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ESTATE PLANNING **REPORT**®

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PLANNING THOUGHTS

Trends in charitable giving

Philanthropy took a big hit in 2008 and 2009, during the financial collapse. It was a one-two punch. The sharp decline in stock values meant that people didn't feel wealthy enough to make major gifts, and the shares that they may have earmarked for charity were not worth as much as they had hoped.

As the stock market has recovered, so has charitable giving. The Dow Jones Industrial Average is more than double its low-water mark of 6,500 in March 2009. Inflation-adjusted charitable giving finally surpassed the 2007 record in 2014, and this year it is expected to be strong as well.

Writing in *Trusts & Estates* magazine, Robert Sharpe points out that the current low-interest-rate environment favors a number of specific planned gift approaches ["Trends in Philanthropy," October 2015, p. 13]. Charitable lead trusts and gifts of remainder interests in homes, for example, yield larger tax benefits when low interest rates are used to value retained private interests. Another concern Sharpe voiced is the possible curtailment of tax benefits for future charitable gifts. These range from the 2% of AGI floor for charitable deductions under Dave Camp's proposal (former Ways and Means Committee Chairman) for limiting the tax benefit to the 28% tax bracket, as favored by the Obama administration. Sharpe observes that making a charitable gift partly taxable would, for example, increase the amount of pretax income required to fund a $10,000 gift to $11,312. Those who favor this approach seem to assume that it would not significantly reduce charitable giving.

No charitable IRA rollover . . . yet

The charitable IRA rollover permits taxpayers who are older than 70½ to arrange for a direct transfer of up to $100,000 from their IRA to a charity. Reportedly, many retirees have used the provision to direct the payment of their required minimum distributions to their favorite charity. Doing so satisfies the minimum distribution rules, while not inflating the retiree's AGI, which could have other negative tax ramifications.

The charitable IRA was first enacted for the 2006 tax year, and it has been available every year since then. However, authorization always has been temporary, requiring periodic renewal with a "tax extenders" package. No such package has been enacted as of this writing. In 2014 the authority for charitable IRA rollovers was not restored until December 19, giving donors a very short window to make their arrangements.

Why can't the charitable IRA rollover be made permanent? Evidently, the "tax cost" is too high. Even

TABLE 1—AMOUNTS ARE IN THOUSANDS OF DOLLARS

Year	Gross estate for tax purposes		Gross charitable bequests		Gross estate for tax purposes, donors
	Number	Amount	Number	Amount	Amount
2010	15,191	130,195,505	3,061	11,971,580	44,144,439
2011	4,588	48,009,811	1,039	7,487,141	17,107,535
2012	9,412	124,320,687	2,398	14,357,858	48,558,991
2013	10,568	138,704,642	2,527	13,927,783	50,318,743
2014	11,931	169,521,932	2,740	18,776,673	60,262,770

Source: IRS *Statistics of Income*

with the very short window, the Joint Committee on Taxation scored that provision as losing $239 million for 2015, and from $12 million to $19 million each year thereafter, *which necessarily assumed that the provision never was renewed again*. The ten-year cost for allowing charitable IRA rollovers only in 2014 was pegged at $384 million.

Query: How many $100,000 charitable rollovers are required to generate a revenue loss of $239 million? The JCT did not show its work.

Trends in bequests

Each year the IRS releases tax facts and figures through *Statistics of Income*. Among the reports is a compilation of charitable bequests. Table 1, on the previous page, shows a summary of the last five years.

The table on page one reports by calendar year, but estates have nine months after the date of death to file an estate tax return. 2010 was the year without an estate tax, until Congress made it optional. (Estates had the choice of carryover basis or an estate tax.) Thus, one sees a drastic fall in bequests reported in 2011—not because there was less charitable giving, but because so many fewer estates needed to file an estate tax return at all.

The other big change reflected in the table is the increase in the amount exempt from federal estate tax to $5 million (plus inflation). It is interesting to note that, despite the 33% reduction in the number of taxable estates, by 2013 the total value of taxable estates was larger than it was in 2010. By 2012 the gross value of charitable bequests was sharply higher than in the higher-tax, lower-exemption regime of 2009, as reflected in the 2010 returns.

Table 2, below, looks at the percentage of estate tax returns with charitable bequests, which has held steady at about 23%. Looking at just those estates with such bequests, the charitable gift composes roughly 30% of the gross reported estate. Comparing total charitable bequests to the total reported estate, we see that proposition has held steady at just over 10% (apart from the anomalous years of 2009 and 2010).

