

The Advisor



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ESTATE PLANNER'S TIP

A death certificate along with a copy of the trust or orders from a probate court are generally enough to provide access to a decedent's accounts – except for digital ones. Beginning in 2015, the personal representatives of Delaware decedents can request access to any digital assets – Twitter, Google, Facebook and others. Other states may have similar laws. A better option may be to leave a list of screen names and passwords that will allow family members to access the accounts after death. This is true not only for social media sites, but especially for bank, brokerage, credit card and any other accounts that would permit the executor to determine whether there are assets that need to be accounted for in administering the estate.

SURVIVING SPOUSE, AS SOLE BENEFICIARY, ELIGIBLE FOR IRA ROLLOVER

Jesse, who died prior to age 70½, directed that his IRA was to pass “as provided by my will.” His wife, Sandy, was named sole beneficiary in his will and appointed his personal representative.

Sandy's financial adviser told her that because Jesse had not named a designated beneficiary, his IRA would have to be transferred to an estate IRA. Sandy took a distribution from the estate IRA, and within 60 days, completed a rollover of the distribution into an IRA in her name. She intends, in her capacity as sole executor and beneficiary, to receive the balance of Jesse's IRA and transfer that to her rollover IRA.

The IRS said that generally, if the proceeds of a decedent's IRA pass through a third party such as a trust or an estate before being distributed to the

surviving spouse, the spouse is treated as having received the IRA proceeds from the third party, not the decedent's IRA. The surviving spouse is not eligible to roll over the distributed IRA proceeds to his or her own IRA. However, the general rule does not apply where the IRA has not yet been distributed and the surviving spouse, as executor of the estate, has sole authority and discretion to pay the IRA proceeds to himself or herself. Therefore, the surviving spouse may roll over the amounts into an IRA within 60 days [Reg. §1.408-8, Q&A 5].

The distribution to Sandy, as personal representative and sole beneficiary, constituted an eligible rollover under Code §408(d)(3)(A), said the IRS. Nothing will not be included in Sandy's income in the year of the distribution (Ltr. Rul. 201430020).

REFORMATION ISN'T SELF-DEALING

Brian and Angela established a private foundation. They also created a trust that allocates certain assets between the foundation and their two children, with the children receiving a larger portion of the assets.

The couple amended the trust to allocate additional assets to their children, but the percentages were changed in only two of the three sections listed in the trust. The error was not discovered until after Brian's death, when the trust became irrevocable. A court interpreted the trust as a consistent whole, based on a clerical error.

Because Brian, Angela and their children are disqualified persons relative to the private foundation, any direct or indirect transfer to, or use by or for the benefit of, any party would be self-dealing [Code §4941(d)(1)(E)]. However, the IRS found that Brian and Angela intended all remainder clauses in the trust to be consistent. Because the error was not discovered while the trust was revocable, and because all parties consented to the reformation, the IRS ruled that no act of self-dealing occurred (Ltr. Rul. 201432025).

NO LONGER A HOSPITAL OR A BENEFICIARY

Harriet Woodward established a charitable trust under her will at her death in 1989. Annual income from the trust was to be paid in equal shares to seven named organizations. If any organization

ceased to be recognized as a tax-exempt charity, its share was to be divided among the remaining organizations.

In 2005, the assets of one of the seven beneficiaries – Chestnut Hill Hospital – were sold to a for-profit entity. A tax-exempt organization – Green Tree Health Foundation – was established to satisfy the hospital's outstanding liabilities. The trustees of Woodward's trust paid a one-seventh share to Green Tree from 2005 to 2009. In January 2009, the trustees asked the court to determine whether Green Tree should continue receiving a share of the income.

Although Green Tree was an exempt organization, it had become a grant-distributing foundation that provided support for entities running after-school clubs, providing food for the homeless, funding playgrounds and providing legal aid for low-income adults. The Orphans' Court ruled that Green Tree was not entitled to distributions from the Woodward trust. The Superior Court of Pennsylvania affirmed.

Green Tree's connection to the hospital is merely "vestigial," the court found. While it may be the legal successor to the hospital, it did not assume the hospital's identity or functions. Green Tree does not share a charitable purpose with the hospital and does not meet Woodward's intent to benefit health care. The fact that the trustees paid income to Green Tree for several years is not binding, the court said. Although Green Tree was the successor legal entity, it is not a successor to the charitable purposes Woodward clearly intended to benefit. (*In re Green Tree Community Health Foundation*, No. 1159 EDA 2013).

PHILANTHROPY PUZZLER

Karen has been buying a U.S. savings bond every pay period for the past 38 years. Now that she is about to retire, she has concluded that her 401(k), IRA, Social Security and other savings will provide her with a more than adequate retirement income – without ever redeeming the savings bonds. She is considering a gift of the bonds to her favorite charity and has asked about the tax consequences. What do you advise?

FOUR STRIKES AND YOU'RE OUT

Philip Mestman executed a will in September 2013, shortly prior to his death. Because Mestman's wife and daughter had predeceased him, his entire estate passed to a charity. Mestman had another daughter, Cathy, but the will specifically disinherited her. Three earlier wills executed by Mestman – in 1997, 2007 and

2008 – also disinherited Cathy. The executrices asked that the will be admitted to probate and for authority to sell Mestman’s home.

Cathy, acting pro se, objected, saying the executrices and counsel for the estate were “duplicitous,” have engaged in “ingannation” (fraud), were “nothing but filchers” and one of the petitioners was “a rank dipsomaniac” (alcoholic). She also claimed court personnel were “inept and unresponsive.” The executrices argued that the cost of maintaining Mestman’s vacant home was causing a depletion of the estate’s assets, to the detriment of the charitable beneficiary. The Surrogates Court dismissed most of Cathy’s objections, calling them “unsubstantiated epithets.”

