The Advisor

BALL STATE UNIVERSITY FOUNDATION
Established in 1951

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ESTATE PLANNER'S TIP

An individual can withdraw IRA savings prior to age 50½ without paying the 10% penalty on early withdrawals if the payments are part of a series of substantially equal periodic payments, made for the life or life expectancy of the owner (or joint life expectancies of the owner and designated beneficiary) [Code §72(t)(2)(A)(iv)]. The payments must continue for at least five years but may cease or be reduced once the owner reaches age 59½ [Code §72(t)(4)]. Because an individual with multiple IRAs is allowed to make the periodic equal withdrawals from one account without tapping into the others (Ltr. Rul. 9243054), a client with a large IRA could fund a new rollover IRA with just the amount needed to provide the desired income each year. For example, a 55-year-old client has an IRA of $4 million and a life expectancy of 28.6 years (IRA Table V). The client would like to receive $50,000 annually. Using a 2.2% interest rate assumption (Jan. 2015 federal midterm rate), if the client transfers $975,000 into a rollover IRA, the annual payments would be $52,193 ($975,000 ÷ 18.6808 annuity factor from IRA Table S). The client does not have to calculate the equal withdrawals on the total $4 million in both accounts. This may be an option for clients with large IRAs who want to work part time but don't want to reduce their income. Income can be increased in later years by establishing additional rollover IRAs.

WHICH CAME FIRST: TAXES OR THE EGG?

Twice in 2009, Nichelle Perez underwent egg retrieval procedures in order to serve as an egg donor to anonymous infertile couples. She signed contracts indicating that she was being paid for her "good faith and full compliance with the donor egg procedure, not in exchange for or purchase of eggs." During each round, she submitted to invasive tests, hormonal injections and a retrieval procedure under anesthesia. She was paid $10,000 each time.

Perez did not include the $20,000 in her gross income, assuming that she was being compensated for her pain and suffering. The IRS disagreed, saying the payments were for her services and, therefore, taxable.

The Tax Court noted that the exclusion from taxes for damages under Code §104(a)(2) refers to amounts received through the prosecution of a legal suit or a settlement agreement in lieu of prosecution. The court added that while Perez has a "legally recognized interest against bodily invasion," when she consents to such invasion for payments, the amount she receives must be included in taxable income. The payments were made not to compensate her for the unwanted invasion, but for services rendered. Ruling in her favor could lead to professional boxers arguing that some portion of the payments are excludible because they are for bruises, cuts and nosebleeds, or a hockey player excluding a portion of his million dollar salary for the chipped teeth that are an inevitable part of his career. Clearly, some of the payments received in these occupations "reflect the risk that they will feel pain and suffering," but it's pain and suffering they agreed to before beginning the work, said the court (*Perez v. Comm'r.*, 144 T.C. No. 4).

ADDING BY DIVIDING

Martin named his revocable living trust as the designated beneficiary of his IRA. Following his death, the successor trustee divided the IRA into five equal shares, labeling each as a beneficiary of Martin's IRA. The trustee proposes to distribute the five separate IRAs to new IRAs, each titled in Martin's name for the benefit of one of his five children. The living trust, which became irrevocable at Martin's death, directed that each share could be distributed outright to any child who had reached the age of 30. All five children had attained age 30 at Martin's death.

The IRS ruled that the trust was a "see-through" trust [Reg. §1.401(a)(9)-4, Q&A-5] and that the five beneficiary IRAs will be inherited IRAs within the meaning of Code §408(d)(3)(C). Therefore, ruled the IRS, each of Martin's five children may take required minimum distributions from his or her respective IRA based on the life expectancy of the oldest of the siblings who remain a beneficiary of the trust on September 30 of the year following Martin's death (Ltr. Rul. 201503024).

PHILANTHROPY PUZZLER

Myra was planning to create a charitable remainder trust but didn't want her favorite charity to have to wait until her death before receiving any benefits. Her advisor suggested that she could include the charity as an income beneficiary, as well as remainder beneficiary, of the trust. In reviewing the computations of the charitable deduction with Myra, her advisor explained that she could deduct the value of charity's remainder interest but could deduct nothing as to charity's share of the income interest. Why is this true?

FOUNDATIONS MAY BE LIABLE TRANSFEREES

Dorothy Diebold, age 94, wanted to make gifts to her three children, but her advisors informed her that she would have to sell shares of closely held stock in the marital trust established by her husband to make cash gifts. Prior to the sale, one-third of the shares were transferred to a charitable foundation created by her husband in 1963.

The closely held shares were valued at about $319 million. The capital gains tax was estimated at about $81 million. Diebold's advisors arranged a sale at a discount in a convoluted transaction to a new, unrelated entity that claimed losses sufficient to offset the built-in gain on the shares. The $309 million paid for the shares was distributed to the marital trust and the foundation. The foundation then distributed all its assets to three foundations formed by Diebold's children.

The IRS assessed a deficiency, saying the sale of the stock was in essence a sale of the company's assets followed by a liquidating distribution to the shareholders. However, when the IRS was unable to find any assets of the company from which to collect the tax, it asserted transferee liability against each of the foundations.

The Tax Court said the original Diebold Foundation was not liable because it lacked actual or constructive knowledge under New York law of the fraudulent tax avoidance scheme. Since the original foundation was not liable, the successor foundations could not be liable. The IRS appealed to the Second and Ninth Circuit Courts of Appeals – representing where two of the three foundations were organized. The Second Circuit, finding the shareholders had constructive knowledge of the scheme, remanded to the Tax Court to determine transferee status and the applicable statute of limitations. The Ninth Circuit found that the Second Circuit decision of the shareholders' knowledge of the fraudulent conveyance was "not demonstrably erroneous." That court, too, remanded to determine transferee status and the statute of limitations (*Salus Mundi Foundation v. Comm'r.*, 2015-1 USTC ¶50,120).

