The Advisor

BALL STATE UNIVERSITY FOUNDATION
Established in 1951

July 2017

ESTATE PLANNER'S TIP

Older brides and grooms, particularly those with families from previous marriages, should review their retirement plans after saying "I do." Certain qualified retirement plans are required to be paid as joint and survivor benefits unless the spouse has properly waived the right to receive survivor benefits [Reg. §1.401(a)-20]. A waiver of this right prior to marriage (e.g., in a prenuptial agreement) may not be effective, since the parties are not husband or wife until after the ceremony. Another consideration is the investment mix of the couple's retirement assets. Newlyweds should review their total retirement plan holdings to determine whether they are invested too heavily in equities or bonds, given the ages of the spouses. Portfolio mix is particularly important where one or both participate in 401(k) plans that may have substantial holdings in an employer company's stock. The couple can choose to achieve a more diversified investment mix by balancing one spouse's more aggressive investments against the other's more conservative holdings, or having one spouse concentrate on growth, or growth and income, while the other invests in international and small-cap stocks.

TAXPAYER DIDN'T MEET "NO FUN" RULE

In 2005, Edgar Brown established the Julian Brown Memorial Fund, which qualified as an exempt organization. The Fund staged an annual soccer tournament in Charlotte, NC, near where Brown owned a house. On his 2011 income tax return, Brown claimed a charitable deduction of $9,200 for out-of-pocket expenses in connection with his volunteer work on the tournament, but eventually reduced the amount to $901.

The Tax Court noted that $492 of the unreimbursed expenses Brown claimed were for meals and travel expenses. "Reasonable" expenditures for meals and lodging incurred in performing volunteer work may be deductible [Reg. §1.170A-1(g)], although Code §170(j) prohibits deductions unless there is "no significant element of personal pleasure, recreation or vacation" in the travel. Brown failed to specify what he did for the tournament or how much time he devoted to it. The

court determined that he was not entitled to a deduction for meals and expenses.

The court did, however, allow him to deduct $409 in expenses he incurred to maintain the Fund's website. Each of the individual expenses on behalf of the website was less than $250 and therefore could be substantiated with a canceled check or receipt, or "other reliable written records" that included the name of the payee, the date and the amount. Because Brown provided a summary of expenses, the court ruled he was entitled to deduct costs in connection with the website (*Brown v. Comm'r.*, T.C. Summ. Op. 2017-29).

ATTORNEY CROSSES THE LINE

In 2004, Siv Ljungwe hired Carl Dimeff to draft a revocable trust, to be funded with Ljungwe's one-half interest in a trust that she established with her estranged husband in 1994. At Ljungwe's death, the assets were to pass in equal shares to four charities.

Dimeff was aware that Ljungwe had a history of mental illness. Ljungwe came to believe she was in an intimate relationship with Dimeff and that he "possessed special powers." In 2008, Ljungwe said she wanted to change the trust to leave everything to Dimeff. He explained that he could not personally draft the document, but referred her to another attorney. Dimeff had several discussions and meetings with the attorney, provided an inventory of assets from the 2004 trust and prepared the introduction to the inventory for the new trust. He also assured the attorney that Ljungwe's mental problems "were in the past."

Following Ljungwe's death in 2010, the charities sought to have the 2008 trust declared invalid because Ljungwe lacked the capacity to execute the document, Dimeff had exercised undue influence and Dimeff was statutorily disqualified from benefitting since he helped draft the trust. The Superior Court of San Diego County found the 2008 trust void ab initio and ruled that the 2004 trust was the governing instrument over Ljungwe's estate. Dimeff was ordered to pay the charities.

On appeal, Dimeff argued that he "did not draft" the 2008 trust. The California Court of Appeals found that Dimeff was a drafter of a provision of the trust and was therefore in a position to "control or influence the distribution of property under the instrument" to his benefit. He was also "directly involved" in the trust's preparation. It was irrelevant, said the court, that the portion he prepared did not contain a donative transfer. There was ample evidence supporting the trial court's finding, the court held (*NPR Foundation v. Dimeff*, D068222).

GIFT TO LEAD TRUST INCLUDED IN ESTATE, BUT NO GIFT TAX LIABILITY

Two days after the creation of NHP, a limited partnership, a son transferred assets worth $10 million from his mother's revocable trust in exchange for a 99% limited partnership interest. The same day, the son, purportedly acting under

PHILANTHROPY PUZZLER

Leslie established a testamentary charitable remainder trust to benefit her grandson, using a vacation home to fund the trust. Her son, Ben, wants to keep the property for his family's use and has asked whether he can purchase the home from the trustee, even offering to pay more than the appraised fair market value. The trustee questioned whether Ben, as Leslie's lineal descendant and therefore a disqualified person, could purchase the property without running afoul of the self-dealing rules. Can Ben purchase the vacation home?

a power of attorney, assigned the mother's interest to a charitable lead annuity trust. The trust was to make payments to a private foundation for the mother's life before assets were divided between the son and his brother. The mother died one week later.

The mother's 2008 gift tax return reported a taxable gift of $1,661,422 for the remainder interest in the lead trust. The IRS determined that because the mother was terminally ill when the trust was funded, the remainder interest was worth $8,363,095. The IRS also determined that the mother's gross estate included the full $10 million under either Code §2036(a) or Code §2038(a), because she retained the right to the income or to change the enjoyment through an exercise of a power. The bona fide sale exception to Code §2036(a) does not apply, said the IRS, because the estate showed no significant nontax purpose for the creation of NHP.

