreed, saying that it made no difference whether the funds were titled in the Gardners’ names or in BAM’s. Their vow of poverty was an “attempt to disguise their enjoyment of their personal income,” the court said. The couple earned the payments as individuals, providing identifiable benefits in exchange for money. They retained complete control over the payments after transferring the funds to BAM accounts. The courts have long held that the person earning income cannot avoid taxation through “anticipatory arrangement,” said the court (*Gardner v. Comm’r.*, 2017-1 USTC ¶150,128).

### PHILANTHROPY PUZZLER

Mike has talked to his attorney about creating a charitable remainder trust in his estate plan to benefit his brother and sister. The trust would last for their joint lives, but Mike is adamant that he doesn’t want either to move more than 50 miles from the family home. He has asked whether it’s possible to “disinherit” a sibling who moves away.

### DEDUCTION ALLOWED FOR FOREIGN BEQUEST

Valerie, a U.S. citizen and resident at her death, included a bequest in her will for an organization located and operating in a foreign country. The will provided that if the organization did not qualify for a charitable deduction under Code §2055(a), the property was to pass instead to an organization chosen by her executor.

The charity to which Valerie left the bequest was founded more than 40 years ago to improve the quality of life for the handicapped and elderly. Its operations were financed primarily from an endowment left by the organization’s founder. None of the funds had come from U.S. citizens or residents. The organization’s board of directors is subject to a code of ethics that prohibits its officers and employees from using any part of the net earnings for the benefit of any individual.

Reg. §20.2055-1(a)(4) provides that the deduction allowed under Code §2055 is not limited to transfers to domestic corporations or associations or to trustees for use within the U.S.

The IRS found that the foreign charity has operated properly to carry out its charitable mission, has not engaged in any “prohibited transactions” within the meaning of Code §4948(c), it is prohibited from private inurement and does not engage in any lobbying or other political activities that would disqualify the deduction. Therefore, ruled the IRS, Valerie’s bequest was made to an organization described in Code §2055(a)(2) (Ltr. Rul. 201702004).

*Note:* The rules governing the estate tax deduction differ from those for the income tax deduction. In general, an income tax deduction is allowed only for organizations “created or organized in the U.S.” Gifts may be made to U.S. charities that have operations in foreign countries where the money is used to further the charitable goals of the U.S. charity, which must maintain control over the use of the funds [Rev. Ruls. 63-252, 66-79].

### TIMES AND RULES HAVE CHANGED, TAX COURT SAYS

Stewart and Shirley Oatman claimed charitable deductions totaling \$7,950 in 2011, by cash and check. The couple substantiated \$3,660 of gifts to the Los Angeles Mission, a university and a church, but the IRS disallowed the remaining \$4,290, for which they had no acknowledgments. Stewart told the Tax Court that much of the couple's giving was "not reflected on paper," adding that he believed the *Cohan* rule applied [*Cohan v. Comm'r.*, 39 F2d 540].

The court agreed that the *Cohan* rule had been applied numerous times to estimate "unverified or inadequately substantiated charitable contributions." However, all those cases were prior to the enactment of the Pension Protection Act in 2006. Since then, cash contributions of less than \$250 can be substantiated by a bank record or written communication [Code §170(f)(17)]. For contributions of \$250 or more, a contemporaneous written acknowledgment from the charity is required. This requirement is "viewed as strict," the court added. The taxpayers had only their testimony – no documentation – which was "insufficient" to permit a deduction in excess of what was allowed by the IRS, ruled the court (*Oatman v. Comm'r.*, T.C. Memo. 2017-017).

### IRS: LARGE GRANT "UNUSUAL"

A charity's status as "publicly supported" under Code §170(b)(1)(A)(vi) can be adversely affected by one or more unusually large grants or contributions. Such contributions are generally included fully in the charity's total support, but if made by an individual, trust or corporation, the contributions are considered "support from the general public" only to the extent of 2% of total support.

To prevent loss of classification, Reg. §1.170A-9(e)(6)(ii) provides for the exclusion of "unusual grants" in determining whether an organization meets a "33<sup>1</sup>/<sub>3</sub>% of support" test. An unusual

grant generally is defined as a substantial contribution or bequest from a disinterested party, which (a) is attracted by reason of the publicly supported nature of the organization, (b) is unusual or unexpected with respect to the amount involved and (c) would, by reason of its size, adversely affect the status of the organization as normally being publicly supported.