It appears that, to this point, the increase in the federal estate tax exemption to $5 million hasn't diminished the number or size of charitable bequests, at least for estates large enough to be potentially subject to the federal estate tax.

TABLE 2

Year	Percentage of estate tax returns with a charitable gift	For returns with a charitable gift, percentage of gift compared to gross estate	For all returns, percentage of charitable bequests compared to gross estate
2010	20.15%	27.12%	9.20%
2011	22.65%	43.77%	15.60%
2012	25.48%	29.57%	11.55%
2013	23.91%	27.68%	10.04%
2014	22.97%	31.16%	11.08%

Source: M.A. Co.

CASES AND RULINGS

A taxpayer is allowed to take the Fifth on Schedule B.

Youssefzadeh v. Commissioner, No. 14868-14

Filing an income tax return is not the act of being a witness against oneself within the meaning of the Fifth Amendment. Those who file blank tax returns and attempt to invoke the Fifth Amendment as a defense have been routinely penalized for filing frivolous returns.

However, recently a taxpayer filed a numerically accurate return but redacted some information on the Schedule B. He omitted the names of certain financial institutions, but he accurately reported (and paid the tax) on the income received from those institutions. The taxpayer was concerned about running afoul of the requirements for reporting foreign bank accounts, which can involve severe criminal penalties for mistakes.

The IRS took the position that there is no Fifth Amendment privilege for any tax return questions, offered no rationale for requiring the omitted information, and imposed the penalty for frivolous returns. The Tax Court refused to enforce the penalty, because the tax return was substantially accurate and because the taxpayer had a legitimate, narrow fear of self incrimination.

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When a trust interest vests upon marriage, a disclaimer is permitted for nine months after the marriage, even if the disclaimant knew of the interest years before.

Private Letter Ruling 201540006

Son is the beneficiary of an irrevocable trust, Trust 1. Son receives all the net trust income each year, except that when he is married, his wife receives half, and he receives the other half. If son dies leaving a surviving spouse, she then receives all the net income for life. Son has adult children from an earlier marriage, and they are contingent future beneficiaries of Trust 1. Trust 1 principal eventually will pass to Foundation.

Son began cohabiting with Taxpayer. Unbeknownst to Taxpayer, Son created Trust 2 for her benefit. She is entitled to a fixed dollar amount, paid monthly and subject to adjustments based upon an index, so long as the two remain cohabiting. After Son dies, the principal of Trust 2 will be distributed to Taxpayer over a period geared to her age.

There's just one catch in Trust 2. In the event that Taxpayer and Son should marry, her interest in Trust 2 will terminate, unless she disclaims the interest that she receives in Trust 1 because of the marriage.

The couple has married, and Taxpayer proposed to disclaim her interest in Trust 1. The dollar values of the trusts are not given, but evidently the prospect of eventually having 100% of Trust 2 is better than the lifetime income of Trust 1. She turned to the IRS to confirm the tax consequences.

Because Taxpayer will disclaim within nine months of the marriage, when her interests vest, the Service holds that the disclaimer will be timely, made within a reasonable time of the "knowledge of the existence of the transfer." The fact that she knew of the trust interest for some time before the marriage does not affect this result. The disclaimed interests will pass to other Trust 1 beneficiaries pursuant to the trust terms, not by her direction. Accordingly, she will not make a taxable gift with the disclaimer.

Because Taxpayer was kept in the dark about Trust 2 and had no control over the conditions included in that trust, the IRS holds that her Trust 2 interest will not be consideration provided to induce her to make the disclaimer. Therefore, there will be no adverse tax consequences to the disclaimer.

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A net gift also may take into account potential estate taxes associated with the gift.

Jean Steinberg v. Comm'r, 145 T.C. No. 7

Jean Steinberg was the beneficiary of a marital trust, established by her late husband, worth $122,850,623. Her will divided her residuary estate equally among her four daughters. In 2007, when Jean was 89 years old, the daughters asked her to terminate the trust in order to accelerate their inheritances. She agreed to do so, subject to three stipulations. First, she reserved $10 million for herself. Second, the daughters would have to pay the gift taxes. That creates a "net gift," which reduces the value of the gift and, in turn, the amount of the gift tax.

The third stipulation was that the daughters would assume any federal or state estate tax liability associated with this gift. Under IRC §2035(b), a decedent's gross estate is increased by the amount of any gift tax paid within three years of death. Despite the fact that the estate and gift taxes have a single unified credit and are imposed at the same tax rates, gift taxes are cheaper than estate taxes, because they are determined on a tax-exclusive basis. Estate taxes are tax inclusive. The "gross-up" rule of IRC §2035(c) defeats this advantage for gifts made within three years of death, making those gifts effectively tax inclusive.

