The Advisor

BALL STATE UNIVERSITY FOUNDATION
Established in 1951

May 2018

ESTATE PLANNER'S TIP

Parents whose children are graduating from high school this year, or even those with children already in college, may want to consider documents that will allow the parents to have input into medical and financial decisions in the event the children are incapacitated. By the time they head off to college, students are considered adults and therefore entitled to privacy under HIPAA rules. A HIPAA release is a simple document authorizing health care providers to share diagnosis and treatment information with the parents. Despite the fact that parents may be paying tuition and expenses for the child, they generally are not entitled to information if the child is injured in an accident. A medical power of attorney would enable the parents to make health care decisions for a child, but only in the event of incapacity. College-age students, or even those who have already graduated and are independent, might also consider executing a durable power of attorney naming the parents to make financial decisions on the child's behalf if the child is mentally or physically unable to do so. This might allow the parents to pay bills, apply for Social Security or access financial accounts to pay for care.

LACK OF RECORDS COSTLY TO TAXPAYER

Andrew Shank withdrew the entire balance of a nondeductible IRA he established sometime in the late 1990s. He did not include the $27,745 on his 2014 income tax return. The IRS said the full distribution was taxable because Shank did not establish his basis in the account.

The Tax Court noted that although the records were sparse, it appeared the account was originally established prior to June 1998, in the amount of $4,760. Because Shank never made any contributions other than his initial investment, the balance in the IRA consisted of untaxed reinvestments of dividends and capital gains. The court said it found Shank's testimony about the account to be credible and determined that the amount in excess of $4,760 was taxable in the year of the distribution (*Shank v. Comm'r*., T.C. Memo. 2018-33).

REMINDER ON VIRTUAL CURRENCY

Although the 2017 filing season is over, clients who have virtual currencies might not realize their transactions were subject to income tax. The IRS treats virtual currency as property for federal tax purposes (Notice 2014-21). The IRS recently reminded taxpayers there could be penalties and interest for failing to report transactions in virtual currency (IR-2018-71). If the currency is a capital asset in the taxpayer's hands, there could be capital gain or loss. Gain could be avoided by making a gift to charity, similar to gifts of stocks or other appreciated property.

SUM OF PARTS NOT EQUAL TO WHOLE

The Registry Group, a real estate development partnership, donated a house to a charity in 2000, with the understanding that volunteers from the charity would disassemble the house and move the building to another location. On his 2001 income tax return, James Platts, a 50% partner, claimed a charitable deduction of $163,000, based on an appraisal.

The Tax Court noted that Platts claimed a deduction for the entire value of the intact home, not just the 50% represented by his interest in the partnership. But, the court added, he was not entitled to deduct even half in 2001. The partnership did not contribute an intact house, but merely the building parts. Platts did not provide an appraisal, as required by Reg. §1.170A-1(c)(1), of the parts. The value of the intact house is irrelevant in deciding the value of the parts extracted from the home, said the court. Platts' deduction was not taken in 2000, when the house was donated, but rather in 2001. Code §170(a)(1) permits a deduction only for the year in which a gift is made.

The court also found problems with the appraisal, noting that Reg. §1.170A-13(c)(3)(iv)(B) requires the donor to obtain the appraisal before the due date (with extensions) of the return on which the deduction is first claimed. The due date for Platts' return was October 15, 2002, but the appraiser's letter was dated November 8, 2002. The valuation date on the appraisal was August 31, 1999, too early to qualify under Reg. §1.170A-13(c)(3)(i)(A), which provides that the appraisal may be done no earlier than 60 days prior to the date of the gift. The appraisal valued a standing dwelling, rather than the building parts, noted the court, which determined Platts was not entitled to any charitable deduction (*Platts v. Comm'r.*, T.C. Memo. 2018-31).

PHILANTHROPY PUZZLER

Lorraine is the income beneficiary of a charitable remainder trust created by her father from which she receives $5,000 quarterly. One quarter, she informed the trustee that instead of taking her payment in cash she would like to receive shares of a particular stock owned by the trust. The trustee is agreeable and the trust language allows for in-kind payments, but the parties question the tax consequences of the transfer. Can the trustee make the proposed payment?

PLAYING FAST AND LOOSE WITH CHARITABLE FUNDS

Richard Moenning was named trust counsel for a charitable remainder trust established by sisters Marie and Helen Carstensen, after they became unable to manage their affairs. At the death of the survivor, the assets in the $1.3 million trust were to pass to two charities.

Between October 2008, five months after Marie's death, and December 2014, four years after Helen's death, Moenning withdrew in cash or transferred into his personal and business accounts more than $339,000. He made only one set of payments to the charities, totaling about $22,700, although neither cashier's check was ever cashed. In late 2014, one of the charities notified the Illinois Attorney General's office that no money had been received from the trust. In

January 2015, Moenning paid the two charities a total of $586,436. Moenning had never registered as a trustee with the attorney general's office nor did he ever provide an accounting.

The attorney general filed a complaint, alleging violations of the state's charitable trust act requiring trustees holding more than $4,000 of charitable funds to register and provide annual reports. The trial court granted summary judgment to the attorney general, finding that Moenning breached his duty against self-dealing and conflicts of interest by paying himself with funds held for the benefit of charity. Moenning was ordered to repay the $335,000 plus interest and was permanently enjoined from acting as a charitable trustee.

