The Advisor

BALL STATE UNIVERSITY FOUNDATION
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ESTATE PLANNER'S TIP

As part of any year-end review, advisors should check whether clients have inherited IRAs during the prior two years. In general, inherited IRAs are paid out over the life expectancy of the oldest beneficiary if there is more than one beneficiary [Reg. §1.401(a)(9)-1]. If multiple beneficiaries are named and each wishes to use his or her own life expectancy to take required minimum distributions, the inherited IRA can be split into individual IRAs. This must be done by the end of the year following the year of the IRA owner's death. Clients who wish to stretch out an inherited IRA over the longest period possible may need to make the split prior to year's end. This can be especially crucial where beneficiaries are from more than one generation.

PLEDGE, LEAD TRUST DON'T EQUAL SELF-DEALING

John and Marsha each had revocable living trusts that provided for the creation of testamentary charitable lead annuity trusts. They are also trustees of a charitable foundation. The couple's extended family had agreed to donate funds to support the development of a new hospital that would be named for the family.

Under a fund agreement entered into by family members, John and Marsha's foundation will donate a specified amount, to be paid in ten equal annual installments. John agreed to contribute an additional amount by funding a charitable lead annuity trust, to make payments annually for eight years. The funding of the lead trust is designed to satisfy John's entire obligation to contribute under the fund agreement.

Reg. §53.4941(d)-2(f)(1) provides that if a private foundation makes a grant or other payment that satisfies a legal obligation of a disqualified person, the payment will normally constitute an act of self-dealing. John and Marsha are both disqualified persons with respect to the foundation and to the lead trusts. They asked the IRS to rule on whether the payments by the lead trusts or the distribution of payments under the fund agreement would constitute self-dealing.

The IRS said the fund agreement was between the foundation and the hospital, with John and Marsha acting as trustees in entering into the agreement. Therefore, neither is personally obligated and the payments will not constitute self-dealing. The same is true with the obligation to fund a charitable lead trust, since the obligation runs from the lead trust to the hospital through the trustees, not John and Marsha personally.

The IRS also said the naming of the hospital after the family is an "incidental or tenuous benefit" that will not be considered an act of self-dealing [Reg. §53.4941(d)-2(f)(2)] (Ltr. Rul. 201421023).

IRA ROLLOVER LIMIT WON'T APPLY THROUGH 2014

Language in IRS Publication 590, Individual Retirement Arrangements, provides that the one-rollover-per-year rule is to be applied on an IRA-by-IRA basis. However, the Tax Court recently ruled that the limitation applies on an aggregate basis [*Bobrow v. Comm'r.*, T.C. Memo. 2014-21]. Therefore, an IRA owner who has made an IRA-to-IRA rollover cannot make another one with a different account within a one-year period [Code §408(d)(3)(B)].

The IRS has announced it will be revising Publication 590 and following the ruling in *Bobrow*, but due to "administrative challenges," will not be applying the court's ruling on rollovers occurring before January 1, 2015. This will allow IRA trustees time to make changes in their processing procedures and disclosure documents.

The one-rollover-per-year rule does not apply to trustee-to-trustee transfers, noted the IRS, because these are not considered rollovers [Rev. Rul. 78-406, 1978-2 C.B. 157] (Announcement 2014-15).

PHILANTHROPY PUZZLER

Ben has an extensive baseball card collection that has been valued at $250,000. His basis in the cards is almost zero. He has considered putting the collection into a charitable remainder trust that would pay income to him and his wife for life and then benefit the sports program at his alma mater. A fellow card collector (an attorney) cautioned Ben that his charitable deduction would be negligible and would be available only when the trustee sold the cards (Ltr. Rul. 9452026). Ben has asked if the trust still makes sense.

WHAT'S IN A NAME?

