Steve Leimberg's Charitable Planning Email Newsletter - Archive Message #207

Date: 31-Jan-14
From: Steve Leimberg's Charitable Planning Newsletter
Subject: Charitable Planning on the Upswing: Jeff Baskies' Top 10 List of Philanthropic Topics Addressed at the 2014 Heckerling Institute

While charitable planning is not often at the forefront during the annual **Heckerling Institute**, this year's conference highlighted the increasing importance of philanthropy and charitable planning in our practices. While this year's Institute will likely be remembered most as the year we were told we were no longer estate planners (apparently we are all or we all should be income tax planners), the elevation of charitable planning will likely be a positive memory as well.

With rising federal income tax rates, the new Net Investment Income Tax (the new 3.8% income tax/surtax our clients face – "NIIT"), and significant state income taxes in many jurisdictions, the value and importance of charitable planning is burgeoning. In fact, charitable planning played a substantial role in many general and special session presentations at this year's Institute.

Given the prominence of charitable planning in this year's institute, **Jeff Baskies** has picked out 10 of the most interesting and important presentations on philanthropic topics delivered at the Institute, at least in his eyes.

Jeffrey A. Baskies is an honors graduate of Trinity College and Harvard Law School. Jeff is a Florida Bar certified expert in Wills, Trusts and Estates law who practices at **Katz Baskies LLC**, a Boca Raton, FL, boutique trusts & estates, tax & business law firm. In total, Jeff has more than 125 published articles. In addition, Jeff is the author of the treatise: "Estate, Gift Trust, and Fiduciary Tax Returns: Planning and Preparation" (published by West). He can be reached at www.katzbaskies.com.

Before we get to Jeff's commentary, members should take note of the fact that a new **60 Second Planner** by **Bob Keebler** was just posted to the **LISI** homepage. In his commentary, Bob comments on Bobrow v. Commissioner (T.C. Memo 2014-21, January 28, 2014) where Tax Court Judge Nega held that the limitation to one 60-day IRA rollover per year applies to all IRAs

owned by a taxpayer, not to each IRA separately. You don't need any special equipment - just click on this link.

Here is Jeff's commentary:

EXECUTIVE SUMMARY:

Two inter-related themes sewed their way through much of the Heckerling Institute this year. First is the skyrocketing importance of income tax planning, including planning to deal with the new NIIT, state income tax, and capital gains taxes and basis issues. Second is the corollary theme of the burgeoning importance of philanthropic planning and the charitable deduction. Obviously, the higher income tax rates climb, the more important the charitable deduction becomes.

Monday during the Recent Developments panel, **Professor Jeffrey Pennell**, **Carol Harrington** and **Dennis Belcher** stressed that income tax planning is taking a more prominent role in our practices. "We're all income tax planners now," they told us.

Then, on Tuesday morning in the second general session of the day, **Paul Lee** blew up the hall, by literally shouting out that our thinking and indeed our estate planning paradigms must shift as the tax paradigms have shifted. Sadly, he said, most of us have not yet caught up with the "new" world order of tax planning. The new order he spoke of is the world we live in now where income tax rates for many are higher (maybe significantly higher) than estate tax rates. For example, Paul demonstrated that for many clients, particularly those with assets that benefit the most from a stepped up basis at death – like owner/creator IP, and depreciated commercial real property – and with beneficiaries in high state tax jurisdictions, gifting assets to use any of one's applicable exclusion amount during life is bad advice.

Indeed, slightly exaggerating for effect, Paul admonished the audience to never, ever, ever use our clients' applicable exclusion amount again. This type of "new" thinking highlights the income tax planning considerations many of us need to address in our estate planning.

Those general sessions presentation confirmed the role of income tax planning at the Institute, but they were not alone. There were at least 2 complete general session programs devoted to the 3.8% NIIT; there was a general session on

income tax issues with life insurance; there was a full afternoon-long double special (breakout) session (by Prof. Sam Donaldson) addressing income tax planning for estate planners the "3 hour tour"); and income tax topics were addressed in the current developments and Q and A panels as well.

