

The Advisor



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ESTATE PLANNER'S TIP

One of the realities of corporate culture is that some clients (or prospective clients) must lead an itinerant lifestyle, moving from one state to another every few years. Such clients present challenges for the estate planner. Not only do the requirements for drafting a valid will or trust vary from state to state, but the definition of property ownership, the age of majority and fiduciary and administrative powers also may differ. For married couples, moves to and from community property states are of particular concern. If any of your clients have moved to town recently, or plan to move away, you should make them aware of the need to review their estate plans to ensure that their estate planning objectives have not been affected by local law. Do they need a new trustee? If the executor resides in the state of former domicile, is he or she still willing and legally able to serve? In planning for "migratory" clients, it makes sense to draft wills and trusts with as much specificity as possible and not use broad terms that might be interpreted differently in another state. Marital agreements and revocable trusts can also be helpful in planning ahead for clients who may move many times during their lives.

DECEDENT HAD NO INCIDENTS OF OWNERSHIP

David established an irrevocable trust that prohibited him from serving as trustee or from revoking, altering, amending or terminating the trust. The trust was for the benefit of his descendants. The trustee used trust assets to purchase a life insurance policy on David's life. David made annual gifts to the trust, which the trustee used to pay the insurance premium. The policy was payable to the trust upon David's death.

The trust gave David the power, exercisable at any time, to acquire any property held in the trust by substituting other property of equivalent

value. The power was exercisable in a nonfiduciary capacity, without the approval or consent of any person acting in a fiduciary capacity. The trustee was obligated under local law to ensure that the property that David sought to substitute was equivalent in value to the property distributed to him.

David died without exercising his power to substitute property. His estate asked the IRS whether the power to substitute property was considered an incident of ownership that would cause the value of the policy to be included in David's estate under Code §2042.

Reg. §20.2042-1(c)(4) provides that a decedent is considered to have an incident of ownership in a policy held in trust if, under the terms of the policy, the decedent has the power to change the beneficial ownership in the policy or its proceeds or the time or manner of enjoyment thereof, even though the decedent has no beneficial interest in the trust. Rev. Rul. 84-179 (1984-2 C.B. 195) provides that a decedent will be deemed to have incidents of ownership over an insurance policy on the decedent's life where the decedent's powers are held in a fiduciary capacity and the decedent has transferred the policy or any of the consideration for purchasing and maintaining the policy to the trust.

The IRS said that David's trust expressly prohibited him from serving as trustee and that the power to substitute assets was held in a nonfiduciary capacity. In view of the trustee's ability to reinvest the assets and duty of impartiality to the trust beneficiaries, there will be no shifting of benefits between or among the beneficiaries that could otherwise result from a substitution of property by David. Provided the trustee has a fiduciary obligation under either local law or the trust instrument to ensure that the substituted property was of equivalent value, and provided that the substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries, the IRS ruled that David did not have incidents of ownership in the policy under Code §2042(2) (Rev. Rul. 2011-28).

PHILANTHROPY PUZZLER

Michael has purchased season tickets for his alma mater's basketball games since graduating from college. The school recently built a new arena and has established a booster club seating section. Anyone wishing to purchase a priority seat in the designated area must pay a \$2,500 annual fee, in addition to the cost of the game tickets. Michael, who hopes to get tickets in the booster section, has asked if the \$2,500 fee is deductible as a charitable contribution.

BUSINESS MILEAGE RATE STAYS CONSTANT

For 2012, the IRS is sticking with the 55.5 cents per mile standard mileage rate for business that it announced effective July 1, 2011. The mid-year adjustment was a 4.5 cents per mile increase from the beginning of 2011. The mileage rate for medical or moving use of a vehicle has dropped, however, from 23.5 cents per mile to 23 cents. The mileage rate for service to a charitable organization remains by statute at 14 cents per mile (IR-2011-116).

VOLUNTEER GETS SOME, NOT FULL, DEDUCTION

Tawana Bradley served as the volunteer cheerleading coach for a football league that her husband coached. The couple claimed charitable deductions in 2006 for out-of-pocket expenses. These included:

- \$660 for the rental of a bus;
- \$162.27 for pizzas, stickers, ribbons, office and party supplies for a team party;
- mileage totaling 1,857.6 miles for practices four times per week.

The Tax Court determined that the volunteer activities were to benefit the Muhammad Ali Yellowjackets, a qualified charitable organization. The court then looked at whether Bradley had properly substantiated the deductions.

Although she had a receipt for the bus rental, she did not have a written acknowledgment from the organization indicating that she had made the gift. For gifts of \$250 or more, taxpayers are required to obtain a written acknowledgment from the donee organization [Code §170(f)(8)(A)]. The court said she was not entitled to deduct the bus rental expense.

Bradley had receipts from the vendors who supplied the pizza, stickers, ribbons and supplies for the team party. Although these are not receipts showing the name of the donee organization, they are "legitimate substitutes" because

they contain all of the pertinent information that would have appeared on a canceled check. She was entitled to deduct the expenses for the party.

Bradley had a computerized map showing directions and mileage to the practice fields. This qualifies as “other reliable written records” for purposes of Reg. §1.170A-13(a)(2), said the court. She was entitled to a deduction of 14 cents per mile for travel to and from practices and games, ruled the court (*Bradley v. Comm’r.*, T.C. Summ. Op. 2011-120).

