DALLAS JEWISH COMMUNITY FOUNDATION

The Advisor

March 2007

ESTATE PLANNER'S TIP

Starting in 2008, the long-term capital gains tax rate for taxpayers in the 10% and 15% brackets drops from 5% to zero [Code §1(h)(1)(B)]. High-income taxpayers should consider making gifts this year of appreciated stock and mutual fund shares to family members in these brackets, as a means of shifting income. For example, a client who wishes to help a grandchild pay for college could make a gift of stock in 2007, to be sold by the grandchild in 2008. The client's basis and holding period will carry over to the grandchild. Or the client could give cash with which the grandchild could buy shares to be held more than one year. Care should be taken, however, to avoid triggering the "kiddie tax" [Code §1(g)(2)] for donees under age 18. The transfer of significant assets may also affect the grandchild's ability to receive certain forms of financial aid. The transfer of stock from high-bracket clients will also work for those who provide financial help for elderly parents in the 10% or 15% brackets.

ESTATE GETS REFUND, BUT NO INTEREST

Helene Blom was named executrix of her aunt's estate in 1996. She submitted $140,000 with her request for an extension to file the estate tax return. The IRS granted the extension until June 1, 1997, but due to protracted litigation a return was not filed until September 9, 2002. The return showed no tax due, but the IRS refused to refund the $140,000, saying it was barred by the statute of limitations.

Blom filed suit to recover the funds. The IRS sought a summary judgment, arguing the court did not have jurisdiction because the refund claim was not timely filed. The U.S. District Court (E.D. PA) denied the motion, determining that the remittance was a deposit, not a payment, and therefore the statute of limitations did not apply. The IRS then filed a motion asking the court to enter judgment for Blom in the amount of $140,000 without interest. Blom asked the court to grant interest from the date of the filing of the estate tax return.

Under Code §6611(a), interest is payable on any overpayment in respect of any tax. To have an overpayment, the payment must be made either (a) on account of the tax shown to be payable by the return or (b) in response to an assessment by the IRS. Taxpayers are not entitled to interest on tax deposits, said the court, noting that otherwise, taxpayers would "deposit money with the government to accrue interest at favorable rates." A deposit is a remittance for a contingent, future liability that may or may not become due.

Blom argued that although her remittance was initially a deposit, it became an overpayment once the estate tax return was filed. The court disagreed, noting that nothing in the tax laws allows a deposit to transform into a payment. Blom could not successfully argue that it was a deposit for purposes of the statute of limitations and then claim it was an overpayment for interest purposes, said the court, which ordered a refund without interest (*Blom v. U.S.*, 2006-2 USTC ¶60,533).

TAXES, EXPENSES COME FROM CHARITABLE RESIDUE

Anna Schulze's living trust directed Lester Schaper, the successor trustee, to distribute $20,000 each to Pets-A-Lone Sanctuary and the Humane Society of Missouri. She left her farm property, valued at about $1,180,000, and personal property to Schaper and other named individuals. The residue, which she expected to be about $60,000, was to pass to Shriners Hospital for Children and Cardinal Glennon Children's Hospital. After satisfying the specific bequests and paying the estate tax, the hospitals each received only $10,450. They sued, claiming unjust enrichment by the other beneficiaries. The trial court granted a partial summary judgment, ordering some of the individuals to make payments to the hospitals. Schaper appealed, saying the trust clearly showed Schulze's intent that the estate taxes be allocated to the residue.

The Missouri Court of Appeals (E.D., Div. Four) noted that the state has no apportionment statute. The doctrine of equitable apportionment, under which property generating the estate tax bears the burden of the tax, is only appropriate where the grantor's intent cannot be discerned. The court found that she wanted to ensure that Schaper or his heirs received her farm and personal property. Therefore, the court concluded that her intent was that these specific bequests not be reduced pro rata for the payment of estate tax.