With increased talk of income tax planning, naturally there was increased focus on the corollary planning of maximizing the charitable deduction, which was part and parcel of many of those presentations. For example, **Prof. Donaldson** addressed the charitable deduction for s-corps and the charitable IRA rollover in his income tax session; the use of CRTs was addressed in the NIIT discussions (as was the charitable IRA rollover); and CRTs were also discussed in several general and special panels for income tax deferral, NIIT deferral and IRD deferral (for IRAs and similar assets).

Moreover, this year, philanthropy and the charitable deduction merited two full general session presentations: on Thursday **Turney Berry** presented "Charitable Giving in the New Estate Planning Environment," and on Friday **Natalie Choate** presented "IRAs and Charitable Giving: Everybody Wins but the IRS."

Notably, charitable planning was presented as vital for advisors working with families of all levels of wealth. For example, **Marty Shenkman**, **Chris Hoyt** and **Steve Akers** spent a lot of time discussing charitable issues in their program called "Planning for Estates Under $10 million: a Rubik's Cube of Simplicity". Thus, we should not assume income tax and charitable planning are only relevant to the richest of our clients, as many clients wish to minimize their income taxes (regardless of net worth) and many charitable donors have non-taxable estates.

With that in mind, while attending the **University of Miami's Heckerling Institute** in January 2014, and reviewing the materials for a presentation, I realized there were many worthy charitable-oriented discussions, and to ease parsing the philanthropic topics from the rest of the materials, I created this top 10 list.

COMMENT:

So here are the Top 10 Philanthropic Topics addressed - in no particular order:

1. Wandry vs. Petter/Hendrix/McCord/Christiansen: **Dennis I. Belcher,**

Carol A. Harrington and **Jeffrey N. Pennell** – Q and A; **Loomis-Price and Pratt**, general session presentation on 709s, and more.

The Wandry vs Petter/Hendrix/McCord/Christiansen (I will just call it "Petter") debate continues. And it is a charitable planning top hot topic.

We know that Wandry style formula gifts are those made in the likeness of the Tax Court Memorandum (TCM) decision by the same name. These formulas are designed to transfer a certain number of units or a certain percentage interest in a discounted entity (e.g. a family LP or LLC) based on values as finally determined for federal gift tax purposes. The hope is to avoid a gift in case of IRS audit and reduction of discounts.

We also know the Petter approach, which is to create a defined value formula gift to a nondeductible trust with a gift of any "spill-over" into a deductible form (or at least a non-taxable gift trust). In these cases, the spill-over was to a charity, mot typically the client's local community foundation.

Stephanie Loomis-Price and **David Pratt** presented the Wandry/Petter issue in their general session presentation on how to report gifts on form 709s. They offered some advice on how to structure such transfers and how to report them - most importantly they reminded us to be sure that our form 709 reporting is consistent with our assignment/gifting.

David described the facts and planning in the Wandry case. As noted, the key to a Wandry gift is that the donor makes a gift of shares equal to a specified value. As he said, the donor is "backing into the value."

Stephanie then described the facts and planning in the McCord case, noting she was second chair during its litigation. McCord was a "Petter-like" approach and so it differed from Wandry as it used a charity as the backstop. Stephanie noted that by using a charity as the backstop, the donor had a third party participating in the process of defining the value of the gifts, making it easier to defend the rights of the charities.

David then described variations to the Petter/McCord gift: a zeroed out GRAT as the backstop or an inter vivos QTIP trust as the backstop. Dave cautioned, however, that both GRATs and inter vivos QTIP trusts have reporting requirements and elections hat practitioners need to be aware of. Indeed, neither seems a wonderful back-end of a defined value formula. Instead

perhaps an incomplete gift trust or an estate trust might be safer alternatives, and David mentioned those variations.

Both Stephanie and David added that Wandry is a single TCM case and the law in this area is still developing so clients should be cautioned to this fact before embarking on these types of gifts.

