

The Advisor



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ESTATE PLANNER'S TIP

Owning property in joint tenancy is the norm for many married couples. It seems logical to hold the house, bank and brokerage accounts, cars and other major assets in joint tenancy with right of survivorship. Estate planners often advise married couples that joint tenancy may not be the ideal form of property ownership. For one thing, couples who own everything "in joint names" waste the unified credit of the first spouse to die. Joint ownership poses additional problems when one spouse is a noncitizen. The unlimited estate tax marital deduction [Code §2056] is not available for transfers to noncitizen spouses. Estate taxes can be deferred through the use of a qualified domestic trust (QDT) under Code §2056(d)(2), but the executor cannot allocate assets to the QDT if they have already passed to the noncitizen spouse under right of survivorship. Clients married to noncitizens may wish to break up joint tenancies to permit use of the QDT. Another option is to make lifetime spousal gifts, taking advantage of the enhanced annual exclusions of Code §2503(b) – \$133,000 for 2009.

MAKING SAVING FOR RETIREMENT EASIER

Several IRS Revenue Rulings and Notices were issued recently, designed to simplify automatic enrollment in 401(k) and other qualified retirement plans and to provide guidance to workers and employers.

Rev. Rul. 2009-30

Default contributions to 401(k) plans will continue to be elective contributions, even though made pursuant to an agreement under which an employee's contribution percentage automatically increases over time and as a result of increases in salary.

Rev. Rul. 2009-31

Profit sharing and 401(k) plans will continue to meet the requirements of Code §401(a) if amended to permit or require annual contributions equal to the value of unused paid time off, provided the contributions meet nondiscrimination rules [Code §401(a)(4)] and limitations [Code §415(c)].

Rev. Rul. 2009-32

The value of unused time off may be paid to a profit sharing plan after termination of employment. The terminating employee does not include these amounts in gross income until distributions are made. These are treated as non-elective contributions and will be subject to the

10% additional tax under Code §72(t) unless they satisfy an exception, such as that for distributions after age 59½.

Notice 2009-65

Two sample plan amendments allow the addition of automatic enrollment in 401(k) and 414(w) plans, along with an escalation feature.

Notice 2009-66

The IRS provides answers to questions regarding automatic enrollment in SIMPLE retirement plans.

Notice 2009-67

A sample amendment is provided to add an automatic enrollment feature to a SIMPLE plan.

Notice 2009-68

The IRS has issued two safe harbor explanations for distributions to qualify for rollover treatment.

In addition to this guidance, taxpayers can elect, starting with their 2009 income tax returns, to take all or part of their income tax refunds in the form of Series I U.S. savings bonds. The bonds, in \$50, \$100, \$200, \$500 and \$1,000 denominations, will be mailed directly to the taxpayer.

NO ESTATE TAX, NO STEP UP

In a heavily edited private ruling, the IRS said that property transferred in trust during the

PHILANTHROPY PUZZLER

Christopher planned to establish a charitable gift annuity for his wife. He owned stock worth \$50,000, with a basis of \$8,000, that he wished to use to fund the gift annuity. The charity's development officer ran a computation to show the tax consequences of the proposed gift and Christopher noticed that he would have to recognize all the capital gain attributed to his wife's annuity in the year the annuity is established. Christopher said he thought the gain could be spread over his wife's lifetime. What should Christopher do?

donor's lifetime did not receive a stepped-up basis at the donor's death. The taxpayer reserved the power in the trust to substitute assets, but did not reserve the right to revoke or amend the trust. While the trust was a grantor trust for income tax purposes, it was not included in the taxpayer's gross estate for estate tax purposes.

In general, Code §1014 provides for a stepped-up basis equal to the value established for estate tax purposes. But the general rule does not apply unless the property is included in the gross estate for federal estate tax purposes [Reg. §1014(b)(9)], ruled the IRS (Ltr. Rul. 200937028).

APPEALS COURT REJECTS ARGUMENTS OF GIFT ANNUITY "SALESMEN"

Mid-America Foundation offered charitable gift annuities from 1996 to 2001, when it collapsed. The Foundation's marketing materials promised donors income for life, with eventual benefit for the charities designated by the donors. More than 400 charitable gift annuities were arranged, with a value of \$55 million. Instead of investing the funds received, however, the Foundation was involved in a Ponzi scheme, using new investor money to make annuity payments to earlier annuitants, paying commissions to facilitators and paying the personal expenses of the individual who established the Foundation.

A receiver was appointed to protect as much of the assets as possible for investors. The receiver sought the return of commissions paid to agents for the sales of charitable gift annuities, alleging breach of fiduciary duty, constructive fraud, negligence and unjust enrichment. The District Court ordered the agents to pay damages ranging from \$31,900 to \$109,900 per person. The court found that the gift annuities were investment contracts subject to regulation as securities.

The U.S. Court of Appeals (9th Cir.) reviewed the promotional material used to market the gift annuities and determined that the gift annuities were sold as investments, "not merely as vehicles for philanthropy." The brochures emphasized

income generation, tax savings and the ability to include children and grandchildren as annuity beneficiaries. The material also spoke of the opportunity for financial gain from gift annuities. The District Court properly determined the gift annuities were investment contracts subject to federal securities law, said the Appellate Court.