Thus, Jean was insisting upon a double net gift, a burden that the daughters accepted. The additional discount to the gift value came to over $5 million. The IRS accepted the basic net gift, but it rejected the additional discount for assuming the burden of potential estate taxes. The Service argued that under the relevant state's estate tax apportionment law, the daughters' obligation had not changed by making that agreement, so an additional $1.8 million in taxes was due.

The Tax Court soundly rejected the IRS's position The value of the gift is what a willing buyer would pay for it. The contingent estate tax liability would, of course, depress that value. Jean provided an expert witness to value the possibility, using IRS mortality tables and interest rates.

WASHINGTON TALK

President Obama's 2016 budget proposal recycles many of the ideas from prior proposals that Congress never addressed. At least one change included in this year's budget proposal already has been adopted—the consistent reporting of basis for estate and income tax purposes. One never knows which items in a budget proposal might be attached to other legislation.

The estate and gift tax proposals include:

- Return to the 2009 transfer tax regime, effective January 1, 2016;
- Require a minimum term for grantor annuity trusts;
- Put a time limit on the generation-skipping transfer tax exemption;
- Change the annual gift tax exclusion from $14,000

per donee per year to $50,000 per donor per year.

Other perennial favorites aimed at higher-income families include:

- Implement the "Buffett rule" with a new "Fair Share Tax";
- Treat the transfer of an appreciated capital asset by gift or bequest as a sale;
- Reduce the value of deductions for higher-income taxpayers;
- Tax carried interest as ordinary income, not capital gain;
- Limit the total accumulation in retirement plans;
- Repeal the exclusion for net unrealized appreciation in a distribution of employer securities.

In September the Joint Committee on Taxation issued an explanation of the provisions and their revenue consequences [JCS-2-15].

An online portal for IRS accounts in 2016? According to Small Business/Self-Employed Division Commissioner Karen Schiller, speaking at the American Institute of Certified Public Accountants' National Tax Conference in Washington on November 3, the IRS hopes to give taxpayers online access to their tax obligations, such as payment history and balance due. "Our future vision is, interacting with the IRS will be similar to how the interaction is with a financial institution or a bank . . . more online access, more self-service capability," she reported.

The key hurdle will be authentication standards. Deployment is expected first for individual accounts. The rollout has been targeted for 2016, but the timing will be influenced by any changes to the IRS budget.

Another interesting tidbit from the CPAs' Washington conference concerned coming Regulations on estate valuations for interests held by family members. The Obama administration has proposed that some restrictive provisions, such as upon future transfers or liquidations, should be ignored when determining the value of intrafamily transfers. There had been widespread speculation that the IRS might try to implement some of these ideas through the regulatory process.

According to Leslie Finlow of the IRS Office of Associate Chief Counsel, such changes are not consistent with the current statutory language. "We are looking to the statute as it is now. . . . We are not looking at the green book" outlining the President's budget ideas. New Regs. in this area are expected by the end of the year.

Marital status Regs. proposed. In late October the IRS proposed amendments to the Regulations under IRC §7701 defining marital status. Changes are required to accommodate appropriate tax treatment for same sex marriages, in accordance with the U.S. Supreme Court's decisions in *U.S. v. Windsor* and *Obergefell v. Hodges*.

However, an actual marriage will be required, according to the preamble. The IRS will not treat civil unions, registered domestic partnerships, or other similar relationships as marriages for federal tax purposes.

Luck and taxes. John McCaw of San Diego bought a used guitar from a friend in 1969 for $275. The friend had purchased the instrument from a pawn shop. Browsing through a 2012 issue of *Guitar World* magazine, McCaw noticed a striking similarity between his guitar and one used by John Lennon. Long story short, a subsequent investigation validated the provenance; McCaw's guitar had, in fact, been owned and played by John Lennon. The guitar sold at auction on November 7 for $2.1 million.

What's the tax rate on McCaw's gain? He no doubt hopes to qualify for long-term capital gain treatment, but the 28% tax rate that applies to collectibles may be more likely. A welcome problem to have, in any event.

Was this guitar used by John Lennon as the Beatles performed *Taxman*?

If you drive a car, I'll tax the street
If you try to sit, I'll tax your seat
If you get too cold, I'll tax the heat
If you take a walk, I'll tax your feet
Taxman!

Trust Department

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