

The Advisor



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ESTATE PLANNER'S TIP

One of the largest assets for older couples going through a divorce may be retirement plan savings. Because different rules regarding the division of assets apply to different types of plans, it's important to consider the fair split of these assets as part of any divorce negotiations. For example, an IRA owned by a wife can be split upon divorce, with no tax consequences, if the funds are rolled over into the husband's IRA. Assets in a 401(k) plan also may be split, although the plan may have rules governing when the division may be made (e.g., when the employee leaves the company). A qualified domestic relations order (QDRO) is a judgment or decree by a state court regarding the division of retirement plan assets [Code §414(p)]. The QDRO must state the name and last known mailing address of the plan participant and the ex-spouse, the portion of the benefits to be paid to each and how long the payments are to continue. Without a QDRO, a qualified plan administrator might not be required to pay an ex-spouse's share, regardless of what the divorce decree or separation agreement provides. The QDRO prevents the participant spouse from withdrawing all funds in the account and makes sure each ex-spouse is taxed on the proper share of distributions.

BEAR MARKET DOUBLE TROUBLE FOR IRA

Marla began taking substantially equal distributions from one of her IRAs in 2002, using the fixed amortization method allowed in Notice 89-25 (1989-1 C.B. 662). In 2008, she consulted her financial advisor about converting a portion of her equities in the IRA to cash, due to the market downturn. He told her that she could convert a portion to cash without penalties, but noted that the IRA custodian did not offer investments in CDs. He suggested that she transfer the funds to an IRA at another institution.

Marla, who is age 56, transferred both an amount from her original IRA plus the entire bal-

ance in another IRA through a trustee-to-trustee transfer. She was later told that the partial transfer from the IRA caused a modification to the series of substantially equal periodic payments, resulting in the 10% additional tax and interest on all amounts that had been distributed from the IRA to that point.

The IRS noted that Rev. Rul. 2002-62 (2002-2 C.B. 710) modified Q&A-12 of Notice 89-25. Under Rev. Rul. 2002-62, payments are considered substantially equal periodic payments under Code §72(t)(2)(A)(iv) if they are made in accordance with the required minimum distributions

method, the fixed amortization method or the fixed annuitization method. Under all three methods, payments are calculated with respect to the account balance as of the first valuation date selected. Therefore, a modification occurs if there is (1) any addition to the account balance other than gains or losses, (2) any nontaxable transfer of a portion of the account balance to another retirement plan or (3) a rollover by the taxpayer of the amount received resulting in the amount not being taxable.

The IRS said that the transfer of a portion of the IRA to another IRA was a modification, adding that it cannot be corrected by transferring the amount back to the original IRA (Ltr. Rul. 200925044).

NEW WHEELS HITTING THE ROAD

The Consumer Assistance to Recycle and Save Program, more commonly referred to as “cash for clunkers,” has been signed into law. Car owners will be eligible to receive vouchers worth either \$3,500 or \$4,500 to offset the purchase or lease price of a new fuel-efficient vehicle when an older vehicle is traded in.

A \$3,500 voucher is available for passenger automobiles when the combined fuel economy of

the new car is at least four miles per gallon higher than that of the vehicle that is traded in. For certain trucks, the combined fuel economy must be at least two miles per gallon higher.

A \$4,500 voucher is available when the fuel economy of a passenger automobile is at least 10 miles per gallon higher than the trade-in vehicle. For a truck, the new vehicle must get at least five miles per gallon higher mileage.

Only one voucher may be issued for a single person or a jointly registered vehicle. The dealer must certify that the trade-in vehicle will be crushed or shredded and will not be sold for use as a vehicle in the U.S. or elsewhere.

GIFT ANNUITY RATES STAYING PUT

The American Council on Gift Annuities recently considered adjustments to recommended rates approved in December 2008, but opted to maintain annuity rates at the levels that took effect February 1, 2009. The recommended rates for one-life gift annuities range from 2.6% to 9.5% (for annuitants age 90 and older).

TRUSTEE COULD EXPOSE UNDUE INFLUENCE

Olie Skonberg created a living trust that named several charities as remaindermen. Bank One was trustee. Sometime prior to Skonberg’s death, she revoked the trust and executed a new plan that eliminated the charitable interests. Instead, a care giver was named to receive a substantial portion of Skonberg’s estate. The new documents were drafted by an attorney selected by the care giver, based on her outline of changes.

Shortly before Skonberg’s death, Bank One learned that the attorney would be the new trustee and entered into an investment agency agreement to manage the funds. When the attorney terminated the agreement about a month after Skonberg’s death, Bank One informed the charitable beneficiaries of the possible undue influence resulting in changes to the estate plan. The bank’s action was based on the advice of its attorney, who said Bank One had an obligation to notify the beneficiaries of the “dubious circumstances” regarding the trust. The charities con-

PHILANTHROPY PUZZLER

Phil gives generously to numerous charities – so much, in fact, that he has to carry over deductions to later years. He attended a charitable planning seminar where the speaker discussed interest-free loans to charity, explaining that, although no charitable deduction is available, the donor isn’t taxed on future income earned on loaned amounts, which produces deduction-like savings. Phil is interested, but doesn’t want to liquidate any stock in order to make the loan. He has asked about the tax consequences of borrowing against his bank line of credit in order to lend the funds to his favorite charities.

tested the will, eventually settling with the estate for \$1.875 million.

