DALLAS JEWISH COMMUNITY FOUNDATION

The Advisor

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ESTATE PLANNER'S TIP

Many married couples automatically elect distributions from qualified retirement plans as a joint and survivor annuity. In fact, that's what the tax laws require unless the spouse affirmatively waives the survivorship benefits [Code §401(a)(11)]. And for many couples it seems logical to keep the same income level for the survivor, particularly if one spouse does not have retirement plan benefits of his or her own. But it may not be the most financially beneficial way to receive distributions. One way to ensure that the survivor has sufficient income without opting for the lower joint and survivor annuity payouts is through life insurance. Couples should consider the difference in joint versus single benefits, the insurability of the spouse with the retirement plan, the ages and health of both spouses, how much insurance would be necessary to "replace" the retirement income at the first spouse's death and the cost of a life insurance policy in comparison to the additional annual income available from the retirement plan. The surviving spouse may be able to elect an annuity payment option with the life insurance and maintain the same income following the first spouse's death.

SOME WILL RECEIVE, OTHERS WILL PAY

The Social Security Administration has announced increases to benefits and maximum taxable earnings for 2008. Those on the receiving end will be getting a 2.3% boost, making the average monthly benefit for all retired workers $1,079 (compared to $1,055 in 2007). The maximum benefit increases from $2,116 to $2,185.

Social Security recipients who have not reached full retirement age (65 years ten months for those born in 1942) will be able to earn more in 2008 before benefits are reduced. The earnings test increases from $12,960 to $13,560. Above that amount, Social Security benefits will be reduced by $1 for every $2 of earned income. There is no cutback for recipients who have reached full retirement age.

On the paying end, workers will continue contributing to the Social Security Old-Age, Survivors and Disability Insurance until income reaches $102,000. In 2007, the maximum is $97,500.

INFLATION ADJUSTMENTS ANNOUNCED BY IRS

The tax numbers advisors will be working with for 2008 have been released by the IRS (Rev. Proc. 2007-66). Among the changes:

	2007	2008
Personal and dependent exemption	$3,400	$3,500
Standard deduction		
Single	$ 5,350	$ 5,450
Joint	10,700	10,900
Head of household	7,850	8,000
Married filing separately	5,350	5,450
Personal exemption phaseout (2% for each $2,500 of income over AGI threshold x 2/3 in 2007, 1/3 in 2008)		
Single	$156,400	$159,950
Joint	234,600	239,950
Tax brackets		
25% bracket starts		
Single	$31,850	$32,550
Joint	63,700	65,100
Head of household	42,650	43,650
Married filing separately	31,850	32,550
28% bracket starts		
Single	$ 77,100	$ 78,850
Joint	128,500	131,450
Head of household	110,100	112,650
Married filing separately	64,250	65,725
33% bracket starts		
Single	$160,850	$164,550
Joint	195,850	200,300
Head of household	178,350	182,400
Married filing separately	97,925	100,150
35% bracket starts		
Single, joint, head of household	$349,700	$357,700
Married filing separately	174,850	178,850
Itemized deduction cutbacks (reductions equal 3% of amount by which AGI exceeds threshold x 2/3 in 2007, 1/3 in 2008, up to 80% of certain deductions)	$156,400	$159,950
Kiddie tax	$1,700	$1,800

PHILANTHROPY PUZZLER

Sally is the executor of her father's estate. Her dad, who generously supported numerous charities throughout his life, had unused excess income tax charitable deductions remaining at his death. Sally has asked whether her dad's estate is entitled to deductions of any kind for the value of these unused income tax deductions.

BOARD ALREADY HAD ALL THE POWER IT NEEDED

Emilie Borda created a charitable trust in 1967 to help finance and operate an extended care wing at the county's hospital. The trust provided that any net income not needed for the wing could be used, in the discretion of the board of trustees, for medical equipment and research. The hospital no longer operates the extended care wing and would like to invade the trust to pay for the purchase of medical equipment, over the objection of one of the trustees.

The hospital asked the court to clarify whether any trust funds – income or principal – could be used for medical equipment, either pursuant to the trust itself or by application of the cy pres doctrine. The Superior Court of Rhode Island noted that the trust contemplates that some income and principal might not be needed for extended care and could be used for medical equipment. The plain language of the trust leaves discretion in the board, said the court.

Because the trust provides for a secondary use of trust assets, it is not necessary to rely on the doctrine of cy pres, said the court. The language of the trust gives the hospital's board the discretion to determine whether and when to use trust principal, the court found (*In re Borda Trust*, No. PC 2007-0590).

NO TIME LIMIT ON DEED RESTRICTIONS

Paul Handlery's parents conveyed property to the County of Solano, California, to be used as county fair grounds. The first deed, executed in 1946, prohibited the sale or transfer of the land, providing that in the event of a breach, the property was to revert to the Handlerys or their heirs. A second quit claim deed in 1947 similarly restricted use of the land, but did not include reverter language.

In 2004, the county filed suit to quiet title in the property, asking the court to rule that Handlery had no interest in the property. The county claimed that any reversionary interest the family may have had under the 1946 deed had expired. Handlery cross complained. The trial court granted summary judgment to the county, finding that the right of reverter was extinguished either upon the recording of the 1947 deed or due to the passage of time. The court said the restrictions were personal covenants that became unenforceable upon the deaths of the grantors.

