The Advisor

BALL STATE UNIVERSITY FOUNDATION
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ESTATE PLANNER'S TIP

One attractive feature of the Roth IRA for clients who do not need added income is that there is no mandatory distribution requirement [Code §408A(c)(5)]. Funds can remain in the IRA until the owner's death and will not be taxed as income in respect of a decedent. However, at the owner's death, the Roth is considered a traditional IRA in the hands of a non-spouse beneficiary and is treated as if the owner died prior to the required beginning date. The beneficiary must either (1) satisfy the five-year distribution rule [Code §408A(d)(2)(B)] by withdrawing the entire account by December 31 of the fifth year after the owner's death, or (2) spread the distributions over the beneficiary's life expectancy. If the beneficiary is the owner's surviving spouse, the Roth IRA can be rolled over to a new Roth in the spouse's name, with no requirement for mandatory distributions. The surviving spouse may then name a new beneficiary who can spread distributions out over his or her lifetime following the spouse's death. These "stretch-out" options may offer the potential for tax-free growth and distributions, particularly where the beneficiaries are relatively young.

CHARITIES GET LIFETIME GIFTS *AND* BEQUESTS

Charles Walgreen included a number of bequests of Walgreen company stock to charities in his living trust. Rotary/One Foundation, Inc. and the Rotary Foundation of Rotary International were each to receive 10,000 shares. In total, he left more than 900,000 shares of Walgreen stock to charity. Walgreen also prepared a "beneficiary list" in September 1999, that he left with his financial advisor.

In October 1999, Walgreen made several outright gifts of stock, calling these "pre-bequest" donations, "prepayment" on bequests or "advance payment" of Walgreen company shares. It was acknowledged that these inter vivos gifts were meant to revoke gifts included in his trust. The Rotary Foundations were among the charities that received outright contributions of stock.

Following Walgreen's death in 2007, family members filed suit, alleging that the bequests to the Rotary Foundations and several other charities had been adeemed by the lifetime gifts. They argued that the lifetime gifts created an ambiguity in the trust that required the consideration of extrinsic evidence. The family said that Walgreen's "beneficiary list" constituted a scorecard for him to keep track of shares given during his lifetime. All of the charities, except for the Rotary Foundations, settled with the family.

The Rotary Foundations claimed that the doctrine of ademption does not apply to trusts under Illinois law, adding that there was no evidence Walgreen intended to adeem the bequests on the beneficiary list. The family argued that Walgreen's pre-bequest gifts to other charities established the same intent with the Rotary Foundations. The trial court granted the foundations' motion for summary judgment, finding no ambiguity in the trust documents.

The Illinois Appellate Court ruled that the doctrine of ademption applies to trusts, noting that the same principles are used to determine a settlor's intent in a will as in a trust. However, the court said that while Walgreen's lifetime gifts can indicate an intent to adeem, "we do not believe that is the case before us." The written communications between Walgreen and certain charities on the beneficiary list show that "when Walgreen wished that his lifetime gift satisfy a specific bequest, he states as much." The court declined to presume Walgreen's intent, when doing so "would be contrary to the language of the trust as a whole," (*Koulogeorge v. Campbell*, 2012 IL App (1st) 112812).

APPRAISAL OF WRONG ASSET FATAL TO DEDUCTION

Chateau Apartments, Inc., owned two apartment buildings in Arizona. Harvey Evenchik owned 15,534.67 shares – approximately 72% – of Chateau's stock. In 2004, Evenchik contributed all his shares to Family Housing Resources to create an endowment fund to assist low-to-moderate income individuals obtain affordable housing.

Appraisals of the two apartment buildings were attached to Evenchik's Form 8283, putting the combined value at $1,445,000. He claimed a charitable deduction of $1,045,289.30, representing 72% of the appraised value. The IRS challenged the deduction carried over to 2006, arguing that Evenchik failed to provide a qualified appraisal.

The Tax Court determined that Evenchik was not entitled to a deduction. First, noted the court, the appraisals attached to the Form 8283 valued the underlying assets of Chateau, not the value of the shares themselves. In addition, the appraisals did not address the value of Evenchik's 72% ownership interest in the company, which could have been overvalued by as much as 35%. The court found the appraisals "woefully short" of meeting the requirements of Reg. §1.170A-13(c)(3)(ii). Specifically, the appraisals did not give a description in sufficient detail to determine what was contributed, did not include a statement that the appraisals were prepared for income tax purposes and did not give the appraised market value on the date of the gift.

The court rejected Evenchik's argument that he had substantially complied with the regulations and therefore was entitled to the deduction. An appraisal of the wrong asset prevents the IRS from properly monitoring the claimed contribution, said the court, adding that a taxpayer can't substantially comply with the appraisal requirements if the appraisal submitted fails to meet the "essential requirements" of the governing statute. The "gaping holes" in the appraisals prevented the IRS from properly evaluating the property interest contributed, said the court (*Est. of Evenchik v. Comm'r*., T.C. Memo. 2013-34).

PHILANTHROPY PUZZLER

In her will, Clarice left $2 million to fund a charitable lead annuity trust. Her favorite charity is to receive $60,000 annually (3% of the $2 million in assets placed in the trust) for 25 years, after which time the assets pass to the grandchildren living at Clarice's death. Charitable remainder trusts must make minimum 5% payouts and term-of-years trusts can last no longer than 20 years. Is Clarice's trust in trouble?