The attorney, as executor of the estate, then sued Bank One to recoup the settlement amount, saying the bank breached its fiduciary duty. If Bank One had “kept quiet” about the revision, the charities would not have known and would not have brought suit, the attorney claimed.

The Supreme Court of Kentucky found that Bank One’s fiduciary duty extended to conditional or contingent beneficiaries under state law. Because the bank was legally obligated to inform the charities, it cannot be liable to the estate for violating a duty of confidentiality, said the court (*JP Morgan Chase Bank v. Longmeyer*, No. 2005-SC-000313-DG).

COURT TAKES IRS’S SIDE ON SUBSTANTIATION QUESTION

Elizabeth Bruzewicz and Howard Prossnitz contributed a facade easement on their home, located in the Frank Lloyd Wright-Prairie School of Architecture Historic District, to the Landmarks Preservation Council of Illinois.

The couple claimed a charitable deduction of \$216,000, based on an appraisal by the owners of a real estate firm. The IRS disallowed the deduction, citing a lack of substantiation.

Code §170(f)(8)(A) provides that no deduction is allowed for a gift of \$250 or more unless the donor has a “contemporaneous written acknowledgment” from the charity. The acknowledgment must include the amount of the cash and a description of any other property, and must indicate whether any goods or services were provided, along with the value of any quid pro quo. The acknowledgment is “contemporaneous” if received by the earlier of the date the tax return is filed or the due date (with extension) for filing the return [Code §170(f)(8)(C)].

Donors must also have a qualified appraisal for deductions of noncash gifts in excess of \$5,000 [Reg. §170A-13(c)(2)(i)]. Among the information that must be included in the appraisal is a description of the property in sufficient detail to ascertain the property that was appraised, the qualification of the appraiser and the basis for the valuation made.

The donors acknowledged that they did not have a contemporaneous written acknowledgment from the Council, although they did have a letter for two cash gifts totaling \$21,600 that they also made. They argued that they had substantially complied with the requirements and therefore should be allowed the deduction.

The U.S. District Court (ND Ill.) found that the requirements related to the “substance or essence of the statute” and were not merely procedural in nature. Therefore, said the court, strict compliance is required. Because the Council’s letter did not satisfy the requirement, no deduction is allowed.

The court also found that the appraisal was insufficient, lacking information about the appraisers’ education, qualifications and the method of valuing the easement. The court also found the description of the donated property to be lacking in detail, noting that it was merely a draft that was unsigned. Without the information, the IRS has no way to judge if the appraisal is reasonable or to understand the basis for the valuation, added the court. While the couple was entitled to the \$21,600 deduction for the cash gifts, the deduction for the facade easement was properly disallowed, the court ruled (*Bruzewicz v. U.S.*, 2009-1 USTC ¶150,317).

PUZZLER SOLUTION

Temp. Reg. §1.7872-5T permits interest-free loans of up to \$250,000 to any number of charities. If Phil borrows from his line of credit to make the charitable loan, he may be entitled to an income tax deduction for the interest he pays. Although he would not be charging interest, a charitable loan is considered to be “held for investment.” Code §163(d)(5) defines “property held for investment” to include any property that produces income of the type described in Code §469(e)(1), which specifies “gross income from interest not derived in the ordinary course of a trade or business.” The IRS has interpreted that broadly to include interest-free charitable loans that produce only imputed interest (TAM 9526003).

PRIVATE FOUNDATIONS: CUSTOM-DESIGNED PHILANTHROPY

Private, or family, foundations are charitable organizations set up by individuals or firms that are managed or strongly influenced by the donors who established them or by members of their families.

Asset size may range from a quarter-million to hundreds of millions of dollars (most family foundations are under \$5 million). According to recent figures, there are more than 30,000 private foundations currently operating in the United States. Here are the principal advantages ascribed to private foundations:

■ **Control.** A private foundation offers donors the ability to custom-design a program of giving. Family foundations can provide continuity of giving after death and multigenerational involvement. Donors also can continue to control the management and investment of assets contributed to their foundations and provide a role for children and grandchildren within the foundation.

■ **Personal Fulfillment.** Maintaining a family foundation can commemorate and memorialize a family's commitment to the community, important causes and institutions.

■ **Continuity.** Establishing a foundation enables individuals to carry on giving programs in perpetuity, or at least for several generations.

The charitable deduction for a private foundation created during the donor's lifetime is limited to 30% of the donor's adjusted gross income for gifts of cash or ordinary income property and 20% for gifts of capital gain property.

The Code also limits the income tax charitable deduction for gifts of appreciated assets. If a donor funds his private foundation with appreciated property, he will be able to deduct the full fair market value of the property only if it is (1) stock of a corporation that is quoted and traded on an established market and (2) held for the long-term capital gain holding period. Otherwise, the deduction is reduced by the amount of gain that would have been long-term capital gain if the property had been sold at its fair market value [Code §170(e)(1)(B)]. A deduction for the full fair market value of appreciated stock is not available where the donor or his family (spouse, siblings, ancestors and lineal descendants) give more than 10% of the total stock in a company.

Private foundations established by will are not subject to any estate or gift tax charitable deduction limits, so the full fair market value of appreciated property will be deductible.

The IRS website has an extensive article, "The Life Cycle of a Private Foundation," that can be found at <http://www.irs.gov/charities/foundations/article/0,,id=127912,00.html>.

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