

# The Advisor

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## ESTATE PLANNER'S TIP

Terminally ill individuals face a broad range of concerns – including taxes – and many will want to take advantage of tax reduction strategies. “Deathbed gifts” qualifying for the annual exclusion can reduce the gross estate by up to \$13,000 per donee (\$26,000 per donee for married donors) [Code §2513(a)]. Cash may be a better option than appreciated assets when it comes to deathbed gifts, considering that beneficiaries receive a stepped-up basis in most assets that pass at death [Code §1014]. But what about *depreciated* assets? The recipient’s basis will be the lesser of the donor’s basis or the fair market value if the asset is given during life [Code §1015(a)]; the lower date-of-death value will become the beneficiary’s basis if transferred at death [Code §1014(a)(1)]. The opportunity for a capital loss deduction vanishes when the item is transferred. Code §1041(b) provides an exception to these general rules, however, for lifetime transfers between spouses. The donee-spouse takes the donor-spouse’s basis, even where it exceeds fair market value. By making a deathbed gift of depreciated property to a spouse, the capital loss deduction that would otherwise expire with the client is preserved.

## LAPSE OF POWER OF APPOINTMENT COSTLY TO PRE-GST-TAX TRUST

Louise Blyth Timken was given a general power of appointment over the assets in a trust created by her husband, Henry, prior to his death in 1968. When Louise died in 1998 without appointing new trust successors, her power of appointment lapsed and the assets passed to Henry’s nieces and nephews. Some executed qualified disclaimers of their shares, which were then divided equally among the grandnieces and grandnephews of Henry. The IRS assessed over \$4 million in generation-skipping transfer tax.

The estate argued that the tax did not apply, under the exemption for trusts that were irrevocable on September 25, 1985, provided no transfers of corpus are added to the trust.

Under Reg. §26.2601-1(b)(1)(v)(A), the value of the entire portion of the trust subject to the power that was released, exercised or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise or lapse. The district court delayed ruling on the parties’ cross motions for summary judgment, pending the U.S. Court of Appeals (6th Cir.) decision in *Estate of Gerson v. Comm’r.* (507 F.3d 435). In *Gerson*, the court held that the grandfather provisions were ambiguous

as applied to a generation-skipping transfer resulting from the exercise of a general power of appointment granted in a pre-GST-tax irrevocable trust. The court held that the constructive additions provision was reasonable because it was in keeping with the expressed intent of Congress to ensure taxation of generation-skipping transfers in a manner similar to outright transfers from one generation to the next.

Following *Gerson*, the district court held that the lapse of Louise's general power of appointment was a post-GST-tax constructive addition and fell outside the grandfather exemption. The Court of Appeals agreed, rejecting the estate's argument that the term "added" in the exemption is limited to additions from an outside source. It is not unfair or contrary to the purposes of the statute to make the grandfather exemption inapplicable to a pre-GST-tax general power of appointment exercised post-GST-tax to skip persons, ruled the court (*Est. of Timken v. U.S.*, No. 04-01188).

#### **DONORS ENTITLED TO DEDUCT HALF A LOAF**

Jeffrey and Patricia Wilkes, members of the Church of Jesus Christ, contributed \$3,450 to individuals identified by their church as Needy Saints, private individuals who sought financial assistance from the church. In most cases the funds were used to cover living expenses.

#### **PHILANTHROPY PUZZLER**

Raymond has extensive real estate holdings, including a cluster of small office buildings. Early last year, when the foundation supporting his favorite charity was looking for a new location, Raymond offered rent-free use of one of the buildings. When he met with his tax advisor at tax time this year, he discovered that he was not entitled to claim a charitable deduction for the \$60,000 fair market rental value. He asked if there is any way to get a deduction for his generosity.

The Wilkeses also gave \$18,500 in contributions directly to three missionaries. Two of the missionaries were establishing churches in Michigan and North Carolina, while the third was working in South Africa. The missionaries prepared detailed reports to their local churches and the donors on the use of the funds. The IRS disallowed all the deductions.

