The Advisor

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ESTATE PLANNER'S TIP

It's the time of year for clients to be formulating year-end tax strategies. Is 2017 a good year to maximize itemized deductions? Should clients defer receiving some income until 2018? Postpone sale of profitable investments? The answers depend on the client's financial picture for 2017 and the forecast for 2018 and whether Congress passes much talked about tax changes. For those looking to maximize deductions, several opportunities exist for supporting charity. Philanthropic-minded clients might consider transferring income-producing property to charitable remainder trusts. With proper planning, grantors will maintain the same level of income they had without the trust. And they will qualify for a charitable contribution deduction for a portion of the fair market value of the securities or other property that goes into the trust (deductions depend on the age and number of income beneficiaries and the amount of lifetime income retained).

DAUGHTER GETS PRISON, AND A REFUND

Rita Sawyer, M.D., was sentenced to life imprisonment for first-degree murder and unlawful administration of a controlled substance in connection with the death of her mother, Mary Sawyer. David Sawyer, administrator of Mary's estate, filed a civil wrongful death action against his sister. An agreement reached between the parties called for Rita to make certain cash payments to a foundation established by David in memory of the siblings' parents.

After some delay, Rita completed the transfers to the foundation, but her attorney later requested a refund of $35,000 that had been overpaid. David argued that the Court of Common Pleas lacked jurisdiction because the foundation was not included as a party to the refund claim. He also said that Rita was precluded from reimbursement because she had claimed the payments to the foundation as charitable deductions on her income tax return.

The Superior Court of Pennsylvania found that the foundation was not an indispensable party to the refund action because David was the "official designee" of the foundation. The trial court's order made clear that David was expected to make the refund from the foundation.

When the overpayment to the foundation was discovered, Rita's attorney amended her income tax refund. Rita's decision to pay the foundation was motivated by her desire to resolve the wrongful death lawsuit, not out of "disinterested generosity," noted the court. The additional taxes that Rita may incur by amending her charitable deduction is an issue for the IRS, said the court. Because the mistaken overfunding was not done with donative intent, the foundation would be unjustly enriched if allowed to keep the funds (*Sawyer v. Sawyer*, J-A09039-17).

NO SELF-DEALING, BUT NO DEDUCTION EITHER

Several years ago, Stuart created a non-grantor charitable lead annuity trust. Over the years, the trust took income tax deductions for amounts of gross income included in the annuity amount [Code §642(c)(1)]. The trust is seeking a judicial amendment that would give Stuart's brother, Simon, the power, exercisable at any time in a nonfiduciary capacity, to acquire trust assets by substituting other property of equivalent value. This would cause the trust to change from a non-grantor to a grantor trust.

The IRS ruled that the conversion of the trust will not be considered a transfer of property from the trust to the grantor. In addition, there will be no self-dealing under Code §4941 because Simon, as Stuart's brother, is not a disqualified person [Code §4946(a)].

Stuart also asked whether he would be entitled to an income tax charitable deduction in the year of the conversion. The IRS said that a deduction is available only if property is transferred from the grantor trust to the non-grantor trust. Because the conversion is not considered a transfer of property for income tax purposes, Stuart is not entitled to an income tax deduction, said the IRS (Ltr. Rul. 201730012).

PHILANTHROPY PUZZLER

Eric owns a parcel of vacant land that has drawn the attention of a developer, who is offering $250,000. The price looks attractive to Eric, so he tells the developer to have a contract drawn up. Later that day, Eric receives a newsletter from his favorite charity describing the advantages of funding a charitable remainder trust with appreciated property – including avoidance of capital gains tax. He decides to transfer the land to a unitrust, but asks whether he should do so before or after signing the contract presented by the developer.

EXCESS FEES CUT INTO CHARITY'S SHARE

In addition to making several specific charitable bequests, Sandra Lesser left the residue of her estate to fund a foundation in her name. She directed that the foundation be created by her attorney and her executor, to benefit organizations, individuals and families in need. Following Lesser's death, the attorney executed a fee agreement with the executor, calling for the attorney to receive a flat commission of 3% of the estate for legal services. The executor was to receive a flat 6%. The attorney assured the executor, a close friend of Lesser, that it was not necessary to keep time records.

The Commonwealth of Pennsylvania, on behalf of the foundation, objected to the final account for the estate and asked that various surcharges be applied. The Orphans' Court found that the attorney had little experience administering estates and failed to complete income and inheritance tax returns. The attorney had also, without court approval, allowed the sale of Lesser's home to the executor's husband for less than appraised value. The attorney also allowed $5,000 to be donated to a charity not listed in the will. The Orphans' Court found the fees unreasonable and surcharged the attorney $35,000.

The Superior Court of Pennsylvania noted that a percentage fee structure cannot justify fees that would otherwise be considered unreasonable in light of what the services were actually worth. Limiting the attorney's fees to $10,000 was not an abuse of the Orphans' Court's discretion, the court held (*In re Estate of Lesser*, J-S20002-17).

"PERPETUITY" NOT IN JEOPARDY

Bosque Canyon Ranch made conservation easements to the North American Land Trust in 2005 and 2007, designed to protect the habitat of the gold-cheeked warblers and other birds. The perpetual easements prohibited most uses on the land, although several five-acre homesites were allowed just outside the boundaries of the easements. The agreement permitted the donors, with the Trust's consent, to modify the boundaries of the homesite parcels, but not increase their area above five acres.