Later, the debate over which is the better approach to gifting discounted assets came up as the lead-off subject of the Q and A panel with **Dennis Belcher**, **Carol Harrington** and **Prof. Jeffrey Pennell** all addressing it. In their presentations, Dennis Belcher and Carol Harrington both explained their preference for the Petter approach over the Wandry approach because (a) Wandry is not precedential as a TCM and (b) Petter and its related cases not only have precedential value but their approach (involving a third party charity in the mix) was more logically defensible to them.

Indeed I believe Dennis said he is uncomfortable with Wandry and does not use that approach at all. He said he would prefer to use alternative approaches such as a Petter formula if an alternative approach is available at all. He expressed two primary concerns: (a) the donor's involvement in the valuation process may impact the ability to define the gift; and (b) the adjustment provision in Wandry may be too indefinite to be a completed gift. Prof. Pennell seemed intellectually interested in the Wandry approach, but I think he too ultimately suggested advisors might favor the Petter approach as safer.

All in all, the panel seemed to agree that using a defined value formula was a "safer" approach.

Regarding Petter-style gifts, at the Institute, we learned that a "Petter project" is underway and some community foundations are working toward providing a solution. Already, Community Foundation Partners is working to create "Petter qualified" community foundations to stand ready to work with clients and their trusted advisors to quickly and seamlessly help implement "Petter-style" defined value gifts.

2. IRAs and Charitable Giving

Natalie Choate led off the Friday general session programs with a presentation on "IRAs and Charitable Giving: Everybody Wins But the IRS". She advocated for lifetime and post-death charitable giving solutions for retirement

benefits.

Natalie noted the "IRA roll-over" may have expired on 12/31/2013, but it may return again. Other presenters suggested it may return retroactively. This technique was something she (and other presenters) touted, especially as the charitable IRA roll-over met the clients' RMDs without increasing the clients' gross income (with the new problems of NIIT and phase-outs of itemized deductions).

An interesting charitable planning discussion came in **Prof. Hoyt's** special session presentation (with **Steve Akers** and **Marty Shenkman**) for estates under $10 million, which goes to show there are opportunities for charitable planning even in non-taxable estates. He posited several scenarios where Charitable Remainder Trusts ("CRTs") ought to be considered for IRA planning.

First, he presented a scenario where an IRA owner dies and a relatively old surviving spouse considers a roll-over. In such a case, he noted, the rules require exhaustion of the IRA within a relatively short time period. An alternative solution for older clients with older spouses, Prof. Hoyt presented, was the use of a Charitable Remainder Trust ("CRT"). When a CRT is the designated beneficiary of an IRA, you avoid one of the most significant adverse consequences of a roll-over, because the CRT can have a constant payout (e.g. 5% per year) rather than the escalating exhaustion payout rates required of a rolled-over IRA. In addition, of course, the CRT may have successor beneficiaries (if they are old enough – to ensure satisfaction of the 10% remainder test) so the children might continue the benefits of the annual payouts after the surviving spouse's death without worrying about the minimum distribution rules.

Second, Chris also presented a scenario of a non-taxable estate plan for a client with a second spouse (from a different marriage from his kids), a valuable jointly-titled house, a reasonably large IRA (he used $4 million) and relatively modest other assets. In planning for this couple, he compared relying on portability and an IRA roll-over to use of a CRT. For clients under $10 million, portability and a roll-over certainly avoided estate taxes, but the plan did not solve the issue of how to protect the children of the prior marriage. Chris presented a multi-life CRUT as a possible approach for the beneficiary of the IRA to allow use of the IRA for the spouse to support her for life, but then to pass the benefits to the children after her death, all in an

income tax efficient manner.

Use of CRTs for IRAs of non-taxable estates was a concept probably many had not considered. And we know the use of an IRA to fund a Credit Shelter Trust ("CST") - particularly a conduit trust - might be very tax inefficient. When comparing a CST to a CRT for the first spouse to die's IRA, he argued for the CRT as the better and more flexible alternative, income tax-wise.

Naturally, the CRT is also a viable option where the owner has no spouse and wishes to use it for her/his children. This can control the "burn rate" of the IRA post-death and also restrict just how much the children receive annually (avoiding beneficiaries possibly cashing out more quickly than the client wishes and/or the conduit trust rules).