The trial court's apportionment of the estate tax has the effect of "negating Grantor's specific instructions" as to the amount of each bequest the primary beneficiaries would receive, said the appeals court (*Shriners Hospital v. Schaper*, No. ED 87672).

PHILANTHROPY PUZZLER

Thelma wants to create a charitable remainder trust in her will to benefit her nephew. She plans to make several specific bequests and then use the residue of the estate to fund the trust. She wants her nephew to receive $25,000 per year. Any drawbacks to Thelma's plan? Special planning considerations?

INCOME BENEFICIARY NOT ENTITLED TO TRUST'S CONTRIBUTION DEDUCTION

Thomas Goldsby, the income beneficiary and trustee of a testamentary trust created by his father, chose not to take the net income distributions in some years, instead allowing the funds to remain in the trust. He did not relinquish his claim to the undistributed income and included the amounts in his gross income each year. By the beginning of 2000, the undistributed income totaled about $2.2 million.

Charitable contributions made by the trust in certain years were treated as deemed distributions to Goldsby, who then claimed deductions on his personal returns. The trust treated more than $46,000 as distributions to Goldsby in 2000.

The trust had significant real estate holdings, and in 2000, Goldsby, as trustee, conveyed conservation easements over several parcels to the Mississippi Land Trust. The appraised value of the easements was $5,640,000, which Goldsby deducted on his personal returns in 2000 through 2004. The IRS challenged both the value of the easements and Goldsby's right to the deductions.

The Tax Court noted that if a trust makes a charitable contribution, the person treated as owner of that portion may deduct the amounts on their own return [Reg. §1.671-2(c)]. Goldsby claimed that he was owner of at least a portion of the corpus, saying the undistributed net income had become commingled with the trust corpus.

The Tax Court disagreed, saying the undistributed income never became part of the corpus and was at all times subject to Goldsby's right to withdraw. The undistributed income was not held subject to the trust agreement. Further, noted the court, there was no showing that the conservation easements were donated from the undistributed income. The court added that Goldsby did not explain how the $2.2 million in undistributed income related to the $5.6 million conveyances. Goldsby and the trust also did not account for the easements in the same way as other charitable contributions made in the same year, which were treated as distributions followed by contributions. Instead, Goldsby was claiming a pass-through deduction. The court did not address the valuation issue (*Goldsby v. Comm'r.*, T.C. Memo 2006-274).

OVER-THE-COUNTER LISTING SATISFIES RULES AS "QUALIFIED APPRECIATED STOCK"

Largesse, a financial holding company, established a private foundation to provide financial assistance to charitable programs and agencies within the communities it serves. Largesse proposes to contribute cash and shares of stock to the foundation. The stock consists of common shares of a financial services company traded on the Over-the-Counter Bulletin Board (OTCBB). The stock is not subject to any legal or SEC restrictions.

The deduction for appreciated property contributed to a private foundation is generally limited to the donor's basis [Code §170(e)(1)(B)(ii)]. There is an exception for gifts of "qualified appreciated stock" [Code §170(e)(5)(A)], defined as stock for which market quotations are readily available on an established securities market [Code §170(e)(5)(B)].

The IRS noted that the OTCBB was established by the SEC in 1990. Trades are required to be reported, registered companies must disclose financial information to the SEC and are subject to many of the provisions of the Sarbanes-Oxley Act of 2002. Market quotations and historical trade information are available through a variety of electronic sources. Access to the sites is available at no charge and without having to register.

Since the company's shares are not traded on a stock exchange, the stock must meet the requirements of Reg. §1.170A-13(c)(7)(xi)(A)(2) to be qualified appreciated stock, said the IRS. The shares must be regularly traded in the national or regional over-the-counter market, for which published quotations are available. The regulations were written prior to when access to the internet was universal, noted the IRS. Congress's intent was to limit the qualified appreciated stock exception to instances where the potential for abuse, including overvaluation, is minimized. Because of the ease of accessing current and historical quotations, the IRS found that market quotations were "readily available."