The estate argued that if the mother retained an interest in NHP, she did not retain that right for the remainder of her life because she transferred the partnership interest to the lead trust. Therefore, the estate claimed, Code §2036(a)(2) does not apply to the transfer of cash and securities to NHP. The court found the estate's argument unpersuasive, noting that under California law, the transfer to the lead trust of the 99% partnership interest was either void or revocable because the son lacked the authority to make gifts in excess of the gift tax exclusion amount. Further, because the transfer occurred within three years of death, the value would be included in the gross estate under Code §2035(a).

The estate did not challenge the IRS's contention that the son had no "legitimate and significant nontax reason" for creating NHP. Therefore, said the court, the transfer of cash and securities was not a bona fide sale for adequate and full consideration. Because the gift exceeded the son's authority under the power of attorney, under California law it was either void or revocable. If void, the value of the limited partner interest on the date of death would be included in the mother's estate under Code §2033. If revocable, the value would be included under Code §2038(a). Under California law, an attorney-in-fact does not have the authority to make gifts unless expressly provided in the power of attorney. The son's power of attorney allowed him to make gifts only to specified donees and only to the extent of the federal annual gift tax exclusion. The estate claimed that, even without the authority, the gift to the lead trust was valid under the ratification provision of the power of attorney. The court disagreed, noting that California courts have held that a general grant of authority to convey property does not provide the power to make gifts. To hold otherwise, said the court, "would render meaningless any limitations or restrictions on the authorized powers." Because the gift to the lead trust was either void or revocable, the estate was not liable for the gift tax deficiency, the court held (*Estate of Nancy Powell*, 148 T.C. No. 18).

PUZZLER SOLUTION

Although Ben cannot buy the property from the trust [Reg. §53.4941(d)-2(a)(1)], he can buy it from Leslie's estate prior to the time the trust is funded, provided several conditions are met. The executor must have the authority to sell the property; the transaction must be approved by the probate court; the sale must occur before the estate is terminated for federal income tax purposes; the estate must receive an amount at least equal to the fair market value of the property and the trust must receive an interest at least as liquid as the one it gave up [Reg. §53.4941(d)-1(b)(3)].

CHARITABLE OPTIONS IN ROLE REVERSALS

Thanks to longer life expectancies, more clients may find themselves in the position of caregivers to their parents. Even where the children don't have responsibility for the day-to-day care of parents, they may be helping financially. For 2017, the annual gift tax exclusion is $14,000 ($28,000 for married couples). In addition, children can pay medical expenses for their parents, tax free. Payments must be made directly to the health care provider. There are also ways for children to assist parents without writing checks every month, while also qualifying for an income tax charitable deduction.

Charitable remainder trusts

A son or daughter who normally provides a parent with $500 per month ($6,000 per year) could establish a charitable remainder trust that would pay the income to the parent. For example, Pamela could fund a 6% charitable remainder annuity trust with $100,000, naming her 85-year-old father as the income beneficiary. Pamela's income tax charitable deduction would be about $66,600 (assumes the use of a 2.4% §7520 rate and quarterly payments).

Although Pamela would face gift tax on the value of the father's income interest ($33,400 less the $14,000 annual exclusion), she might avoid the gift tax on the creation of the trust by reserving the right to revoke his interest in her will, which would be characterized as a "qualified contingency" under Code §664(f)(2). Pamela could also apply some of her gift tax credit, which shelters up to $5.49 million in gifts.

Alternatively, Pamela could create a charitable remainder unitrust that permits additional contributions. She could fund the trust with $50,000 late one year and add $50,000 early the next year to reach the desired level. With a unitrust, her father would not be assured of receiving at least $6,000 annually, although if the trust's investments did well, he could actually receive more. Her charitable deduction would be more than $70,800 over the two years, making her father's interest lower ($14,600 per year, less the $14,000 annual exclusion).

Pamela might also choose to fund a two-life $100,000 unitrust that would continue payments for her life after her father's death. Her charitable deduction would drop to $36,800 (assuming she is age 65), but she can then retain the right to revoke his interest in her will [Reg. §1.664-2(a)(5)(i)], making the gift incomplete for gift tax purposes. The total of her father's annual payments from the unitrust would fall well below the annual exclusion amount.

Charitable gift annuities

Charitable gift annuities, as with charitable remainder annuity trusts, offer the assurance of a fixed payment. In addition, because gift annuity rates are higher for older annuitants, the child might not have to contribute as much to provide the same benefit for the parent. Pamela's father, for example, would be entitled to a 7.8% annuity payment. If she contributes $80,000 to charity to fund a gift annuity, her father would receive $6,240 annually and she would be entitled to a charitable deduction of nearly $45,300. She can retain the right to revoke his interest during life or at death, making the gift incomplete for gift tax purposes. Pamela should use cash, rather than appreciated securities, to fund the gift annuity, to avoid recognition of capital gains on the annuity portion.

With either the charitable remainder trust or the charitable gift annuity, the child will no longer have to make gifts with after-tax dollars to provide the same support to the parents, while also making a substantial gift to a favorite charity.

Cherí E. O'Neill
President and CEO

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

D. Mark Helmus
Senior Vice President
for Development

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