

The Advisor

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ESTATE PLANNER'S TIP

Many retirees put off withdrawing funds from IRAs and other qualified retirement plans until required distributions begin after age 70½, preferring instead to spend down assets that don't grow tax deferred. However, it may be smarter from an income tax perspective to begin taking withdrawals from retirement plans at an earlier age. Withdrawals from IRAs and 401(k) plans are taxed at ordinary income rates. If a retirement plan is allowed to grow, the minimum distribution amounts may be so large that they push the account owner into a higher income tax bracket every year. On the other hand, assets sold from an investment portfolio are generally taxed at capital gains rates (maximum 15%), which are lower than ordinary income tax rates. By spreading out the distributions from qualified retirement plans over a longer period, the required minimum distributions may be smaller. Distributions prior to age 70½ that aren't needed for immediate living expenses can be invested in growth stock or other instruments that will defer the recognition of income. At the client's death, an IRA or 401(k) plan, which are items of income in respect of a decedent subject to both income and estate tax, will be smaller. Investments outside the sheltered accounts may be larger, but they will be entitled to a stepped-up basis.

ESTATE'S DEDUCTION GETS DEEP DISCOUNT

Gertrude Saunders' estate claimed a deduction of \$30 million under Code §2053 for a claim against the estate of her late husband. He had been accused of legal malpractice, breach of confidence, breach of duty of loyalty and fraudulent concealment for allegedly acting as a secret IRS informer against a client who maintained a Swiss bank account. The action filed against Saunders' husband's estate asked for compensatory damages of more than \$90 million. Based on reports prepared by several experts, the estate estimated its potential liability at \$30 million.

In 2007, the jury in the malpractice action found that Saunders' husband had breached his fiduciary duty, but said the breach was not the cause of any injury to the client. The court awarded Saunders' husband's estate costs of \$289,000. To avoid an appeal, the estate agreed to waive its right to payment and to pay \$250,000 in attorney's fees to the plaintiff.

Under Reg. §20.2053-1(b)(3), a deduction is allowed, even though the exact amount is not known, "provided it is ascertainable with reasonable certainty, and will be paid." Deductions are not allowed for "vague or uncertain" estimates.

The Tax Court was convinced, based on the wide-ranging estimates of the estate's appraisers, that the value of the claim against the estate was too uncertain to be deducted as of November 2004. While the \$30 million deduction claimed was not allowed, the estate could deduct the amount actually paid (*Est. of Saunders v. Comm'r.*, 136 TC No. 18).

DAYS LATE AND NOW SEVERAL DOLLARS SHORT

When Harold's mother developed mobility issues, he and his siblings pooled their money, added it to the proceeds from the sale of her home and she bought a new residence. His mother then entered into a reverse mortgage, receiving a lump-sum that she used to repay her children.

Harold, age 49, took a distribution from his IRA to provide his share of the transaction. His intention was to redeposit the funds from his mother within the 60 days allowed by Code §408(d)(3)(A). The bank assured Harold that the reverse mortgage would be completed in time to allow him to meet the 60-day rollover period.

Due to delays, Harold was not reimbursed during the 60 days. When he received the check, he mailed it to his bank, directing the bank to redeposit it in his IRA. Harold claimed that the failure to

replace the funds in time was due to "numerous and unreasonable processing delays" by the bank, and asked the IRS to waive the 60-day rollover period, saying it would be "against equity and good conscience" not to do so.

Rev. Proc. 2003-16 (2003-4 IRB 359) provides that in determining whether to grant a waiver, the IRS is to consider factors such as bank errors and the use of the amount distributed. The IRS declined to grant Harold a waiver, saying he had not presented evidence of how any of the factors in Rev. Proc. 2003-16 affected his ability to make a timely rollover. Harold made a short-term loan of his withdrawal, and while he intended to redeposit the funds, he assumed the risk that the money would not be returned to him in time (Ltr. Rul. 201118025).

FIXING WHAT'S WRONG

Don and Mary funded what was intended to be an 8% net-income with make up charitable remainder unitrust. The trust was supposed to convert to a standard charitable remainder unitrust following the sale of specified property contributed to the trust, but due to a drafting error, the "flip" language was not included.

The court granted the reformation, contingent on IRS approval. The couple said that from the inception of the trust, no deduction has been allowed for any income interest that either beneficiary has received or been entitled to.

The modification or reformation of a charitable remainder trust does not violate Code §664 if it is necessary to conform the trust to the grantor's intent. The IRS found that the state court's reformation does not violate the code or adversely affect the trust's qualification.

Don and Mary, as settlors and income beneficiaries of the trust, are disqualified persons under Code §4941. However, the self-dealing rules do not apply to amounts payable under the terms of a split-interest trust to income beneficiaries, so long as no deduction was allowed for an income

PHILANTHROPY PUZZLER

Genevieve walked into the development office of her favorite charity with a copy of a variable annuity that she purchased in 1995 for \$65,000. The current market value is \$250,000. She would like income from the annuity, but she does not want to pay tax on the built-up growth. She asks about using the annuity to fund a charitable remainder trust, retaining an income for life. The development officer promises to research the issue and get back to Genevieve. What should the charity tell her?

interest. Therefore, ruled the IRS, the judicial reformation is not an act of self-dealing (Ltr. Rul. 201113040).

COURT A STICKLER ON GIFT RECEIPTS

In 2004, Randall Schrimsher executed a preservation and conservation easement, granting a facade easement to the Alabama Historical Commission. The agreement provided that it set forth the “entire agreement of the parties” and indicated that the conveyance was in exchange for “TEN DOLLARS, plus other good and valuable consideration.”