Virginia Rogers, a widow with no children, had an estate plan with several million dollars in bequests to friends and distant relatives. The rest of her multi-million dollar estate was left to seven charities and her alma mater. In 2000, when Rogers was age 89, she executed a document in which she agreed to leave her co-op and furnishings, worth about $1.5 million, along with $4 million cash to a neighbor, George Dohrmann. In 2004, Rogers transferred ownership of the co-op to her living trust and, in 2008, the probate court determined she was suffering from dementia.

In 2007, Dohrmann filed suit seeking to enforce the contract. He said Rogers had wanted her name to continue after her death. As consideration for the contract, Dohrmann had the name "Rogers" legally added as a middle name to his two sons' names. Dohrmann had, years earlier, approached Rogers with the idea of an adult adoption, going so far as to lease an apartment in Arkansas, where such adoptions were allowed.

The circuit court agreed with Rogers' estate that the contract was unenforceable. The Appellate Court of Illinois affirmed, citing the "gross inadequacy of consideration" and the unfair circumstances surrounding the contract's execution. The court noted that the contract called for no future services to be performed, making the addition of Rogers' surname to his sons' middle names the only consideration. Rogers "did not gain much" in the arrangement, particularly since the boys did not consistently use the names and could have the names legally changed again. The court found the benefit to Rogers to be "almost nonexistent."

At the time the contract was signed, Rogers was an 89-year-old widow, who shortly afterward was diagnosed with Alzheimer's. Her long-time attorney was not consulted. By contrast, Dohrmann is "a highly educated neurosurgeon" who had consulted an estate planning attorney to draft a "skeleton" agreement for Dohrmann to present to Rogers. The court found the consideration grossly inadequate and the circumstances surrounding the contract unfair to Rogers (*Dohrmann v. Swaney*, 2014 IL App (1st) 131524).

IRS OKAYS "DO-OVER"

A charitable remainder unitrust created a number of years earlier was to pay income for life to the settlors and their two children. Over the years, the trustees had paid out the stated percentage, even though trust language called for the trust to pay the lesser of net income or the stated percentage. In many of those years, net income had been less.

The settlors are now dead, leaving the children as the only income beneficiaries. A court issued an order reforming the trust ab initio into a standard trust, finding that inclusion of net-income language was a scrivener's error. The children asked the IRS to rule on whether the reformation would be self-dealing.

In general, the self-dealing rules of Code §4941 do not apply to amounts payable under the terms of a split-interest trust, so long as no deduction was allowed for the income interest under Code §§170(f)(2)(B), 2055(e)(2)(B) or 2522(e)(2)(B). According to the trustees, neither the trust nor the settlors took the deductions for payments to the income beneficiaries.

The reformation of the trust from a net-income to a standard unitrust will have the effect of increasing the annual amount payable to the income beneficiaries, the IRS noted. This could constitute self-dealing under Code §4941(d)(1)(E), as a transfer to or for the benefit of a disqualified person. However, the IRS found no self-dealing, saying a court had determined a scrivener's error, the trust had been administered from the beginning as a standard unitrust and affidavits by the drafting attorney and one of the income beneficiaries indicated the settlors' intent had been to establish a standard unitrust. The IRS also found that the children would not reduce their own taxes and were not using the benefit of hindsight to reform the trust (Ltr. Rul. 201426006).

WAIVER OR ELECTIVE SHARE EFFECTIVE

One day prior to marrying his second wife, Albright Zimmerman signed an antenuptial agreement prepared by lawyers for his new wife, Janet. It provided for Janet to have a life estate in his home and receive the $1,000 per month income from a friend who rented an office in the house. Both parties waived their elective shares. Zimmerman was to establish a trust to hold his real estate and investments. Janet would receive income quarterly from this trust following Zimmerman's death. In addition, the agreement indicated that Zimmerman intended to create a charitable trust that would pay income of at least 6% and would continue for Janet's life.

