

The Advisor



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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 the 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.

OLD AND COLD LIABILITY STILL HOT FOR IRS

When Robert Roth died in 1991, his executor elected to defer the payment of a \$216,366 tax liability over ten years under Code §6166. The estate included small business stock, which was eventually sold on March 1, 1999.

In 2008, the IRS sought to collect unpaid estate taxes from the beneficiaries of Roth's estate. Code §6324(a)(2) imposes personal liability for unpaid taxes on persons receiving property from an estate. The beneficiaries argued that the ten-year statute of limitations under Code §6324(a)(1) had expired.

The U.S. District Court (WD PA) found that a special lien automatically attached to Roth's estate at his death in 1991, and expired ten years later in 2001. The beneficiaries said that the right to collect unpaid tax expired when the special lien expired. The court noted, however, that the IRS was not attempting to collect unpaid taxes pursuant to the special lien provisions of Code §6324(a)(1), but rather on the basis of transferee liability under Code §6324(a)(2). This provision is not subject to the same limitation period.

Under Code §6502(a)(1), any action to collect a

tax must be commenced within ten years after assessment of the tax. However, the limitation period may be suspended or extended. Where the estate consists of a small family business and an election is made under Code §6166 to pay taxes over ten years, the running of the period of collection is suspended for the period of any extension of time for payment. Transferee liability limitation did not begin running until after the extension period ended, said the court. The IRS had ten years following the March 1, 1999 sale of stock to begin action against the transferees. Therefore, the action filed on July 24, 2008 was timely, the court ruled (*U.S. v. Kulhanek*, 2010-2 USTC ¶60,610).

GET MORE FOR DRIVING

The standard mileage rate for business use of a personal vehicle has gone up, effective January 1. The rate increased – slightly – from 50 cents per mile to 51 cents. The rate for medical and moving use of a vehicle jumps from 16.5 cents per mile in 2010 to 19 cents in 2011. The rate for charitable use of a vehicle remains fixed by Code §170(i) at 14 cents per mile (Notice 2010-88).

PHILANTHROPY PUZZLER

When meeting with Paul to discuss his estate plans, he says that he wants to make a major gift or bequest to a charitable organization but is concerned that his children will be disappointed if he does not leave them everything from his estate. He owns substantial income-producing securities and may even owe estate tax. How might he benefit charity, reduce transfer taxes and still leave everything to the kids?

A PROMISE IS A PROMISE, COURT FINDS

North Fork Radiology made a \$200,000 pledge to the expansion and modernization campaign for Peconic Bay Medical Center. Shortly after making its first payment of \$15,000 in 2006, North Fork's contract to provide exclusive radiologic services for the hospital was terminated.

Starting in 2009, the hospital foundation began making demands for the remaining payments. North Fork claimed that it informed a foundation representative that the loss of the exclusive contract had resulted in a financial setback and was "orally released" from the pledge.

The foundation filed suit against North Fork seeking to enforce the pledge. North Fork argued that its pledge referenced modernization work to be done in the radiology department, although none of the foundation's request letters indicated that any work was done in radiology. North Fork also claimed that the hospital clearly was not relying on its \$200,000 pledge when undertaking an expansion and modernization project estimated at \$50 million.

Under state law, charitable pledges are unilateral contracts that become binding obligations when relied upon by the charity. The expenditure of money, time or labor in reliance on a donor's pledge are valid consideration for the promise. The hospital said that over \$5 million in improvements were made to the radiology department. The Supreme Court of New York found a valid, enforceable contract. A donor may only be released from such a contract by showing that consideration was tendered in return for the oral release from the written pledge. The court ruled that North Fork showed no consideration and was responsible for satisfying the outstanding pledge (*Central Suffolk Hospital v. North Fork Radiology*, 2010 NY Slip Op. 33230).

2010 TAX ACT RENEWS IRA QUALIFIED CHARITABLE DISTRIBUTIONS

The “Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010,” signed into law December 17, 2010, extended for 2010 and 2011 the law permitting persons over age 70½ to arrange direct gifts from their IRAs to qualified charitable organizations, up to a maximum amount of \$100,000 per year [Code §408(d)(8)]. Several other provisions of the new law facilitate charitable giving, including:

- Repeal through 2012 of the “Pease” limitations on certain itemized deductions for individuals with high incomes [Code §68]; without repeal, some donors could lose 3% of affected deductions (including charitable contributions) above a threshold amount, up to 80% of allowable deductions.