The IRS disallowed the Ranch's deductions of $8.4 million and $7.5 million, saying the easements failed to qualify as deductible charitable contributions because they were not given in perpetuity, as required under Code §170(h)(2)(C). The Tax Court agreed, citing *Belk v. Comm'r*. [140 T.C. 1], which held that if the boundaries of property subject to an easement may be modified, the easement was not considered in perpetuity.

The U.S. Court of Appeals (5th Cir.) said the Tax Court's reliance on *Belk* was "misplaced." In *Belk*, the entire easement could be moved to a completely different tract, remote from the property originally covered by the easement. In the agreement between the Ranch and the Trust, only the homesite parcels can be changed, and only with the Trust's consent. This may be done, noted the court, to account for locations subsequently chosen as nesting sites by the warblers. The donors would not benefit financially by any changes. The court said it was satisfied that the "tweaking of the boundaries" of a few homesite locations would not detract from the conservation purposes and would not prevent the easements from meeting the perpetuity requirement (*Bosque Canyon Ranch v. Comm'r.,* 2017-2 USTC ¶50,306).

WILL DIDN'T COVER EVERYTHING

Evelyn Shakir and her brother, Philip, inherited the family home in Boston when their mother died in 1990. When Evelyn died, she left a number of specific bequests in her will, including a gift to the Virginia Center for the Creative Arts (VCCA). The residuary clause of her will directed that "any monies remaining in [her] estate" pass to George Ellenbogen, her life partner. Upon his death, the funds would pass to VCCA. No mention was made of her half interest in the family home, where Philip lived until his death in 2012.

The executor of Philip's estate, in a quiet title action, argued that Evelyn's will did not devise her interest in the home and that it therefore passed under intestacy to Philip, her only heir. Evelyn's executor said that her half interest passed to Ellenbogen under the residuary clause. The Probate and Family Court ruled that Evelyn died intestate as to her interest in the home, and that it passed by intestacy to Philip.

The Appeals Court of Massachusetts agreed, finding no precedent in which "moneys" has been interpreted to include an interest in real property. Although there is a general presumption against intestacy, a testator's estate is deemed to pass by intestacy when the plain language of the will requires such a result, said the court. Nothing in Evelyn's will, which was executed while Philip was still living in the home, indicated her intent regarding her interest in the property (*Roth v. Newpol*, No. 16-P-715).

PUZZLER SOLUTION

Any gain on the sale of the property will be attributed to Eric if he secures a purchaser prior to creating the trust [*Martin v. Machiz*, 251 F.Supp. 381 (D.C. Md. 1966)]. Eric would still get the charitable deduction, but he would have to report any capital gain realized upon the sale. Instead, Eric should transfer the land to the trust and allow the trustee to negotiate with potential buyers (including the developer). Prior negotiations aren't necessarily fatal, but they should not have proceeded so far that the trustee has no choice but to step into the donor's shoes and complete the sale.

WHAT WE CAN LEARN FROM THE IRS

The IRS's Statistics of Income Bulletin offers an interesting glimpse into the estate tax and charitable giving. Among the findings:

Estate taxes

■ Between 2006, when the applicable credit amount sheltered estates up to $2 million, and 2015, when the filing threshold was $5.43 million, the number of estate tax returns filed dropped from 49,050 to 11,917 (nearly 76%).

■ For estate tax returns filed in 2015, stock made up the largest single asset in all estates (estates under $5 million, estates from $5 million to under $10 million, estates of $10 million to under $20 million and estates of $20 million or more).

■ More than 2,000 estate tax returns were filed in 2015 from residents of California. The next four highest states were Florida, New York, Texas and Illinois. In terms of the number of returns filed per 100,000 of adult population, South Dakota topped the list, followed by the District of Columbia, Florida, Connecticut and North Dakota.

■ The total net estate tax on all returns filed in 2015 was nearly $17.1 billion.

Split-interest trusts

■ The number of tax returns (Form 5227) filed for charitable remainder unitrusts, charitable remainder annuity trusts and pooled income funds dropped every year between 2009 and 2012. Charitable lead trusts, which showed a minuscule increase in return filings from 2010 and 2011, showed declines between 2009 and 2010 and 2011 and 2012.

■ Corporate stocks represented the largest investment category in all split-interest trusts in both 2011 and 2012. In 2012, corporate stocks accounted for 88% of investments held by split-interest trusts.

■ The IRS received 113,688 Forms 5227 in 2012, a drop of 4,022 over the 117,710 returns filed in 2011. Of these returns, charitable remainder unitrusts represented 80.3%.

■ In 2012, split-interest trusts made distributions of approximately $4.3 billion to charities. $2.5 billion (58%) of that amount passed to organizations involved in public and societal benefit. Education, the next largest category, accounted for about 20% of distributions.

Donor advised funds (DAFs)

■ The value of DAFs sponsored by charitable organizations was nearly $53 billion for 2012.

■ In 2006, there were 1,779 organizations sponsoring DAFs; by 2012, the number had risen to 2,121. Most of these are held by organizations that are considered "small," with DAFs of less than $1 million. "Large" sponsoring organizations – those with DAF holdings in excess of $100 million – made up only 4% of the total number of sponsoring organizations, but 80% of the funds held, at about $43 billion.

■ Fidelity Investments Charitable Gift Fund was the largest single DAF, in terms of value, in 2012, with $10.2 billion.

■ The median payout rate for DAFs in 2012 was 10% of the total value held by the sponsoring organization.

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