The IRS disallowed the \$705,000 charitable deduction on the grounds that Schrimsher had failed to satisfy the substantiation requirements. The IRS said Schrimsher did not have a contemporaneous written acknowledgment of the facade easement, as required by Code §170(f)(8).

The Tax Court noted that the acknowledgment must include the amount of cash and a description of the property other than cash and must specify whether the donee provided any goods or services in consideration. If so, a good faith estimate of the value of the goods or services must be included. Schrimsher argued that the easement agreement, as the full agreement of the parties, met that requirement. The IRS did not dispute that the agreement was a contemporaneous acknowledgment, but said it failed to meet Code §170(f)(8)(B)(ii) because it did not state whether goods or services were provided. The reference to ten dollars was boilerplate, said the IRS.

The court granted the IRS’s motion for partial summary judgment, noting that even if the donee actually provided no consideration, the written acknowledgment must say so. Because the agreement did not specifically say that the commission provided no goods or services, it did not satisfy the substantiation requirements. (*Schrimsher v. Comm’r.*, T.C. Memo. 2011-71).

NO END RUN ALLOWED FOR ACKNOWLEDGMENT

The IRS cited the ruling in *Schrimsher* (above), to deny a deduction where the donee organization sought to correct the lack of a contemporaneous written acknowledgment by amending its Form 990 to include the information required under Code §170(f)(8)(B).

Code §170(f)(8)(D) provides that substantiation is not required for contributions reported by the donee organization, provided the charity files a return “on such form and in accordance with such regulations as the Secretary may prescribe.” The donor’s hope was to salvage the deduction where he had not obtained a written acknowledgment by the date the return was filed or the later due date for filing the return.

However, the IRS noted that although the Omnibus Reconciliation Act of 1993 authorized the IRS to prescribe regulations permitting charities to satisfy the requirements of Code §170(f)(8) by filing a return that includes the required information, the IRS has “decided not to implement this suggestion at this time.” To date, noted the ruling, the IRS has not identified any existing forms that could be used to provide the needed information, and donors, therefore, cannot satisfy the substantiation requirements through a charity’s Form 990 (Ltr. Rul. 201120022).

PUZZLER SOLUTION

Genevieve has to recognize \$185,000 (\$250,000 minus \$65,000 basis) of ordinary income on her gift of an annuity issued after April 22, 1987, whether the transfer is to a charitable remainder trust or outright to charity. Her charitable deduction for the remainder trust would offset a portion of the tax she would owe. A better option, tax-wise, might be to name charity as the death beneficiary of the annuity contract – avoiding all income and transfer taxes.

GIFT ANNUITY RATES GO IN ALL DIRECTIONS

Most donors who establish charitable gift annuities after June 30 will encounter new suggested rates, and depending on the annuitant’s age, the results might be more or less favorable. The American Council on Gift Annuities’ (ACGA) new rates call for slightly lower rates for those age 69 or younger. Where single-life rates for this age group previously ranged from 3.1% to 5.8%, the new rates start at 3% and top out at 5.7%. For those ages 70 through 72, the rates remain the same at 5.8%, 5.9% and 6.0% respectively. Rates for annuitants ages 73 and older are now higher, starting at 6.2% and topping out at 9.8%. Rates in effect prior to July 1 ranged from 6.1% to 9.5%. Two-life rates have also been revised, from a low of 2.8% (previously 3.0%) to 9.6% (previously 9.3%). Another change is a drop in the investment rate assumption used to compute the deduction for deferred payment charitable gift annuities, from 4.5% to 4%, resulting in generally lower deferred gift annuity rates. The goal with the gift annuity rates is to provide issuing charities with at least a 50% residuum of the gift amount at the termination of the annuity.

The new rates affect the deductions available for charitable gift annuity donors, as the table below shows, assuming a \$10,000 cash gift at a 3% §7520 rate and quarterly payments:

Age	Old Rate	Deduction	New Rate	Deduction
60	5.2%	\$2,149	4.8%	\$2,753
65	5.5	2,801	5.3	3,063
70	5.8	3,605	5.8	3,605
75	6.4	4,252	6.5	4,162
80	7.2	4,898	7.5	4,685

The change also affects the tax-free portion of the annuity, as shown below for the same ages and rates as the chart above:

Age	Old Rate	Tax-free Portion	New Rate	Tax-free Portion
60	5.2%	\$326	4.8%	\$301
65	5.5	362	5.3	349
70	5.8	402	5.8	402
75	6.4	463	6.5	471
80	7.2	543	7.5	566

One reason for the change in suggested rates is the §7520 rates, which have fluctuated between 1.8% and 3% over the past year. Low §7520 rates result in reduced charitable deductions. Charities are subject to tax on revenues they receive from charitable gift annuities that don’t comply with the rules in Code §514(c)(5). One requirement is that the value of the annuity must be less than 90% of the value of the property contributed for the annuity. According to the ACGA, the new rates will yield a charitable deduction of at least 10% if the §7520 rate is 3% or higher, regardless of the frequency of payments. When the §7520 rate drops below 3%, the deduction may be less than 10% for annuitants at certain ages. In those cases, the ACGA recommends that the issuing charity reduce the gift annuity rate to whatever level is necessary to generate a deduction of at least 10%. The chart below shows how the §7520 rate can affect the deduction at certain ages under the new rates, again assuming a \$10,000 cash gift and quarterly payments:

Age	§7520 Rate			
	1.8%	2.0%	2.4%	2.8%
45	\$304	\$615	\$1,192	\$1,715
50	592	864	1,373	1,611
55	1,271	1,496	1,920	2,312

Even with the lowered rates for annuitants under age 70, achieving a 10% charitable deduction may be difficult when the §7520 rate drops.