NO RECEIPTS, NO DEDUCTIONS

Edgar and Julia Flores claimed a charitable deduction of $1,230 for gifts by cash or check to miscellaneous charities and $5,999 for expenses related to Julia's volunteer work. The IRS disallowed both amounts, saying the couple failed to substantiate their contributions, as required by Code §170(f)(17).

The Tax Court agreed, noting that they had no receipts, bank records or documentation for the gifts by cash or check and that Julia did not produce documents to substantiate her volunteer expenses (*Flores v. Comm'r.*, T.C. Memo. 2015-9).

Note: Out-of-pocket expenses and unreimbursed expenditures incurred in performing volunteer services may be deducted, provided the taxpayer produces a canceled check, a receipt from the charitable organization with the donee's name, address and date of contribution or other reliable written records [Reg. §§1.170A-13(a)(1), (f)(10)(i)].

DIY RECEIPT NOT ADEQUATE

Reg. §1.170A-13(f)(1) requires that donors claiming charitable deductions of more than $250 have a contemporaneous written acknowledgment. What's more, the substantiation letter must come from the charity; it can't be written by the donor. The U.S. Court of Appeals agreed with the IRS and the Tax Court that John Longino was not entitled to the $25,000 deduction he claimed because the acknowledgment he produced was "a self-generated receipt thanking himself," noted the court. Worse yet, Longino's statement lacked the required language attesting that either no goods or services were provided in exchange for the transfer, or a good faith estimate of the value of any quid pro quo (*Longino v. Comm'r.*, 2014-1 USTC ¶50,104).

"FLOATING" EASEMENT NOT QUALIFIED

In 2013, the Tax Court ruled that donors were not entitled to a charitable deduction for a conservation easement on a golf course because the easement agreement permitted the donors to move the restriction to other property. The court said the easement was not a restriction in perpetuity, as required by Code §170(h)(2)(C).

The U.S. Court of Appeals (2nd Cir.) has affirmed, saying that although a restriction granted for less than a perpetual term might be valid under state law, it is not eligible for a federal income tax charitable deduction (*Belk v. Comm'r.*, 2015-1 USTC ¶50,107).

COMPARISON OF CHARITABLE GIVING TECHNIQUES

There are a variety of charitable giving techniques available to potential donors with varying future income and tax consequences. Donors, obviously, have different financial needs and tax problems, so the choice of a gift technique requires careful planning.

The following table compares a charitable remainder unitrust, a charitable remainder annuity trust, a charitable gift annuity and an outright gift

(*continued on back page*)

PUZZLER SOLUTION

In order to deduct the value of charity's income interest, the grantor must be considered the owner of the trust [Code §170(f)(2)(B)], as in a reversionary charitable lead trust. But for charitable remainder trust purposes, a qualified trust is not created until neither the grantor nor any other person is considered the owner under the grantor trust rules [Code §§671-677]. Myra receives no additional deduction for charity's income interest. A different rule applies to testamentary trusts, where the estate can be entitled to a deduction for the value of charity's income and remainder interests [*Estate of Boeshore v. Comm'r.*, 78 TC No. 34 (1982)].

COMPARISON OF CHARITABLE GIVING TECHNIQUES . . . (*continued from page 3*)

in light of the possible income tax charitable deduction, avoidance of capital gains tax through a contribution of appreciated property and possibility of favorably taxed income in the future.

Technique	**Income tax charitable deduction**	**Estate tax charitable deduction**	**Future income**	**Capital gains tax**	**Favorably taxed income**
Charitable remainder unitrust	Present value of charity's remainder interest (e.g., grantor age 65 deducts 45% of amount transferred with 5% payout and 2% §7520 rate). Generally higher than annuity trust deduction at low §7520 rates.	100% of 1-life trust; for 2-life trust, subtract value of survivor's interest. QTIP rules avoid tax for spouses.	Fixed percent of value of trust – a possible hedge against inflation. Minimum 5% payout; maximum 50%, with 10% remainder value required.	Capital gains tax avoided if trust is funded with appreciated property, meaning trustee can sell and reinvest for higher income or diversified portfolio, without loss to capital gains tax. This is true even if donor is not the income beneficiary.	Income beneficiary can receive tax-exempt income if trust has nothing but tax-exempt income and trust has not realized any capital gains. Trust's gains may be passed through to beneficiaries as income, under 4-tier system of Reg. §1.664-1(d)(i), with ordinary income paid first.
Charitable remainder annuity trust	In general, lower deductions than unitrusts at low §7520 rates.	100% of 1-life trust; for 2-life trust, subtract value of survivor's interest. Eligible for QTIP.	Fixed payout; minimum 5% payout; maximum 50%, with 10% remainder value required.		
Charitable gift annuity	Deductions identical to those for annuity trusts at same payouts.	100% of 1-life annuity; for 2-life annuity, subtract value of survivor's annuity. Eligible for QTIP.	Recommended rates set by American Council on Gift Annuities, 2-9%.	Only part avoided – other part deferred and realized as part of payout.	Annuity payments are 30-60% tax-free return of principal during life expectancy, where cash is used to fund annuity.
Outright gifts	Larger than deferred techniques because value of contribution not reduced by value of life interests.	100% if included in gross estate.	None	Capital gains tax avoided if capital gain property is given, if there is no mortgage or bargain sale.	None – no income.

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