The Tax Court agreed with the IRS as to the gifts to Needy Saints, noting that under Code §170(c)(2), a gift is defined as a contribution that does not inure to the benefit of any private individual. Money given directly to an individual for his or her personal benefit is deemed a private gift. Although the Needy Saints were "morally obligated" to use the funds in accordance with church teachings, no organization or entity benefited from the gifts, said the court.

The court agreed with the IRS regarding the gifts to the missionary working in South Africa, saying that the donee organizations must be created or organized in the U.S. However, the court did allow a deduction for the contributions to the missionaries working in the U.S. Under Church of Jesus Christ doctrine, local churches are prohibited from accepting contributions directly from individuals who are not local members. Therefore, the Wilkeses could not have made gifts directly to those churches. Contributions "to" an organization can be deductible if given to an agent of the organization, said the court. The local churches had given the missionaries authority to represent them in recruiting members, indicating that the missionaries were serving as agents. Because the two were agents of their respective churches, the contributions to them were given "to" a qualified donee and the couple was entitled to a charitable deduction (*Wilkes v. Comm'r.*, T.C. Summ. Op. 2010-53).

#### **MORTGAGE STANDS BETWEEN DONORS AND DEDUCTION**

Gordon and Lorna Kaufman own a single-family rowhouse located in a historic preservation district in Boston. In 2003, the couple entered into an agreement with the National Architectural Trust (NAT) to grant a facade easement. NAT also required the owners to make a

cash contribution based on the value of the easement, for monitoring and administration.

The Kaufmans claimed a charitable deduction of \$220,800, a portion of which they carried over to the 2004 tax year. The IRS disallowed the deduction on the grounds that the easement was not a qualified conservation contribution in perpetuity due to the mortgage on the property.

Under Code §170(h)(1), a qualified conservation contribution must be a contribution of a qualified real property interest, exclusively for conservation purposes. An interest in property for a facade easement must be protected in perpetuity for the gift to be a qualified conservation contribution, noted the Tax Court. Under Reg. §1.170A-14(g)(6)(ii), when a change in conditions causes the extinguishment of the perpetual conservation restriction, the donee must be entitled to a portion of the proceeds on a subsequent sale, exchange or involuntary conversion.

The bank holding the mortgage had a prior claim to all proceeds of condemnation and all insurance proceeds as a result of any casualty, hazard or accident. The bank's interest was "in preference" to NAT's until the mortgage was satisfied. Because the easement was not enforceable in perpetuity, it was not a qualified conservation contribution, ruled the court. The couple was entitled to a deduction for the cash contribution to NAT, however (*Kaufman v. Comm'r.*, 134 T.C. No. 9).

#### **PROPOSED DIVISION OF PROCEEDS NOT SELF-DEALING**

Gladys was given a life estate in the couple's principal residence under her husband's trust. At her death, the home is to pass to a private foundation he established prior to his death. Gladys is a disqualified person with respect to the foundation [Code §4946].

The trustee, who has the power to sell, exchange or transfer the real property, has entered into a contract with an unrelated third party to sell the home for its fair market value. The trustee then proposes to allocate the proceeds to Gladys and the foundation according to the actuarial value of their respective interests in the home. The estate is still in the administrative

stage and will not be closed until the IRS rules on whether the transaction constitutes self-dealing. The probate court has approved the sale and proposed distribution of the proceeds.

In general, an excise tax is imposed on acts of self-dealing between a disqualified person and a private foundation [Code §4941(a)(1)]. There is an "estate administration exception" [Reg. §53.4941(d)-1(b)(3)], designed to allow an estate or trust the flexibility to shift assets in order to carry out the decedent's intent. To qualify for the exception, (1) the trustee must possess a power of sale with respect to the property or have the power to reallocate the property to another beneficiary, (2) the transaction must be approved by the probate court, (3) the transaction must occur before the trust is considered subject to Code §4947, (4) the foundation must receive an amount equal to or exceeding the fair market value of its interest or expectancy in the property and (5) the private foundation must receive an interest or expectancy at least as liquid as what it relinquished.

