The Advisor

March 2018

ESTATE PLANNER'S TIP

The limit for deducting mortgage interest is $750,000 of indebtedness for new mortgages entered into after December 15, 2017, under the Tax Cuts and Jobs Act of 2017. Interest on home equity loans is no longer deductible. Acquisition indebtedness is defined as debt incurred in acquiring, constructing or substantially improving any qualified residence and secured by the residence [Code §163(h)(3)(A)]. The lack of a deduction for home equity loan interest might prompt some clients to consider refinancing a mortgage, rather than taking out a home equity loan. In general, a refinancing is considered acquisition indebtedness, provided it does not exceed the balance of the old loan as of the refinancing date [Code §163(h)(3)(E)]. A homeowner who wants to refinance to tap into greater equity thanks to rising home prices should exercise caution not to exceed the balance on an existing mortgage.

TRUST CAN USE BENEFICIARY'S LIFE EXPECTANCY

When she died at age 61, Joan's living trust became irrevocable. Her daughter, Paula, was the sole beneficiary of the trust and a subtrust that held Joan's retirement accounts. Language indicated Joan's intent was for the subtrust to qualify as a "see through" trust [Reg. §1.401(a)(9)-4].

Joan's estate asked the IRS to rule that the distribution period for the retirement accounts be calculated based on Paula's life expectancy as the designated beneficiary of the subtrust. The IRS found the trust to be valid and irrevocable, adding that the beneficiary must be identifiable within the trust document to meet the "see through" requirement that Paula be the sole designated beneficiary.

Trust provisions requiring the trustee to pay Paula any and all funds in the subtrust that are withdrawn mean that no distributions can accumulate in the subtrust for the benefit of anyone other than Paula. Her interest is identifiable and she is considered the designated beneficiary of the retirement accounts under Reg. §1.401(a)(9)-4. Therefore, ruled the IRS, required minimum distributions can be calculated based on Paula's life expectancy (Ltr. Rul. 201750004).

WHERE DO YOU THINK YOU'RE GOING?

Before buying airline tickets or reserving a room for travel outside the U.S., the IRS warns taxpayers who are "seriously delinquent" on their taxes that their passports may be denied or revoked. This applies to those who owe more than $51,000 in back taxes, penalties and interest for which a tax lien has been filed.

The IRS announced it is beginning implementation of new procedures under the Fixing America's Surface Transportation Act (FAST), signed into law in 2015. FAST requires the IRS to notify the State Department of taxpayers with seriously delinquent tax debt. There are several ways to avoid having the IRS notify the State Department, including by paying (1) the tax debt in full; (2) under an approved installment agreement; (3) under an accepted offer in compromise or (4) under a settlement agreement with the Department of Justice (IR-2018-7).

COURT: WILL'S MISSING, NOT REVOKED

Relations between Sylvia Braun and her daughter, Courtney, were strained following the death of their husband and father, Felix. In 2010, Sylvia executed a new will, leaving her entire estate to a special needs trust to assist two relatives for life before distributing trust assets to religious charities. Courtney was completely disinherited. During this same time, extensive litigation over Felix's estate was occurring.

At her death in 2014, Sylvia's will could not be found. Her attorney said she had signed it and taken the original. The question facing the Probate Court was whether Sylvia had destroyed the will with the intent to revoke, or whether a copy of the will should be admitted.

The court found that Sylvia did not intend to die intestate and did not revoke her 2010 will. Proponents of admitting a copy of the will provided evidence that Courtney had access to Sylvia's house for at least two months prior to the appointment of a neutral administrator and that there was evidence that papers had been disturbed. Sylvia's attorney, who had spoken to Sylvia earlier on the day of her death, testified that she had "never wavered" in her intent to provide for her disabled relatives and leave the remainder to charity. The court found the will's proponents had shown by clear and convincing evidence that Sylvia did not destroy her will.

The Superior Court of New Jersey rejected Courtney's argument that the Probate Court should have required proof "sufficient to exclude every possibility of a destruction of the will by the testator," rather than the clear and convincing evidence standard. Recent legislation had tended toward making it easier to probate an informal will in order to avoid intestacy and implement the testator's intent, said the court, also noting Courtney's access to the house and her "strong financial motive to destroy the original will if she found it" (*In re Estate of Braun*, Docket No. A-3816-14T2, Docket No. A-2861-15T2).

PHILANTHROPY PUZZLER

Max retired from farming four years ago but hesitates to sell the farmhouse and land that have been in his family for three generations. He wants to continue living in the house and receiving rental income from the farmer who works the land. He read an article about the tax advantages of giving property to charity while retaining a life estate. He has asked whether he can contribute his house, its contents and just a portion of his farmland and claim a charitable deduction.

CY PRES SALVAGES DECADES-OLD BEQUEST

Under Tom Alexander's nearly 50-year-old will, because certain named individuals were not alive at his death, his estate was to pass to "Sparks Hospital, Fort Smith, Arkansas as a

memorial gift to permit the hospital to make necessary improvements or to purchase necessary equipment." Sparks Memorial Hospital had gone through various changes, eventually becoming Sparks Regional Medical Center (SRMC) and later a subsidiary of a for-profit entity by the time of Alexander's death.

SRMC continued to function as a non-profit, with the mission of providing healthcare and education for parts of Arkansas and Oklahoma. Its assets were transferred to a foundation for the development of an osteopathic school to train physicians to serve the community. SRMC plans to build and equip the school with the help of Alexander's $5.6 million bequest.