The brokers also argued that they were exempt from the broker-dealer registration requirements under the Philanthropy Protection Act of 1995. Charities are generally exempt from registration in the issuance of shares in pooled income funds and gift annuities, provided that anyone soliciting donations is a volunteer or “engaged in the overall fund raising activities of a charitable organization and receives no commission or other special compensation based on the number of donations collected for the fund.” The Court rejected the brokers’ claim that the limitation did not apply to them because they were independent contractors – a term not mentioned in the exemption. Because the brokers received commissions, they were not eligible for the exemption from the registration rules. The gift annuities sold by the brokers on behalf of the Foundation were investment contracts and therefore were securities for purposes of federal and state securities laws (*Warfield v. Bestgen*, No. 0715586p).

COURT NOT ALLOWED TO “CREATE” TESTATOR’S TRUST

Mary Petticrew’s will left the entire residue to the Petticrew Foundation, which was to “be created by separate instrument for the charitable purposes set forth in said instrument.” Petticrew did not execute any instrument creating the foundation prior to her death. If the residuary bequest lapses, the assets would pass to her son by intestacy. The executor, joined by the Ohio attorney general, asked the probate court to imply or create an entity to carry out the unstated charitable purpose.

The probate court found an intent to create a trust. Because the will did not include language

such as “solely,” “only,” or “conditioned upon,” Petticrew was not conditioning the bequest on the creation of the trust in a separate instrument. The court granted summary judgment finding the terms of the will created a charitable trust. The son appealed.

The Court of Appeals of Ohio noted that a charitable trust can be established even where a particular charitable purpose or beneficiary is not indicated. The probate court is allowed to select one or more purposes or beneficiaries “consistent with the settlor’s intention to the extent it can be ascertained.” However, the probate court could not select a purpose or beneficiaries when none were indicated by Petticrew, said the court.

The specification in Petticrew’s will that the foundation would be created by a separate instrument was a condition precedent. The terms in her will were insufficient to create a trust and did not indicate a charitable purpose. Although state law favors charitable trusts, Petticrew’s will “cannot arbitrarily be ignored,” in order to create one, the appeals court said (*Will v. Rokus*, 2009 Ohio 3948).

PUZZLER SOLUTION

Reg. §1.1011-2(a)(4)(ii) permits capital gain to be spread over the donor’s lifetime if the donor or the donor and a designated survivor are the only annuitants. Where a gift annuity is established for another annuitant using appreciated assets, the donor must recognize all the capital gain in the year of the gift. A simple solution is for Christopher to make a tax-free gift of the stock to his wife. She takes his basis and holding period and can then establish her own gift annuity, spreading the gain over her life expectancy. The couple would have the same charitable deduction as if Christopher had funded the gift annuity, but with better capital gains tax results.

TIMELY REMINDERS ABOUT NONCASH GIFTS

According to the Summer 2009 Statistics of Income Bulletin from the IRS, 24.7 million taxpayers itemized \$52.6 billion in deductions for noncash charitable contributions in the 2006 tax year. Of those, 6.2 million taxpayers had contributions in excess of \$500 on Form 8283, totaling \$46.8 billion.

Special rules apply to substantiate noncash charitable gifts in excess of \$500. In general:

■ *Stocks, bonds, mutual fund shares or other marketable securities* – For deductions between \$250 and \$500, donors must obtain a contemporaneous acknowledgment from the charity. The substantiation must indicate that no goods or services were received in return, or provide a good faith estimate of the value of any quid pro quo. If the deduction claimed is more than \$500, the donor must also complete Section A of Form 8283. An appraisal generally is not needed for securities for which market quotations are readily available. The donor's deduction for publicly traded stock is the average between the high and low selling price of the security on the date of the gift. For gifts of mutual fund shares, the deduction is the net asset value on the date of the gift.

■ *Closely held securities* – For gifts valued at \$5,000 or less, the donor must obtain a receipt from the charity and complete Section A of Form 8283. For gifts between \$5,000 and \$10,000, donors must also complete Section B of Form 8283. If the securities are valued in excess of \$10,000, a qualified appraisal is required.

■ *Tangible personal property* – Donors claiming deductions between \$250 and \$500 need a receipt from the charity, including quid pro quo language. If a single item is valued at more than

\$500, up to \$5,000, Section A of Form 8283 must be completed. If one single item or multiple "similar" items are valued at more than \$5,000, the donor must complete Section B of Form 8283 and obtain a qualified appraisal. If the tangible personal property is put to a use unrelated to the charity's exempt purpose, the deduction is limited to basis [Code §170(e)].

How strictly are the rules applied? Michael Tilman and Emily Olin donated every piece of furniture in their 800-square foot New York City apartment to charity in 2001. On an amended return they claimed a deduction of \$11,995 for the furniture. They had a contemporaneous letter from the charity acknowledging the contribution. Tilman attached a list of the donated furniture, although he did not value the items and did not have a qualified appraisal. After an IRS audit, Tilman prepared a spreadsheet with an estimated value for each item of furniture. The couple also contributed clothing and a plastic rack to another charity, valuing the items at \$1,306. The IRS disallowed the deductions. The U.S. District Court (S.D. NY) agreed with the IRS, noting that for noncash gifts in excess of \$500, the taxpayer must maintain written records showing how and approximately when the item was acquired [Reg. §1.170A-13(b)(3)(i)]. The donor must have a qualified appraisal for deductions in excess of \$5,000 [Reg. §1.170A-13(c)(2)(i)(A)]. The furniture donated by the taxpayers falls within the category of "similar items of property," which must be aggregated in order to determine whether the value exceeds \$5,000 [Reg. §1.170A-13(c)(7)(iii)]. Because Tilman and Olin did not have the furniture appraised, they are not entitled to the deduction, the court ruled (*Tilman v. U.S.*, 2009-2 USTC ¶150,549).

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