- A two-year extension of low tax rates on long-term capital gains and qualified dividends, enabling individuals who receive such income from charitable gift annuities and charitable remainder trusts to pay tax at only a 15% rate (or 0% in some cases); dividends passed through to taxpayers from mutual funds and real estate investment trusts will now qualify for the 15% top rate;

- Increased deductibility for 2010 and 2011 of gifts of appreciated real estate for conservation purposes by certain corporate farmers and ranchers [Code §170(b)(2)(B)(iii)];

- Enhanced deductions for gifts of food inventory by businesses [Code §170(e)(3)(C)(iv)];

- Enhanced deductions for gifts of book inventories to public schools by C corporations [Code §170(e)(3)(D)(iv)];

- Enhanced deductions for corporate gifts of computer equipment and software to public schools [Code §170(e)(6)(G)];

- Favorable basis adjustment for shareholders in S corporations that contribute property to charity in 2010 and 2011 [Code §1367(a)(2)].

2011 TAX NUMBERS - INSTALLMENT II

	2010	2011
Personal and dependent exemption	\$3,650	\$3,700
Standard deduction		
Single	\$5,700	\$5,800
Joint	11,700	11,600
Head of household	8,400	8,500
Married filing separately	5,700	5,700
Tax brackets		
25% bracket starts		
Single	\$34,000	\$34,500
Joint	68,000	69,000
Head of household	45,500	46,250
Married filing separately	34,000	34,500
28% bracket starts		
Single	\$82,000	\$83,600
Joint	137,300	139,350
Head of household	117,650	119,400
Married filing separately	68,650	69,675
33% bracket starts		
Single	\$171,850	\$174,400
Joint	209,250	212,300
Head of household	190,550	193,350
Married filing separately	104,625	106,150
35% bracket starts		
Single, Joint,		
Head of household	\$373,650	\$379,150
Married filing separately	186,825	189,575

PUZZLER SOLUTION

Paul might transfer some securities to a testamentary or inter vivos charitable lead trust that pays income to charity for a period of years, then returns all trust principal to the children. The children receive everything – eventually. A gift tax or estate tax charitable deduction is available for charity’s income interest, which cuts the cost of transferring the property to the children and eases liquidity needs.

BACK TO THE FUTURE WITH POOLED INCOME FUNDS

One of the least-used tools in a fund raiser's arsenal may be the pooled income fund. But in the low-interest rate environment, it may be time to take another look at these funds. A pooled income fund is often compared to a mutual fund, in which earnings are distributed annually to fund participants in proportion to their interests.

There are several requirements for pooled income funds [Code §642(c)(5)]:

■ The pooled income fund must be maintained by a public charity. This requirement can be satisfied where the public charity has the power to remove the trustee and designate a new one, or where the charity exercises direct or indirect control over the fund.

■ Donors contributing to a pooled income fund make an irrevocable gift of the remainder interest to the public charity maintaining the fund [Reg. §1.642(c)-5(b)(1)].

■ Donors must retain an income interest for life for themselves and/or other beneficiaries. The fund may not make a payout to one beneficiary for the life of another individual (Rev. Rul. 79-61, 1979-1 C.B. 220).

■ Income must be paid to the beneficiaries based on the fund's rate of return [Code 642(c)(5)(F)].

■ Property in a pooled income fund must be commingled with and invested with property transferred to the fund by other donors. Charities may offer more than one pooled income fund, with different investment strategies.

■ A pooled income fund is prohibited from accepting or investing in tax-exempt securities [Reg. §1.642(c)-5(b)(4)].

■ Donors to pooled income funds may not serve as trustees.

■ At the death of an income beneficiary, the trustee must sever from the fund an amount equal to the value of the remainder interest in the property. This passes to the charity maintaining the fund.

Pooled income funds lost favor with donors in recent years, in part because of low yields and inability to pay tax-exempt income. But the combination of low §7520 rates and the 15% tax rate on qualified dividends make it worthwhile to give new pooled income funds another look.

The deduction for a gift to a pooled income fund is calculated using the fund's highest yearly rate of return for the preceding three years. The higher the rate, the lower the deduction will be. But for a new pooled income fund, without a history of returns, a deemed rate is used. The deemed rate is one percentage point less than the highest average applicable federal interest rate (§7520) for the three preceding years [Reg. §1.642(c)-6(e)(3)]. Beginning in 2011, the deemed rate is 2.8%, compared with 4.6% in 2010. What does that mean for a donor? Assuming a \$50,000 gift to a fund with a deemed rate of 4.6%, a 65-year-old donor could claim a deduction of \$24,302 (49%). The same donor to a fund with a 2.8% deemed rate could deduct \$31,525 (63%).

Relatively few charities offer pooled income funds, but the impetus for establishing a fund could come from a donor. Distributions from pooled income funds retain their character in the hands of beneficiaries. A fund that makes distributions of favorably taxed qualified dividends might be an attractive option for some donors.

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