

The Advisor



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ESTATE PLANNER'S TIP

Several tax provisions were scheduled to expire at the stroke of midnight on December 31. Among these were the expanded AMT exemption, the sales tax deduction in lieu of a deduction for state and local income taxes, the \$250 above-the-line deduction for out-of-pocket expenses by schoolteachers and the enhanced expensing allowance under Code §179 for up to \$500,000 in purchases. Also expiring: the provision allowing persons age 70½ and older to make direct distributions from IRAs to charity of up to \$100,000 [Code §408(d)(8)]. Although no charitable deduction was allowed for amounts passing to charity, gift amounts escaped all taxes. And because qualified charitable distributions (QCDs) could satisfy required minimum distributions, donors realized tax savings. Many tax experts believe some or all of these provisions will be revived, retroactively, at some point during 2012. But clients who are eligible to make QCDs can still have IRA custodians write checks to charity, with little risk, up to the amount of their RMD for 2012. For example, a client who normally makes charitable gifts totaling \$5,000 and whose RMD for 2012 is \$7,500 can have the gifts made from an IRA. If the QCD rules are reinstated, as they have been annually since 2006, the transfer would avoid income tax on the amount of the gift, and the client will have to take only an additional \$2,500 RMD. If QCD rules are not reinstated, the client will be subject to tax on the payment to charity, as part of the RMD, but will be entitled to a charitable deduction for a gift that would have been made anyway.

TIME ISN'T UP, COURT SAYS

Shirley Wallace was executor of the estate of her sister, Sarah Buncom. Among the assets included on the estate tax return were several parcels of real property. About 15 months after filing the return, Wallace filed a request for tax abatement, claiming that although title to the parcels was held in Buncom's name, Wallace was actually the owner of some of the property. After the IRS denied the request and claimed a lien on all the parcels, Wallace filed suit in San Diego

Superior Court to quiet title to the property. The IRS removed the case to the U.S. District Court (S.D. CA) and moved for dismissal, claiming the complaint was untimely.

The IRS argued that the statute of limitations began running when Buncom died in 2004, but Wallace claimed that it began when estate taxes were assessed in 2005. The court determined that the statute began running when the taxes were assessed, noting that although the "lien attaches

upon the date of death, the necessity of the lien is not determined until well after that date.” The executor of an estate has up to 15 months to file a return, and the IRS can take four to six months to provide the estate with a closing letter indicating whether the return was accepted. Given this procedure, said the court, it is more appropriate to trigger the statute of limitations by the assessment of the taxes rather than the attachment of the lien. Therefore, Wallace’s claim was filed in a timely manner, ruled the court (*Wallace v. IRS*, 2011-1 USTC 60,628).

TAX NUMBERS GET BOOST FROM INFLATION

The IRS issued inflation-adjusted tax numbers for 2012 that permit larger 401(k) contributions, increase the exclusion for gift, estate and generation-skipping transfers and provide a larger personal exemption, but leave the kiddie tax threshold and the annual gift tax exclusion unchanged (Rev. Proc. 2011-52).

	2011	2012
Kiddie tax	\$1,900	\$1,900
Nanny tax	\$1,700	\$1,700
Annual gift tax exclusion	\$13,000	\$13,000
Annual gift tax exclusion for non-citizen spouse	\$136,000	\$139,000

	2011	2012
Special use valuation for real property devoted to farming or closely held business use	\$1,020,000	\$1,040,000
401(k) contribution limit	\$16,500	\$17,000
401(k) catch-up contribution limit	\$5,500	\$5,500
Savings bond interest total phase out		
single taxpayers	\$86,100	\$87,850
joint taxpayers	\$136,650	\$139,250
Gift, generation-skipping transfer and estate tax exclusion	\$5,000,000	\$5,120,000
Personal and dependent exemption	\$3,700	\$3,800
Standard deduction		
Single	\$5,800	\$5,950
Joint	11,600	11,900
Head of household	8,500	8,700
Married filing separately	5,700	5,950
Tax brackets		
25% bracket starts		
Single	\$34,500	\$35,350
Joint	69,000	70,700
Head of household	46,250	47,350
Married filing separately	34,500	35,350
28% bracket starts		
Single	\$83,600	\$85,650
Joint	139,350	142,700
Head of household	119,400	122,300
Married filing separately	69,675	71,350
33% bracket starts		
Single	\$174,400	\$178,650
Joint	212,300	217,450
Head of household	193,350	198,050
Married filing separately	106,150	108,725
35% bracket starts		
Single, Joint, Head of household	\$379,150	\$388,350
Married filing separately	189,575	194,175

PHILANTHROPY PUZZLER

Bernice visits the graves of her parents, husband and aunts every week at the Peaceful Acres Cemetery. She places flowers there on birthdays, anniversaries and other special occasions. She plans to spend “eternity” there someday herself. In having her will drafted, Bernice expressed an interest in leaving a bequest to the cemetery. The attorney suggested that she instead make a lifetime gift to the nonprofit cemetery. Why should it matter?

THIRD-PARTY BENEFICIARY HAS STANDING TO SUE

Hamilton James had an agreement with State Street Bank to serve as custodian of his assets and make transfers upon receipt of authorized instructions. Between 2002 and 2007, James made a number of transfers from his account to The James Family Charitable Foundation.

On February 13, 2007, James directed State Street to transfer all his shares in a Vanguard fund to the foundation's account, with an indication that it was a charitable gift. Although State Street immediately sent a letter of instruction, it was mistakenly sent to the foundation's broker, rather than to Vanguard. State Street discovered the error on February 22 and sent a corrected letter of instruction to Vanguard.