Zimmerman died five months later without having established either trust. Under a will executed in 2005, Zimmerman's estate passed to various friends, relatives and charities. Janet elected to take her spousal share. The trial court confirmed the validity of the antenuptial agreement and directed the executor to establish the trust referenced in the agreement. Janet appealed, claiming that without the creation of the trusts, there was no bargained for consideration in return for her waiver of her elective share.

The Superior Court of Pennsylvania found that there had been full and fair disclosure by the parties. Further, Janet received the life estate along with the rental income from Zimmerman's home. The court found the language regarding the creation of the trusts to be "speculative," noting Zimmerman died only five months after the wedding. Because the trial court ordered that the estate establish the trust, Janet will receive the benefit of all the agreed upon promises (*In re Estate of Zimmerman*, No. 2315 EDA 2013).

PUZZLER SOLUTION

Although Ben's deduction would be calculated on his basis in the collection rather than the fair market value, it might nevertheless be worthwhile to use the cards to fund a trust. If he were to sell the cards instead, he would owe capital gains taxes of about $70,000 – and possibly another $9,500 in net investment income tax – reducing the amount left to reinvest. The trustee, on the other hand, can sell the collection free of tax and pay income based on the full fair market value of the sale proceeds, potentially providing Ben with significantly higher spendable income. He is able to satisfy philanthropic goals without sacrificing current income.

COUNTING ON CONGRESS TO BE CHARITABLE

The U.S. House of Representatives recently approved H.R. 4719, the America Gives More Act. One provision would retroactively renew and make permanent the ability of those ages 70½ and older to make direct transfers from IRAs to charity, up to $100,000 per year, without recognizing income on the distributions. Code §408(d)(8) expired at the end of 2013, but is included in the package of extenders currently awaiting Congressional action. Making the law permanent may be a hard sell, however. The Joint Committee on Taxation estimates that federal revenue would be reduced by $8.4 billion between 2014 and 2024.

The law has been a staple in the philanthropic arsenal since 2006. Qualified charitable distributions (QCDs) provide tax savings, even though no charitable deduction is allowed, because they can satisfy required minimum distribution rules. Gifts may come only from Roth and traditional IRAs, not 401(k)s or other qualified retirement accounts. Checks must be made directly to public charities and cannot be directed to donor advised funds or be used to arrange charitable gift annuities or fund charitable remainder trusts.

Philanthropic clients who normally itemize their deductions can make their annual gifts to charity from their IRAs – up to their required minimum distributions – with little risk. If the law is extended retroactively, as it has been three times, the gift will be considered a QCD and the donor will avoid the income tax that would otherwise be owed on the required distribution. If the law is not reinstated, the gift to charity will be considered a withdrawal on which the donor is taxed, but an offsetting charitable deduction would be available.

What are other options with IRAs for those who aren't eligible for the QCDs?

■ *Outright bequests* – A charity can be named the beneficiary of all or part of an IRA or other retirement account. If family members are also named as beneficiaries, charity's share can be cashed out, allowing family members to use the stretch-out option.

■ *Charitable remainder trusts* – It may be attractive to name a charitable remainder trust to receive IRA proceeds at death, with family members as income beneficiaries. An estate tax charitable deduction is available, if needed, and the amount passing to the trust will not be depleted by the tax on income in respect of a decedent (IRD).

■ *Charitable gift annuities* – The IRS has ruled privately that an IRA can pass to charity at death, in exchange for charity's promise to pay a gift annuity to a named individual at a payout rate based on rates in effect at the donor's death for a person the age of the named annuitant (Ltr. Rul. 200230018).

■ *Charitable trusts for spouses* – Married clients can use IRAs to make additional contributions to inter vivos charitable remainder unitrusts, or to fund testamentary trusts for surviving spouses. The trust could also be an excellent vehicle for other IRD assets as well, such as U.S. savings bonds.

■ *Family trusts that benefit charity* – Clients whose estates are below the estate tax threshold may establish trusts to benefit family members, and finally charity, without the complexity and restrictions of a qualified charitable remainder trust.

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