The IRS determined that the proposed allocation and distribution to Gladys and the foundation complies with the estate administration exception and therefore will not constitute an act of self-dealing (Ltr. Rul. 201016084).

#### **PUZZLER SOLUTION**

The rent-free use of space is a partial interest that does not meet any partial interest rule exceptions. Therefore, no deduction is allowed [Reg. §1.170A-7(d)]. Raymond could charge fair market rent for the building and then make a corresponding cash charitable gift, but he would be taxed on the \$60,000 of rental income. Another option, if allowed under state and local law, would be to subdivide the property. Raymond could then make an outright gift to the foundation of the parcel containing the office building and receive a charitable deduction for the value of the building and land.

## NEW HIGHER RATES, GLIMPSE INTO GIFT ANNUITIES

New charitable gift annuities will make larger payouts under suggested gift annuity rates that take effect in July. Rates go up for ages 81 and younger but remain unchanged for annuitants ages 82 and older. The new rates (see chart below) were approved at the bi-annual American Council on Gift Annuities conference on April 28.

The higher rates will translate into slightly lower charitable deductions, as shown below, assuming a \$10,000 gift annuity, quarterly payments and a \$7520 rate of 3.4%:

Age	Old Rate	New Rate
55	\$2,192 (4.8%)	\$1,867 (5.0%)
65	3,312 (5.3%)	3,060 (5.5%)
75	4,488 (6.3%)	4,400 (6.4%)

Suggested rates have also changed for two-life annuities. For example, the old rate for two 65-year-olds was 4.9%; the rate for gift annuities established after June 30, 2010 is 5.1%. Also changing is the interest rate assumption for calculating deferred gift annuities. The previous rate was 1.0425%, while the new rate is 1.045%. This will result in higher payouts for those establishing deferred gift annuities.

The American Council on Gift Annuities also released the results of a survey done in 2009 among charities issuing gift annuities:

- 44.1% of gift annuitants were male and 55.9% were female

- the average age of annuitants was 79, compared with 78.1 in a 2004 study

- 71% of annuitants were over age 75

- 30.6% of responding charities reported that donors who arranged gift annuities were more likely to increase their annual giving, while 3.7% said it likely decreased the annual gifts

- 72.4% of gift annuities were for one life, 27.6% were two-life annuities

- the average size of reported gift annuities was \$43,371, down from the 2004 survey showing an average gift size of \$59,926

- the median dollar value of gift annuities issued in the last year was \$167,500 per organization

- deferred gift annuities accounted for 10.1% of all gift annuities reported – an increase over the 8.4% in the 2004 survey

- cash was the asset of choice for most gift annuities, with 80% of the reporting organizations saying that cash was used in 75% to 100% of the gift annuities they arranged

- charities reported 864 flexible deferred annuities, which allow the donor to begin payments earlier or later than a selected target date, with a total market value of \$21,518,766

### One-life charitable gift annuity rates

Age	Rate	Age	Rate	Age	Rate
0-5	3.1%	48-49	4.7%	75	6.4%
6-11	3.2	50	4.8	76	6.5
12-16	3.3	51-53	4.9	77	6.7
17-20	3.4	54-56	5.0	78	6.8
21-25	3.5	57-58	5.1	79	7.0
26-29	3.6	59-61	5.2	80	7.2
30-31	3.7	62-63	5.3	81	7.4
32-33	3.8	64	5.4	82	7.5
34-36	3.9	65-66	5.5	88	7.7
37-38	4.0	67	5.6	84	7.9
39-40	4.1	68	5.7	85	8.1
41	4.2	69-70	5.8	86	8.3
42-43	4.3	71	5.9	87	8.6
44-45	4.4	72	6.0	88	8.9
46	4.5	73	6.1	89	9.2
47	4.6	74	6.3	90+	9.5

