The Advisor

BALL STATE UNIVERSITY FOUNDATION
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ESTATE PLANNER'S TIP

As clients prepare their income tax returns this year, those not already retired should check with Social Security for an estimate of future benefits. Social Security had been mailing statements about three months prior to workers' birthdays showing the amounts credited to earnings. Those mailings have stopped, but the estimates are still available on the Social Security Administration website (socialsecurity.gov). It's a good idea to compare the information contained on W-2 forms from prior years to Social Security's records, since this will help determine the benefits at retirement. If the earnings record is incorrect, it's easier to notify Social Security of the discrepancy now than trying to reconstruct the history when lower-than-expected benefits begin at retirement.

FORM 706 SIGNER ASSUMES RESPONSIBILITY

Jane Gudie created a living trust in 1991 that named her two nieces, Mary Norberg and Patricia Lane, as remainder beneficiaries. In 1999, Gudie and her nieces entered into an agreement under which each niece agreed to pay Gudie an annual annuity of $937,483, with the first payment due in four years. In return, Gudie issued a note to each niece, due in four years or upon her death, in the amount of $3 million with 6% interest, secured by the assets in the trust. No payments were ever made. In 2003, the unpaid annuity amounts were rolled over into new annuities and the annuity commencement date and due date of the notes were deferred for another four years. No payments were made on these notes. Gudie died in 2006.

Although no one was formally appointed as executor of Gudie's estate, Norberg signed the estate tax return as executor. The return reported a taxable estate less $2 million exclusion of zero and tax due of zero. The return listed lifetime gifts of $6,990,000. The assets were listed subject to the outstanding debt owed to the nieces of $6 million principal and $2,643,300 in accrued interest. The estate tax return showed total assets transferred during Gudie's life of negative $1,572,785. Each niece received $3,404,343.

The IRS audited the return and determined that Gudie had made nearly $3 million in adjusted taxable gifts in 1992 that were not reflected on the return. Further, said the IRS, the estate's deduction of principal and interest to the nieces was not deductible because it was not a bona fide loan for full and adequate consideration, and the transfers to the nieces were subject to generation-skipping transfer tax. The IRS determined a deficiency of nearly $5 million and an accuracy-related penalty of nearly $1 million.

Norberg argued that the IRS notice was issued to the wrong person and the Tax Court therefore had no subject matter jurisdiction. She said that she was never appointed executrix by a probate court and the IRS notice should have been addressed to the trust. The IRS said that because Norberg was in actual or constructive receipt of Gudie's property, she was a "statutory executor" under Code §2203. The Tax Court agreed, finding Norberg had the responsibility to file the estate tax return, which thereby notified the IRS of her fiduciary relationship. Because she never filed a notice of termination, she was not relieved of the powers, rights and duties of a fiduciary and was the proper person to receive the notice of deficiency (*Estate of Gudie v. Comm'r.*, 137 T.C. No. 13).

COURT SYMPATHETIC, BUT BOUND BY RULES

Irving Duke's holographic will provided that in the event he and his wife died simultaneously, his estate was to pass in equal shares to the City of Hope (COH) and the Jewish National Fund (JNF). The will intentionally omitted other heirs and included a no-contest clause. Duke's wife died in 2002 and he died in 2007.

COH and JNF filed a petition for probate. Several months later Robert and Seymour Radin, Duke's nephews, filed a petition for determination of entitlement to estate distribution. While they agreed that the will was valid, they argued that the condition under which COH and JNF were to take – the simultaneous deaths – had not occurred. Therefore, they claimed, they were entitled to the $5 million estate under intestacy rules.

The charities urged the court to consider extrinsic evidence of Duke's intent. In the years after his wife's death, he had established several large charitable gift annuities with the organizations and told them he was leaving them his entire estate. The court declined to admit the extrinsic evidence, saying the will was not ambiguous or uncertain.

The Court of Appeals of the State of California agreed, saying that the fact that Duke's will addressed only what was to happen if he and his wife died at the same time did not constitute an ambiguity that would allow the introduction of extrinsic evidence. While wills are to be construed according to the intent of the testator and so as to avoid intestacy, "a court may not write a will which the testator did not write," the court said. The court also said that the no-contest clause in Duke's will only operates to prevent claimants from taking under the will, but cannot prevent heirs at law from taking under intestacy rules.

The court added that it was difficult to imagine that after leaving specific gifts to the charities in the names and memories of family members that Duke intended the bequests to take place only in the event of simultaneous deaths. Perhaps, the court suggested, the rule regarding admission of extrinsic evidence "should be more flexible when a testator's conduct after an event that would otherwise cause his will to be ineffective brings into question whether the written word comports with his intent." The court added that it might be

PHILANTHROPY PUZZLER

Mike's will left a number of sizable charitable bequests, with the balance of his estate passing to his wife, Rosemary. Realizing that it might be several years before the estate was settled, he gave his executor the discretion to pay the net income from his entire estate to Rosemary during the administration of the estate. The executor has asked whether Mike's estate is entitled to a charitable deduction for the value of the charitable bequests.

time for the Supreme Court to consider whether there are "cases where deeds speak louder than words when evaluating an individual's testamentary intent" (*Radin v. Jewish National Foundation*, B227954).

EASEMENTS WEREN'T CHARITABLE, COURT SAYS

One day after purchasing parcels of land in Colorado, three owners conveyed conservation easements to The Greenlands Reserve, a Colorado conservation group. All three agreements provided for extinguishment of the easements by judicial proceeding or "by mutual written agreement of both parties," if future circumstances rendered the purpose of the easement impossible to accomplish. The IRS disallowed the deductions, saying that the easements had not been granted in perpetuity, as required under Reg. §1.170A-14(g)(6)(i).