An organization formed to enrich the lives of at-risk youth and foster children receives all of its support from public sources such as private companies, individual donors and fund-raising events. It was awarded a multi-year grant to help end teen homelessness. The private foundation awarding the grant has no prior affiliation with the charity and has no one in a position of authority with the charity or its board of directors. The charity expects to continue receiving financial support from businesses, individuals and from fund-raising events.

The IRS determined that the grant would be from a disinterested party and is "unusual or unexpected with respect to the amount." Therefore, the grant is considered unusual within the meaning of Reg. §1.509(a)-3(c)(4) and will not adversely affect the charity's status as publicly supported (Ltr. Rul. 201704019).

### PUZZLER SOLUTION

Generally, a charitable remainder trust must last either for the life of an individual or individuals or for a term of not more than 20 years. However, a trust can terminate earlier upon the happening of a "qualified contingency" [Reg. §§1.664-2(a)(5)(i),-3(a)(5)(i)]. Although Mike could include contingency language covering the event that a sibling moves more than 50 miles from home, his charitable deduction will be computed without regard to the contingency.

### DEFERRED GIFTS OFFER IMMEDIATE DEDUCTIONS FOR FUTURE BENEFIT

Clients have several ways to make lifetime gifts to charity, enjoy immediate income tax charitable deductions and have the satisfaction of current recognition for their gifts – all without visibly parting with any assets. These are sometimes referred to as “deferred” gifts, meaning charity’s benefit is postponed.

*Undivided interests in property* – Tony owns a summer home that he and his family use about six months of the year. He made a gift of a one-quarter undivided interest in the home to his college and was entitled to an income tax charitable deduction [Code §170(f)(3)(B)(ii)] for about 25% of the home’s \$300,000 value. The gift saved Tony about \$24,750 in income taxes in his 33% tax bracket.

Tony and his family can continue using the home, just as they always have. The college is entitled to use the property three months a year, but the real benefit occurs when the home is sold and the college receives one-quarter of the proceeds. Tony will be entitled to additional charitable deductions if he reimburses the college for its share of expenses related to the property. And if he leaves the remaining portion of the home to the college at his death, his estate will be entitled to a further charitable deduction.

It’s also possible to make a gift of an undivided interest in personal property – such as a painting – and realize similar benefits, although charities receiving a fractional interest in an item of tangible personal property must take complete ownership of the item within ten years or at the death of the donor, whichever comes first. In addition, the donee must have (1) taken possession of the item at least once during the ten-year period as long as the donor remains alive and (2) used the item for the organization’s exempt purpose [Code §170(o)].

*Gifts for conservation, open space* – The owner of property with significant historical or ecological

features may make a gift to charity of an irrevocable easement in perpetuity and receive an income tax deduction while continuing to use the property for specified purposes [Code §§170(f), (h)]. If sold, the property will be subject to the conditions of the easement, which may restrict the uses to which the land may be put or the alteration of structures on the property. The deduction is equal to the difference between the value of the property without the easement and the reduced value with the encumbrance.

*Remainder interest in home or farm* – A donor who places a personal residence or farm land into a charitable remainder trust is prohibited by the self-dealing rules [Code §4941(d)] from continuing to use the property, even if fair market rental is paid. But the donor can have the property eventually pass to charity, receive an immediate income tax charitable deduction and continue to use the property by deeding the home or farm to charity and retaining a life estate – a gift of a remainder interest not in trust [Code §2055(e)(2)].

Take the case of Tom and Maureen, who own a home worth \$250,000 that they wish to leave to their local hospital. They can deed the home to the hospital, retaining a life estate for their joint lives. They are entitled to a charitable deduction for the value of the remainder interest in the home. Assuming they are both age 68 and the land on which the home sits is worth \$75,000, their deduction would be almost \$110,000 – even though nothing would pass to the hospital until after they died (assuming January’s 2.4% §7520 rate).

During their lifetimes, Tom and Maureen could continue living in the home or rent it out and receive the income. If the home were sold prior to their deaths, proceeds would be divided, with the parties receiving the actuarial value of their interests.

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