The Court of Appeals of California reversed the summary judgment, noting that the use restrictions were specifically agreed to by the county. The court also cited public policy that strictly construes deed restrictions when public entities acquire land through private dedications. Allowing a public entity to "jettison those restrictions on their own whim" would discourage future gifts, noted the court, which added that the covenants ran with the land (*County of Solano v. Handlery*, A114120).

DONORS' SUBSTANTIATION NOT ENOUGH FOR DEDUCTION PURPOSES

Bobby Lorn and Libby Claborn claimed a charitable deduction in 2003 for $2,775, including $2,096 in cash donations to their church and three boxes of clothing and toys to The Salvation Army. The IRS determined a deficiency, citing the lack of substantiation.

The Tax Court noted that in order to grant any deduction under the *Cohan* [39 F.2d 540 (2d Cir. 1930)] rule, the taxpayers must provide "some basis upon which an estimate of the amount of a claimed deduction may be made." For the church donations, the couple provided a self-prepared list of the contributions and dates, along with letters from the church elders stating that they attend church regularly and participate in church programs. The court said the documents were not prepared contemporaneously with the gifts and were "not reliable enough" to support the claimed deduction, even under the *Cohan* rule. The court did find, however, that the couple were regular churchgoers and allowed $169 in cash gifts.

The couple did have a receipt from The Salvation Army stating the date of the noncash gifts, but the receipt did not state whether any goods or services were provided in exchange for the contributions. The receipt did not satisfy the requirements of Code §170(f)(8)(B). The court said that while it was unlikely that the couple received any goods or services from the Army, "we are required to apply the statute and cannot escape its clear command." The court limited the couple's deduction to the $25 allowed by the IRS (*Lorn v. Comm'r.*, T.C. Summ. Op. 2007-172).

Note: Under the Pension Protection Act of 2006, the $250 threshold for cash gifts has been eliminated. All cash gifts, regardless of amount, must be substantiated by either a bank record or a receipt, letter or other written communication from the donee indicating the name of the organization, the date of the gift and the amount [Code §170(f)(17)]. Without these, no deduction is allowed.

PUZZLER SOLUTION

Carryover deductions may be claimed on her father's final income tax return for the year of death, subject to the 30% or 50% deduction ceilings [Code §170(b)(1)]. Any excess deductions that are not claimed on this return are lost and may not be claimed on the estate's income tax return [see, generally, Reg. §1.170A-10(d)(4)(iii)].

IRS APPROVES IRA LOAN TO CHARITY TO BUY INSURANCE ON OWNER

The IRS recently issued a private letter ruling on a transaction between a taxpayer and a church (Ltr. Rul. 200741016). The owner, who had a self-directed IRA, planned to direct an investment of a portion of his IRA assets in the form of a loan to the church. He is not a board member or employee of the church and has no control, ownership or financial interest in the church. In return for the loan, the IRA will receive a 20-year promissory note paying 5% interest. The taxpayer will not claim a charitable deduction for the loan.

The church will purchase life insurance on the taxpayer. The church will own the policy and pay all premiums, but the IRA will be given a security interest in the policy. The church cannot convey, borrow or transfer the policy without the taxpayer's consent. The purpose of the security interest, said the IRS, is to provide certainty that the policy will qualify as an insurable interest under state law. The IRA is not the death beneficiary of the life insurance policy, having only the right to receive the interest payments and the repayment of the loan amount. The taxpayer will satisfy his required minimum distributions with withdrawals from other IRAs that he owns.

The IRS ruled that the transaction is not a prohibited transaction under Code §4975 that would cause the IRA to lose qualification under Code §408(e)(2). The loan is also not a prohibited investment in insurance under Code §408(e)(3).

This ruling appears to be a rather convoluted way of making the church the beneficiary of a life insurance policy on the taxpayer's life, although one that does not provide a charitable deduction. Assuming state law allows, the taxpayer could simply purchase a policy naming the church the owner and beneficiary. Not only is there a charitable deduction for the gift, but there are additional deductions each year as premiums are paid. If the taxpayer doesn't want or need the income tax deduction, he could obtain a policy in his own name, designating the church as beneficiary. He would be free to borrow against the policy, change the beneficiary or even let the policy lapse. Only at his death would the value passing to the church qualify for the estate tax charitable deduction.

Life insurance is one of a number of ways clients can provide for charity on a revocable basis. Among other ways:

Bequests/revocable living trusts – The donor retains total control over the assets until death, including the right to change the beneficiaries. Bequests can be outright, contingent, percentage or a specific amount. The estate is entitled to a deduction for anything passing to charity.

Financial accounts – Bank deposits and brokerage accounts can be made payable at death to charity. As with a bequest, the client retains full control over the funds during lifetime, but is entitled to an estate tax deduction for whatever passes to charity. Transfers also bypass probate.

Interest-free loans – Unlike the loan in the letter ruling, which carried 5% interest, clients may make interest-free demand loans of up to $250,000 to charity [Temp. Reg. §1.7872-5T(9)]. Although there is no income tax deduction available, the donor nevertheless saves taxes by reducing investment income each year the loan is outstanding. This can be an especially attractive option for donors who do not itemize or who have exceeded their deduction limits (50% of AGI for cash gifts, 30% of AGI for gifts of appreciated assets). If the client's estate plan calls for the loan to be forgiven at death, an estate tax deduction is available.

Jacob Feldman Building | 7800 Northaven Road | Dallas, Texas 75230-3296
(214) 615-9351 | info@djcf.org | www.djcf.org