The court said that even if Cathy was able to have Mestman’s 2013 will set aside, there are still three other wills that disinherit her. The odds against nullifying all four wills so that she can inherit under intestacy are “formidable,” said the court, which granted authority to sell the home (*In re Probate Proceeding of Will of Mestman*, 2014 NY Slip Op 51183).

SUBSTANTIATED ANONYMOUS GIFTS AN OXYMORON

Irene and Peter Jermihov claimed charitable deductions of \$7,762 in 2009, most of which were for contributions to their church. The couple said they made anonymous cash gifts for sanctuary candles, the poor box or collection plate. The IRS disallowed the deductions for lack of substantiation.

Due to their anonymous gifts, they lacked cancelled checks or a contemporaneous written acknowledgment required under Reg. §1.170A-13(a)(1).

The Tax Court said it was satisfied that the couple had made contributions to the church when they attended services. The court allowed a \$1,000 deduction, based on the *Cohan* rule [*Cohan v. Comm’r.*, 39 F.2d 540]. However, the court refused to allow deductions for gifts to any other charities, noting there was nothing in the record to support an allowance for other gifts (*Jermihov v. Comm’r.*, T.C. Summ. Op. 2014-75).

DUELING WILL PROVISIONS INTERPRETED

The will of fashion photographer Francesco Scavullo left half of his collection of photos, negatives and transparencies to fund a charitable foundation in Scavullo’s name. He left “the balance of my tangible personal property” to a friend, Sean Byrnes. Later in the will, Scavullo provided that the remaining half of his photos, negatives and transparencies was to fund a trust. Income from the trust was to be paid to Byrnes for life, with the remainder passing to the foundation. Byrnes argued that he was entitled to half of the photos collection outright, rather than in trust.

The Surrogate’s Court of New York said it was clear that the same property could not be bequeathed both outright and in trust. Therefore, a canon of will construction provides that a prior will provision generally gives way to a later provision. The court found Scavullo’s general intent had been to provide for Byrnes partly outright and partly in trust. It was likely, said the court, that Scavullo used the phrase “tangible personal property” more broadly at one point and more narrowly at another (*In re Scavullo*, 2014 NY Slip Op. 31848(U)).

PUZZLER SOLUTION

Karen can’t contribute the bonds during her lifetime without redeeming them and giving the cash proceeds – and recognizing the interest earned on the bonds [*U.S. v. Chandler*, 410 U.S. 257 (1973)]. She would be entitled to a charitable deduction for the proceeds, however. If she leaves the bonds to charity at death, the value will be included in her gross estate, but her estate will be entitled to a charitable deduction. She also avoids the tax on income in respect of a decedent, so long as the bonds are a specific bequest to charity or pass to charity as sole residuary beneficiary [Code §691(a)(1)].

NONQUALIFIED CHARITABLE TRUSTS WORTH A LOOK

Most donors, and their advisors, are interested in making sure that a charitable remainder trust satisfies all the requirements of Code §664 in order to qualify for a charitable deduction. Generally, split-interest gifts must be in the form of a charitable remainder annuity trust [Code §664(d)(1)], charitable remainder unitrust [Code §§664(d)(2) and (3)] or a pooled income fund [Code §642(c)(5)] to entitle the donor to an income tax or estate tax charitable deduction. A trust that fails to qualify not only means a lost tax deduction, but the IRS could impose a gift tax on the charitable interest, and the trust will not be tax exempt.

But is an estate tax charitable deduction always necessary? Possibly not, particularly if the client's estate is completely sheltered by the estate tax credit (\$5.34 million for 2014). It's estimated that fewer than 4,000 estates per year will be subject to tax.

Consider Ben, who has an estate of \$2 million. He wants to benefit his only sister, Becky, and have the assets eventually pass to his favorite charity. But Ben doesn't want Becky's interest to be limited to a specified dollar amount or percentage as it would be with either an annuity trust or unitrust. He would like her to have all the income generated by the trust assets. If the charity had a pooled income fund, he could achieve that goal, but Ben would also like to give the trustee the right to distribute corpus to Becky if she needs additional funds. If Becky were Ben's wife, he could establish a qualified terminable interest trust that would allow distributions of principal and still qualify for the marital deduction [Code §2056(b)(7)]. At Becky's death, the

value of the assets passing to charity would qualify for a charitable deduction in her estate. But there is no such deduction available for non-spouses.

Ben could, however, create a testamentary trust for Becky's benefit and have the assets pass at her death to charity. The result? Ben's estate is not entitled to a charitable deduction, but it is more than sheltered by the estate tax credit. Becky is subject to tax on distributions from the trust, just as she would be with a qualified charitable remainder trust. At her death, no part of the trust is included in her gross estate, unless Becky held a general power of appointment. Charity is entitled to as much or as little as is left in the trust at Becky's death. Because the trust is not a qualified charitable remainder trust, it is not subject to the private foundation rules [Code §§4941, 4943, 4944, 4945].

The drawbacks to a nonqualified trust? The trust is not a tax-exempt entity. Therefore, the sale of assets within the trust will not avoid capital gains tax. This may not be as much of a concern with a testamentary trust, where the assets funding the trust will receive a stepped-up basis at Ben's death. Taxes may be a problem, however, if the trust is funded with U.S. savings bonds or other income in respect of a decedent. In addition, a trust itself may potentially be subject to income tax – at steep rates. Trusts hit the top tax rate (39.6%) when taxable income reaches \$12,150 in 2014. However, a trust is not taxed on income distributed in a particular year. Nonqualified trusts may be worth investigating for clients who want to benefit charity but would like more flexibility than what is offered by charitable remainder trusts.

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