CY PRES SAVES SKIMPY ENDOWMENTS

The revocable trust created by Robert and Olga Von Tauber provided several charitable bequests, including two that created problems for the estate. The first directed that \$200,000 be used to create a foundation, the annual income of which was to be distributed to a needy minor student from the town of Huntington, NY, to support his or her continuing education.

The trustees asked the Surrogate’s Court to allow the funds to instead be placed in a separate fund in the Von Taubers’ names with the Long Island Community Foundation. The purpose of the fund would be to provide scholarship money to high school students from Huntington who demonstrate financial need. The trustees said that \$200,000 was inadequate to fund and administer a foundation that would continue over a substantial period of time.

The court noted that where literal compliance with the terms of a charitable bequest are impracticable, the court can apply the cy pres doctrine to direct the funds in a manner that will most effectively carry out the charitable purposes. It was clear, said the court, that the scholarship program was charitable in nature, and that the Von Taubers demonstrated their charitable intent in their trust. The expense of administering the foundation would reduce the funds available to provide scholarships, thereby thwarting the

couple’s intent. Placing the funds with the community foundation allows the scholarship to be offered as the couple intended.

A second bequest of 25% of the remainder of the trust was to be used to establish a perpetual endowment, with income to fund a fellowship for the advanced study of psychiatry at the School of Medicine at SUNY. The school informed the trustees that the amount available to fund the endowment – approximately \$266,000 – was insufficient to establish a fellowship. University rules prohibit unaccredited fellowships.

Instead, the trustees proposed to establish a fund, to be administered by the school in the Van Taubers’ names, for the benefit of fourth year medical students and fellows. The court approved the transfer under the doctrine of equitable deviation, saying it did not effect a change of the charitable intent and did not significantly alter the classification of the recipients (*In re Von Tauber Revocable Trust*, 2011 NY Slip Op. 52095).

PUZZLER SOLUTION

Generally, a payment made with the expectation of a benefit is not made with charitable intent and does not qualify for a charitable deduction [*Comm’r. v. Duberstein*, 363 U.S. 278]. There is an exception, however, for payments made to a college or university in exchange for the right to purchase tickets to athletic events. Under Code §170(l), taxpayers may deduct 80% of the payment, even though the cost of the tickets themselves is not deductible. Since 80% of Michael’s payment exceeds \$250, he will need a contemporaneous written substantiation from the school [Reg. §1.170A-13(f)(14)] to qualify for the deduction.

S CORPORATION GIFTS POSSIBLE, BUT MAYBE NOT ADVISABLE

Since 1998, charities have been able to own S corporation stock [Code §1361(c)(7)]. While this presents an opportunity for the owner of an S corporation to make a charitable gift of stock in the company, it can create adverse tax consequences for the donee charity that are not present with gifts of C stock.

Unlike C corporation stock, the items of income, loss, credit or deduction and any gain or loss on the sale or disposition of S corporation stock by a charity will be taken into account in determining the organization's unrelated business taxable income (UBTI). Having UBTI is not unusual for many organizations, but it does make a gift such as S stock less valuable.

Gifts of S stock to charity present several challenges:

■ Can the stock be sold easily? It is the policy at most charities to immediately sell gifts of stock. In the case of S stock and other closely held shares, the market may be limited. A sale to another shareholder in the company or even to a third-party within a short time of the gift may raise the issue of a prearranged sale. The IRS may try to impute the capital gains to the donor.

■ The donor's deduction will have to be reduced if there is any ordinary income element in the stock value (e.g., appreciated inventory). Ordinary income property is property which, if sold at fair market value on the date of the gift, would produce gain other than long-term capital gain [Reg. §1.170A-4(b)(1)].

■ If the charity does not or cannot sell the S stock quickly, it will be subject to tax on its proportional share of the S corporation's income, even if all income is not distributed to the shareholders. Incorporated charities will pay tax at corporate rates (15% on UBTI up to \$50,000; 39% on UBTI between \$100,000 and \$335,000). But charities organized as trusts will reach the top

35% tax bracket at UBTI of only \$11,650 (2012 level).

■ Donors of S stock may have a relatively low basis, which will carry over into the hands of the charitable donee, resulting in large capital gains upon sale, greater UBTI and a lower net gift to the organization.

S corporation stock may not be used to fund charitable remainder trusts. In addition to charities, S shares generally may be owned only by individuals, estates and special trusts known as qualifying subchapter S trusts (QSST). A QSST must distribute all of its income to only one individual who is a citizen or U.S. resident. An irrevocable election must be made to treat the trust as a QSST [Code §1361(d)].

The IRS has ruled that the QSST election and the charitable remainder trust provisions are mutually exclusive (Ltr. Rul. 8922014). A charitable remainder trust must distribute either a fixed unitrust or annuity trust amount – not all the income, as required by a QSST. Further, the grantor of a QSST is considered the owner of the trust under the grantor trust rules (Code §§671-679). But Reg. §1.664-1(a)(4) specifically provides that a charitable remainder trust is not deemed created until the earliest time that neither the grantor or any other person is treated as the owner of the trust under the grantor trust provisions. The IRS ruled that the income tax charitable deduction for transfers to a trust for which the QSST election has been made would be disallowed and the trust would not be tax-exempt.

While legally permissible, charities are unlikely to accept S corporation stock in exchange for a charitable gift annuity, due to the issues raised above with lack of liquidity and UBTI. For outright gifts, however, where sale or redemption is not a problem, many charities would accept the stock.

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