The foundation sued State Street for breach of contract, claiming that the delay resulted in a loss of more than \$1.6 million, due to a drop in share price between February 13 and the date the shares reached the foundation's account. The trial court granted State Street's motion for summary judgment, finding the foundation had no standing to bring suit for a breach of contract.

The Appeals Court of Massachusetts reversed and remanded the matter, saying the foundation's right to enforce the contract is needed "to effectuate the intention of the parties." State Street had obligated itself to carry out the instructions from James, even though the details were not known until instructions were received. But once received, the instructions formed "an integrated whole with the agreement." The instructions from James clearly identified the foundation as the recipient of the transfer and stated the purpose, the court found. While the court ruled that the foundation had standing to pursue the breach of contract claim, it expressed no opinion as to whether State Street breached the agreement, and if so, whether the breach caused any loss (*James Family Charitable Foundation v. State Street Bank and Trust Co.*, No. 10-P-1616).

VOLUNTEER LOSES ON SEVERAL FRONTS

The Tax Court acknowledged that Pamela van der Lee performed volunteer work, but noted that no income tax deduction was available for her

contribution of services. Although she might be entitled to deductions for unreimbursed expenses [Reg. §1.170A-1(g)], she must provide proper substantiation, said the court.

For deductions of \$250 or more, the donor must have a contemporaneous written acknowledgment from the charity [Code §170(f)(8)(A)]. In the case of unreimbursed expenses, this requirement is met if the taxpayer "(1) has adequate records to substantiate the amount of the expenditures and (2) obtains by a prescribed date a statement prepared by the donee organization containing specified information." The court said van der Lee had no list of expenses or receipts and no trip log or written acknowledgment. It wasn't clear which, if any, of the expenses were for more than \$250.

Van der Lee also claimed a deduction for the rental value of a week at a Caribbean residence she had contributed. The Tax Court agreed with the IRS that no deduction was allowed because the use of the property was a partial interest not in trust [Code §170(f)(3)(a)].

The court also disallowed a deduction for donated kitchen items, saying these were "similar items," the value of which exceeded \$5,000. Because no appraisal was obtained, van der Lee failed to meet the substantiation requirement for noncash gifts in excess of \$5,000 [Reg. §1.170A-13(c)(1)(i)] (*Van der Lee v. Comm'r.*, T.C. Memo. 2011-234).

PUZZLER SOLUTION

An income tax charitable deduction is allowed for a gift to a cemetery owned and operated exclusively for the benefit of its members, or any nonprofit corporation chartered solely for burial purposes [Code §170(c)(5)]. There is no such corresponding estate tax charitable deduction [*Est. of W. Robert Amick*, 67 T.C. 924]. In addition, Bernice is more likely to benefit from an income tax deduction, rather than an estate tax deduction that is only of value if her estate is in excess of the sheltered amount at the time of her death.

GIFT ANNUITY PAYOUTS DRIVEN DOWN BY LOW §7529 RATES

Just six months after raising recommended gift annuity rates for most annuitants age 73 and older, the American Council on Gift Annuities has lowered rates across the board. Annuitants age 69 and younger had seen rates drop on July 1, 2011, but now face an additional decline. The change is due primarily to the downward spiral of §7520 rates, which hit a historic low of 1.4% in October and November of 2011.

One-life annuities will now range from 4% at age 55 to 9% (age 90 and older). Previously, rates ranged from 4.4% at age 55 to 9.8% (age 90 and older). Two-life annuities will range from 3.5% (two annuitants age 55) to 8.8% (annuitants age 91 and older).

When §7520 rates decline, the deduction for charitable gift annuities – and also charitable remainder trusts – drops as well. Lower deductions might make it difficult to meet the minimum 10% charitable deduction. From charity’s standpoint, a 10% present value for the gift amount is important to avoid problems with unrelated debt-financed income. Under Code §515(c)(5), charitable gift annuities are not considered acquisition indebtedness if “the value of the annuity is less than 90% of the value of the property received in the exchange” [Code §514(c)(5)(A)]. (Charitable remainder trusts are subject to a similar 10% remainder value requirement [Code §§664(d)(1)(D), 664(d)(2)(D)]. A trust that does not satisfy the requirement is not a qualified charitable remainder trust.)

The new recommended rates are designed to produce at least a 10% deduction for all ages, even at the 1.4% §7520 rate. The following table shows

the effect of the lowered rates on deductions at various ages, assuming a \$10,000 transfer and quarterly payments:

Age	Pre-2012 Annuity Rate	Deduction	2012 Annuity Rate	Deduction
55	4.4%	\$ 791.28	4.0%	\$1,628.44
60	4.8	1,322.61	4.4	2,045.72
65	5.3	1,893.44	4.7	2,811.16
70	5.8	2,701.28	5.1	3,582.16

Of course, a donor is not required to use the 1.4% §7520 rate to calculate the charitable deduction. Under Code §7520(a), the donor may choose the rate for the month of the transfer or the rate for either of the two previous months, whichever is most favorable. A donor arranging a charitable gift annuity in November 2011 could have chosen to use the 2.0% rate for September. But because §7520 rates may drop and remain low for several months, the new recommended annuity rates are designed to qualify, even for younger annuitants and even at the 1.4% rate.

Note: Many gift annuity donors do not itemize deductions and would be unable to use all or part of their deductions, in any event. Low §7520 rates provide high tax-free payments, however.

The American Council on Gift Annuities has also lowered the compound interest assumption – from 4% to 3.25% – meaning deferred payment charitable gift annuities will also be impacted. If §7520 rates continue to decline and deductions fall below the 10% threshold, the American Council on Gift Annuities advises charities to reduce gift annuity rates to whatever level is needed to generate a charitable deduction of at least 10%.

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