The Tax Court questioned whether the contributions were made exclusively for conservation purposes, a requirement for a deduction.

Under Reg. §1.170A-14(g)(6)(i), if continued conservation use is made impossible or impractical by a change in conditions, a conservation purpose can still be treated as protected in perpetuity if the restrictions are extinguished by judicial proceedings and all of the proceeds from a subsequent sale or exchange of the property are used by the charity "in a manner consistent with the conservation purposes of the original contribution." The IRS argued the easements were not protected in perpetuity because the easements could be extinguished by "mutual agreement." The taxpayers said that the donations created charitable trusts or restricted gifts, which, under cy pres rules, would require a judicial proceeding to extinguish.

The court determined that, under state law, conservation easements could be extinguished by mutual consent of the parties. The transfers to Greenlands did not create charitable trusts, said the court, because there was no manifestation of an intent to create such a relationship. The transfers were restricted gifts, in that they were conditioned on the use of the property in accordance with the donors' instructions. However, for cy pres to apply, the donors must have "manifested a more general intention to devote the property to a charitable purpose."

The court agreed with the IRS that cy pres was not applicable to the restricted gifts because the donors did not manifest a more general intention to devote the property to charitable purposes. While the easement required that the property be "retained forever predominantly in a natural, scenic and open space condition," the taxpayers retained all rights over the property not specifically granted to Greenlands. They therefore did not manifest a general charitable purpose and cy pres is not applicable, said the court.

There is no guarantee that the conservation purposes will be protected in perpetuity, said the court, due to the ability to terminate the easements by mutual agreement. The transfers were not qualified conservation contributions and the IRS's motion for summary judgment was granted (*Carpenter, et al. v. Comm'r.,* T.C. Memo. 2012-1).

PUZZLER SOLUTION

Rosemary essentially has an income interest in property that is designated for charity, based on the potential that the executor can give her all the income for an extended period of time. Because this "split-interest" is not in the form of a charitable remainder trust or pooled income fund, Mike's estate is not entitled to a charitable deduction under Code §2055 [Rev. Rul. 83-45, 1983-1 C.B. 233; TAM 9347002]. Instead, Mike's will should have provided that income would be paid to charity and Rosemary in proportion to their respective interests in the entire estate during the period of administration.

SAVING FOR RETIREMENT THROUGH CHARITABLE GIFTS

A major concern facing younger Baby Boomers is the health of Social Security. But do tax-favored options exist for those already contributing the maximum to IRAs, 401(k)s and other qualified retirement plans? There are two plans that couple philanthropy with retirement savings:

Deferred payment charitable gift annuities

Clients can arrange a series of charitable gift annuities to begin payments at some future time. They receive an immediate charitable deduction for a portion of their gifts. The chart shows the tax and financial benefits of such an arrangement established by a 55-year-old donor who funds a $5,000 gift annuity annually for ten years. The donor will receive income of $2,785 annually starting at age 65, as well as combined charitable deductions of $14,283.

Donors who don't know exactly when they'll retire can choose a flexible target date. If they retire earlier, annual payments will be lower, but postponing retirement will result in larger annuity payments.

Benefits of Deferred Gift Annuities

Year	Contribution	Deduction	Payout rate	Payout at age 65
2012	$5,000	$1,311	6.4%	$320
2013	5,000	1,345	6.2	310
2014	5,000	1,380	6.0	300
2015	5,000	1,416	5.8	290
2016	5,000	1,453	5.6	280
2017	5,000	1,426	5.5	275
2018	5,000	1,464	5.3	265
2019	5,000	1,503	5.1	255
2020	5,000	1,473	5.0	250
2021	5,000	1,512	4.8	240
Total	$50,000	$14,283	5.6%	$2,785

(assumes quarterly payments and a §7520 rate of 1.6%)

Charitable remainder unitrusts

Although charitable remainder unitrusts must pay income at least annually [Code §664(d)(2)(A)], the trust may permit the trustee to pay the lesser of trust income or the required payout amount and make up any deficiencies in later years when trust income exceeds the required unitrust percentage [Code §664(d)(3)].

Trust corpus could be invested initially in growth stock that produces little income. When the income beneficiary is ready to begin receiving substantial income, the trustee could change the investment mix, with no loss to capital gains tax, and begin receiving income sufficient to pay the unitrust amount and begin making up deficits. The chart shows the growth potential of a 5% unitrust funded with $100,000 in stock that pays dividends of $2,000 annually and grows at 8% annually.

Unitrusts can allow additional contributions, making it possible for the donor to boost retirement savings and secure added charitable deductions in later years.

There are several advantages to saving for retirement through deferred payment charitable gift annuities and unitrusts:

■ There is no maximum contribution, as there is with an IRA, 401(k) or qualified plan.

■ Both the gift annuity and the unitrust may be funded with appreciated assets, offering capital gains tax advantages.

■ Payouts can begin prior to age 59½ or be postponed beyond age 70½.

■ A portion of each payout may be capital gains or tax-free return of principal, rather than ordinary income.

■ Clients can reduce or avoid estate taxes and income tax on income in respect of a decedent.

Benefits from a Retirement Unitrust

Year	End of year value	Actual payout	Deficit from 5%
2012	$108,000	$2,000	$3,000
2013	116,640	2,000	3,400
2014	125,971	2,000	3,832
2015	136,049	2,000	4,299
2016	146,933	2,000	4,802
2017	158,687	2,000	5,347
2018	171,382	2,000	5,934
2019	185,093	2,000	6,569
2020	199,900	2,000	7,255
2021	215,892	2,000	8,000
			$52,438

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