The regulations do not list over-the-counter markets by name, said the IRS, so "it is clear that more than one over-the-counter market can be an established securities market." OTCBB is such a market under Code §170(e)(5), the IRS ruled, so Largesse will be entitled to a deduction for fair market value (Ltr. Rul. 200702031).

PUZZLER SOLUTION

In order to pay her nephew exactly $25,000 per year, Thelma would have to use a charitable remainder annuity trust. Because the trust is to be funded with the residue of her estate, it will not be known until Thelma's death whether the trust will meet the 5% minimum payout requirement [Code §664(d)(1)(A)], the 10% remainder interest requirement [Code §664(d)(1)(D)] or satisfy the 5% probability test (Rev. Rul. 77-374, 1977-2 C.B. 329). Thelma's will should allow the personal representative to modify the trust to ensure that it qualifies and entitles the estate to a charitable deduction. Modifications might include reducing the $25,000 payout if the residue too small or, if the residue of the estate is too large, funding the trust with only that portion of the residue needed to meet the minimum 5% payout and still give the nephew $25,000, with the remaining residue passing outright to charity.

HELPFUL GUIDANCE FROM IRS ON IRA GIFTS

The IRS has provided favorable answers to questions raised by donors, advisors and charities regarding Code §408(d)(8), added as part of the Pension Protection Act of 2006 (Notice 2007-7). The provision allows IRA owners age 70½ and older to direct account custodians to make contributions to charity of up to $100,000 in both 2006 and 2007. These qualified charitable distributions (QCDs), while not eligible for deductions, are excluded from the owner's gross income and satisfy required minimum distributions. As of January 18, 2007, the National Committee on Planned Giving had received notification of nearly 1,500 QCDs, including 130 that were for the maximum $100,000, with a total value of just under $30 million. The new IRS guidance may assist clients contemplating charitable distributions in 2007.

■ In addition to traditional and Roth IRAs, owners of SEP and SIMPLE IRAs may make QCDs, provided the SEP or SIMPLE are not "ongoing." An account is considered ongoing if an employer makes a contribution for the year of the distribution.

■ Beneficiaries of inherited IRAs are eligible to make QCDs, provided they are age 70½ or older.

■ An IRA owner who made a contribution to charity prior to the August 17, 2006 effective date of Code §408(d)(8) – possibly by writing a check on the account – may exclude the amount from gross income, provided the owner was age 70½ or older at the time.

■ IRA owners are not required to have taxes withheld from the distributions under Code §3405. An owner requesting a distribution is deemed to have elected out of withholding under Code §3405(a)(2). The IRA trustee or custodian may rely upon the IRA owner's reasonable representations regarding the need for withholding.

■ A check made payable to a charity will be considered to be a direct payment from the IRA custodian or trustee [Code §408(d)(8)(B)(i)], even if it is personally delivered by the IRA owner.

■ The Department of Labor, which has interpretive jurisdiction, has determined that a distribution made by an IRA trustee directly to a charity will be treated as a receipt by the IRA owner under Code §4975(d)(9), and therefore will not constitute a prohibited transaction. This is true even if the distribution satisfies an outstanding pledge of the IRA owner.

■ QCDs may be made only to organizations described in Code §170(b)(1)(A), other than supporting organizations described in Code §509(a)(3) or donor advised funds described in Code §4966(d)(2).

■ Even though the QCD is not deductible as a charitable gift under Code §170, the distribution must still satisfy the requirements to be a deductible charitable contribution under Code §170, including the substantiation requirements of Code §170(f)(8). The deduction limitations of Code §170(b) do not apply, however.

■ If the direct payment from an IRA to charity does not satisfy the requirements of Code §408(d)(8), the amount of the payment will be treated as a distribution from the IRA to the owner, includible in gross income, followed by a contribution from the owner to charity that is subject to the percentage limitation rules of Code §170(b).

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