CONVEYANCE WAS QUID PRO QUO, NOT CHARITABLE

James Pollard wished to build a second home on a parcel of farmland he owned in Colorado, but because the lot was slightly smaller than 70 acres, he needed approval from the county. While the county's land use staff recommended that Pollard's request to subdivide be denied, it added that if the recommendation were to be disregarded by the county board, approval should be subject to several conditions. One of these was that Pollard dedicate a conservation easement over the property to the county.

The county eventually agreed to allow the subdivision after Pollard executed a conservation easement that restricted use of the property to two homes and continued use for agriculture. An appraiser, using the before-and-after method, put the value of the easement at $1,049,850, which Pollard claimed on his income tax return. No one from the county signed Pollard's Form 8283. The IRS's appraisal put the value of the easement at $128,000.

A charitable gift for income tax purposes is defined as a payment made "with no expectation of a financial return commensurate with the amount of the gift" [*Hernandez v. Comm'r.*, 490 U.S. 680 (1989)]. The Tax Court noted that the granting of the conservation easement to the county was part of a quid pro quo exchange for the county granting the subdivision request and was of "substantial benefit" to Pollard. The county would not have been inclined to grant Pollard's request had he not granted the conservation easement, said the court. He did not convey the easement for "detached and disinterested motives," but did so to secure a personal benefit. Therefore, ruled the court, he was not entitled to a charitable contribution deduction (*Pollard v. Comm'r.*, T.C. Memo. 2013-38).

LESSON: GET IT IN WRITING

Before his death, Roland Arnall made three payments of $180,000 to Chabad of California, which the organization claimed were part of Arnall's $18 million oral pledge. The funds were to be used to construct a new facility.

Chabad sought to enforce the pledge against the estate, claiming promissory estoppel. Dawn Arnall denied any knowledge of her husband's pledge. The trial court said Chabad failed to prove the existence of the oral promise.

Chabad appealed, saying the trial court erred in refusing to draw negative inferences from Dawn Arnall's alleged withholding of the spreadsheets on which her husband's charitable contributions were recorded by his assistant. According to the assistant, the entries showed the purpose of each entry. Dawn Arnall argued that even without her testimony, there was no affirmative evidence of an oral promise to pay $18 million. The trial court found no evidence that she willfully concealed the spreadsheets.

The California Court of Appeals agreed, saying that the disregard or disbelief of one witness's testimony is not affirmative evidence of a contrary conclusion. Both the trial court and the appeals court noted Chabad's failure to produce evidence of the pledge, noting that it did not appear that a "diligent search and reasonable inquiry had been made" (*Chabad of California, Inc. v. Arnall*, B234059).

PUZZLER SOLUTION

Charitable lead trusts, unlike *remainder* trusts, are not required to pay a 5% minimum to the income beneficiary. Likewise, the 20 year maximum length for a term-of-years remainder trust does not apply to lead trusts, so neither of these factors will cause Clarice's trust to be disqualified [Reg. §1.170A-6(c)]. Note: An inter vivos reversionary lead trust, intended to generate an income tax deduction for the grantor, may lose the deduction if the trust term is so long that the reversionary interest falls below 5% (Code §673(a)].

LETTING HEIRS BUY ESTATE ASSETS MAY SAVE TAXES

Eli, the patriarch of a wealthy family, has several sons, daughters and grandchildren who have been handsomely provided for through various trusts. His interest now, he told his attorneys, is to leave his remaining $20 million to assure the continued support after his death of the numerous charities he has supported during his lifetime.

Real estate holdings, stock portfolios and other investments make up the bulk of Eli's estate. In addition, he owns a large collection of antique porcelain and several paintings by famous artists. His children have expressed an interest in some of the items of personal property, but, relying on the advice of his attorneys, Eli is hesitant to bequeath these items to his children.

First, his attorneys explained that a bequest of the porcelain and artwork worth, for example, $3.5 million to his children could produce an estate tax liability of as much as $1.4 million. Payment of that amount out of the charitable residue of his estate would mean the amount passing to charity would be reduced by the $3.5 million value of the property, the $1.4 million paid in estate tax and the added estate tax due to the reduction of the charitable bequest from taxes.

An alternative – one that may cost less in estate taxes – is to bequeath the items to the children, with charity as a contingent beneficiary. The children then may disclaim, under Code §2518(a), those items they do not wish to receive, and the property would pass directly from the estate to charity. The estate still will be subject to estate tax if total bequests and adjusted taxable gifts to noncharitable beneficiaries exceed the estate tax exclusion ($5.25 million in 2013).

Eli's attorneys suggested a way for charity to receive the full value of the estate, avoid any estate tax, and still permit the children to have ownership of selected pieces from their father's collection: They can buy the items from the estate.

Language would be included in the will giving the children the first option to purchase certain items of personal property at the fair market value as determined for estate tax purposes, within a set period after Eli's death. The cash proceeds would be added to the residuary estate passing to charity, leaving both charity and the estate in the same position as if Eli had left the property outright to charity. The option also should provide that if the IRS determines the fair market value to be greater than the amount paid, the purchaser shall make up the difference, with interest from the date of death, to avoid any estate tax liability.

At first glance it would appear that only Eli's children appear to be worse off under this arrangement. However, purchasing the property is a completely voluntary move on their part, allowing them to select the items they wish, given the price established for each. We have assumed, of course, that Eli has already provided for them amply enough to make the purchases. This arrangement permits them to select certain items to stay in the family, if they wish, or allow everything to pass to charity at zero tax.

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