Moenning appealed, saying the attorney general provided no evidence of wrongdoing in his failure to register or of any self-dealing. The Illinois Appellate Court found the evidence "undoubtedly shows" he failed to register. The court also said the evidence showed numerous withdrawals and transfers Moenning made to himself, while he had yet to distribute the funds to the charities, even years after the surviving sister's death (*People ex rel. Madigan v. Moenning*, 2017 IL App (1st) 163108-U).

Note: While the court referred to this as a charitable remainder trust, it was not a trust qualified under Code §664, for several reasons. The trust was established by the sisters, but the IRS has taken the position that a trust created by non-spouse grantors is considered an "association" for tax purposes (Ltr. Rul. 9547004). Further, the sisters retained the right and did, in fact, amend the trust during their lifetimes. Under Reg. §1.664-1(a)(4), the power to amend would make the trust a grantor trust, not a qualified charitable remainder trust. In addition, the trust directed that $50,000 was to be paid to a friend of the sisters if he was living at the death of the survivor, prior to distributing the balance to the charities. Under Reg. §§1.664-2(a)(6) and 3(a)(6), the entire corpus must pass to or for the use of charity.

FAMILY GETS HEIRLOOMS, NOT ALL PERSONAL PROPERTY

In his will, Randall Guise directed a niece and nephew to sort through his personal property to identify those items that should be distributed within the family. All other personal property was to be sold at auction, with the proceeds passing to named individuals and charities. While certain items were distributed to Guise's nieces and nephews, one niece retained a tractor for herself, later selling and keeping the $2,000.

Guise's executor asked the probate court to order the niece to return the $2,000 and other items removed from the home. He argued that the will only allowed distribution of heirlooms, not all personal property. The probate court agreed, ordering that a family-only auction be held as to certain items, with the proceeds distributed to the individuals and charities named in the will.

The executor appealed, saying the will directed the distribution to family of only the heirlooms, not all personal property. The Michigan Court of Appeals agreed, finding the niece and nephew were to identify only those items to be distributed to family versus those to be sold at auction. Guise provided a purchase option for real estate and left his retirement and savings accounts to named individuals and charities (*In re Estate of Guise*, No. 334771).

PUZZLER SOLUTION

Reg. §§1.664-2(a)(4) and 1.664-3(a)(4) require that the adjusted basis of distributions in kind to charities be fairly representative of the adjusted basis of all property in the trust. This is to prevent the trust from distributing low basis property to charity in order to avoid gain to the income beneficiary. Several private letter rulings have applied the same rule to income beneficiaries. The fair market value of distributed shares would be treated as an amount realized from a sale of the property by the trust and potentially passed through to Lorraine.

A LITTLE OF THIS AND A LITTLE OF THAT

While there are numerous charitable giving techniques, many clients find that their philanthropic goals cannot be met solely through one vehicle. More donors are discovering that they can best satisfy their generosity by using blended gifts. These may combine current gifts with bequests through wills or living trusts, or may involve pledges that will be paid in a variety of ways over a number of years.

Blended gifts generally involve a combination of one or more of the following: (1) an outright gift of cash, securities, real property or closely held business interests, (2) pledges spanning several years, (3) split-interest gifts such as charitable remainder trusts, charitable lead trusts, charitable gift annuities or pooled income funds and (4) bequests in a will or revocable living trust or a beneficiary designation on life insurance, retirement account or brokerage account.

Many blended gifts involve donors making major charitable commitments – typically events that carry six- to eight-figure price tags. Consider a couple who wish to create a named fund at their favorite charity. They can't afford to part with the full $500,000 now, but they want to see the fruits of their giving during their lifetimes.

One option might be to fund half the total today with a gift of appreciated securities and possibly qualified charitable distributions from their IRAs, if they are eligible. They might also establish a charitable remainder trust from which they will retain an income interest for their joint lives. At the death of the survivor, trust assets will pass to provide the balance of the $500,000. During their lifetimes, the pair might make annual gifts of cash or appreciated securities that will match the earnings that the deferred $250,000 would have produced. In short, the couple gets to see the results of their generosity during their lifetimes, without parting completely with assets today. Rather than a charitable remainder trust, they might instead name charity the beneficiary of a $250,000 second-to-die life insurance policy.

With relatively few estates subject to federal estate tax, charitable strategies have taken on less importance as a means of reducing the amount sent to the IRS. That doesn't mean that charitable techniques don't still have a role to play in estate planning. Consider David, a widower with an estate valued at about $25 million.

David knows his estate will be subject to tax. He is considering the creation of a $5 million inter vivos charitable lead unitrust, with the assets passing to his grandchildren at the trust's end. The lead trust would accomplish two objectives: he could make a major gift to charity and postpone the day when his grandchildren receive the funds. When the lead trust ends, assets can continue to be held in a non-charitable trust, with distributions to the grandchildren at specified ages. His $11.18 million gift and generation-skipping transfer tax exclusions will more than shelter any taxes at the creation of the lead trust.

His estate will still be subject to tax, but David could also fund testamentary charitable remainder unitrusts for his children, entitling his estate to charitable deductions. If he funds the trusts with assets from his IRA, the income tax that would normally be owed on distributions is spread out over the terms of the trusts. In this way, he has provided for both his children and grandchildren, as well as made significant gifts to support favorite charities.

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