Several heirs challenged the will, saying that because Sparks Hospital no longer exists, the estate passed by intestacy. The circuit court determined Alexander intended to support healthcare services in the area, rather than the physical structure itself. SRMC remains capable of carrying out these intentions, the court ruled, adding that even if Alexander intended the non-profit hospital, not the non-profit entity, to be the beneficiary, the doctrine of cy pres would apply and SRMC would be the appropriate beneficiary.

The Arkansas Court of Appeals affirmed that Alexander intended to bequeath his estate to the entity owning Sparks Hospital, rather than to the hospital itself, noting that a building cannot "make improvements or buy equipment." While agreeing with the heirs that SRMC is not the same entity as the Sparks Hospital named in Alexander's will, the court found that SRMC is an appropriate cy pres beneficiary, since it continues the mission of promoting healthcare (*Estate of Alexander v. Sparks Regional Medical Center*, 2017 Ark. App. 588).

IRS HANDED A VICTORY

The Green Dynasty Trust allowed the settlors to distribute amounts from gross income to charity. In 2004, the trust distributed various parcels of land held more than one year to charity and claimed a deduction of about $20.5 million. On an amended return, the trust increased the deduction to $29.6 million and sought a refund. The IRS disallowed the refund, saying the charitable deduction was limited to the trust's basis in the parcels, not the fair market value. The U.S. District Court (WD OK) agreed with the trust, saying that Code §642 deductions were "without limitation," (*Green v. U.S.*, 2015-2 USTC ¶50,549).

The IRS appealed, arguing that "any amount of the gross income" in Code §642(c)(1) means that the charitable gifts must be made out of a trust's gross income. The U.S. Court of Appeals (10th Cir.) agreed, noting that nothing in the regulations discusses whether real property purchased with gross income can be treated as the equivalent of gross income.

The court acknowledged the phrase "any amount of gross income" as used in Code §642(c)(1) was ambiguous, finding the IRS's requirement that the gift be made out of a trust's gross income to be "reasonable and thus permissible." The court added that "unless and until" Congress acts to make it clear that the deduction should include unrealized gains associated with real property originally purchased by gross income, the court cannot construe the deduction in that manner (*Green v. U.S.*, 2018-1 USTC ¶50,126).

PUZZLER SOLUTION

Max would be entitled to a deduction for his gift of a remainder interest in the home, including items that are permanently affixed to the residence (e.g., fixtures). He would not be entitled to an income tax deduction for the gift of a future interest in the furniture and other personal property (Rev. Rul. 76-165). There is no requirement that Max give his entire farm [Reg. §1.170A-7(b)(4)], so he may contribute and deduct a remainder interest in only certain acreage.

TAX SAVINGS: NOT THE ONLY REASON FOR CHARITABLE BEQUESTS

With estates up to $11.2 million sheltered from federal estate tax, the use of outright charitable bequests and testamentary life-income arrangements may no longer be as important in estate planning, but clients may want to include charitable vehicles to address other planning concerns.

Generation-skipping transfers

The GST credit shelters the same $11.2 million as the estate tax for transfers to grandchildren and younger generations. But just because a grandparent can leave more does not mean the recipients are necessarily old enough to handle the windfall responsibly.

Peter and Linda want to leave a significant portion of their $8 million estate to their five grandchildren, currently ages 12 to 18. A charitable lead trust would allow the couple to postpone the age at which the grandchildren receive the funds. They could direct that $2 million pass to a lead trust at the survivor's death. The trust would make payments to one or more charities for a term of years before the assets are distributed to the grandchildren or pass to noncharitable trusts in the grandchildren's names.

Peter and Linda could instead fund a lead trust during their lifetimes. The transfer would be shielded from gift and GST taxes, thanks to their credits. Assets passing to the lead trust would be removed from the couple's estates, which could reduce their income taxes. In addition, they could see the good their charitable gifts accomplish during their lifetimes.

Avoiding tax on income in respect of a decedent

Warren's $4 million estate includes a $1.5 million IRA. He'd like the IRA to benefit his two nephews, but he'd also like to leave something for a favorite charity. Warren could simply name the nephews as the designated beneficiaries of the IRA and allow them to take withdrawals over their life expectancies, but he's not sure they could resist the temptation to withdraw all the funds immediately.

Warren could name the charity as beneficiary of the IRA, conditioned on the organization issuing a gift annuity for each nephew (Ltr. Rul. 200230018). The gift annuities would be directed to pay the rate equal to the rate paid to other annuitants the same ages as the nephews at Warren's death. The nephews would receive payments based on the full value of the IRA, without depletion from income tax. He also has the satisfaction of knowing that the nephews will have a steady source of income for their lives. If either of the nephews is younger than the charity's minimum gift annuity age at Warren's death, the charity could issue a deferred annuity, resulting in higher payments to the nephews.

Too much of a good thing

Some parents or grandparents just don't feel the need to leave everything to family members. Vince has a $6 million estate, and while he wants the bulk to go to his children and grandchildren, he also wants to provide continuing support for the charities to which he has contributed during his lifetime. Vince could determine the amount he'd like each family member to receive, with the remainder passing to one or more charities.

BALL STATE UNIVERSITY FOUNDATION
2800 W. Bethel Ave., Muncie, IN 47304
(765) 285-8312 • (765) 285-7060 FAX
bsu.edu/give

Cherí E. O'Neill
President and CEO

D. Mark Helmus
Senior Vice President for Development

If you know another professional advisor who would benefit from this publication, please contact The Foundation.