3. Charitable Gift Annuities Are Not Dead – Contrary to Popular Belief (maybe)

In a special session presentation on Thursday entitled "Charitable Planning Today", **Martin Hall** presented a discussion of how Charitable Gift Annuities ("CGAs") might still have relevance to clients today.

Predictably, the primary motivator for clients considering CGAs is increased cash flow. In a low interest rate environment (such as we live in), many clients (particularly elderly and not wealthy) are looking to squeeze as much income as possible from their portfolios, and they are still running short annually. For them, CGAs provide a way to convert largely low-income productive portfolios into a stream of income to support life style expenses.

Not surprisingly, this topic also has the most relevance to clients well below the taxable threshold. And that's been a consistent theme – just because we have a $10+ million exemption for most client couples that does not mean charitable planning is unimportant. For some clients of quite modest means (clearly not taxable estates), charitable planning like this is a simple, easy and traditional means to increase cash flow and income.

4. Charitable Limited Partnerships

In his general session presentation entitled "Charitable Giving in the New Estate Planning Environment", **Turney Berry** addressed appropriate and non-abusive ways to blend LPs with charitable giving.

This is a controversial topic to some. Abusive techniques have been described where clients create LPs with liquid assets and give a 99% interest to a charity (perhaps with little or no discounting on the client's income tax return). The same client may create a family dynasty trust and put liquid assets into it. Then the dynasty trust might approach the charity and offer to buy out the LP interest at a substantial discount. Given the total illiquidity of the LP interest, the charity might sell it for pennies on the dollar.

However, Turney presented scenarios where legitimate charitable planning could be supported. And Turney rightfully cautioned that such planning required clients with general charitable intent – otherwise, they might as well make the gifts and pay the gift taxes as the kids will wind up with more money.

As described in Turney's presentation, the ideal client for this planning would have a concentration in a specific asset with a very low basis, which the client intends to sell, while also having intent to both support charity and transfer wealth to family members.

First, the client would create a limited partnership. Assume for example, the client will own the entity that holds a 1% GP interest and will also own the 99% LP interest to start (or, for example, the client could share some of the LP interest with a spouse or an adult child).

In this example, the partnership would be funded with the appreciated assets. The donor would contribute the 99% LP interest to a public charity. A donor advised fund at a community foundation might work, but Turney cautioned against using a private foundation because of the self-dealing rules.

The client takes an income tax deduction for the contribution of the LP interests (but, Turney says, at the discounted value). There should be a valuation done to appraise the LP interest to justify and substantiate the deduction (see Treas. Reg. §1.170A-13).

The LP may then sell the appreciated asset and the gain should flow through to the owners: i.e. 99% to charity and 1% to the owner of the GP (assume the client).

Thereafter, the 1% general partnership interest may be transferred, for example, to a GST exempted dynasty trust for the family.

Eventually, the charity should be willing to sell the LP interests for their fair

market value – again as determined by appraisal. If so, then eventually, the dynasty trust might buy the LP interests based on the appraisal. In the end, the dynasty trust will eventually have the entire LP (which means it has the full, undiscounted value as it could liquidate the LP) the charity will have cash assets worth whatever the discounted value was, and the donor got an income tax deduction - while 99% of the capital gain was avoided, if this all works.

In his presentation Turney posited a LP funded with $1,500,000 of assets. The 99% LP interest might be valued at $1,000,000 due to discounts. The 1% that's gifted to the dynasty trust should be valued without discounts – i.e. valued at $15,000. Assuming the dynasty trust eventually purchases the 99% interest for $1,000,000 then it has assets worth $1,500,000, as the trust can liquidate the partnership - thus unlocking the full value.

Even if the assets are not sold and there is no capital gains avoidance, the client will pass $1,000,000 to charity (and will get a deduction) and will pass $500,000 to the dynasty trust for his descendants with only a $15,000 gift and generation skipping tax exemption hit.

Note: The capital gain part seems to add a level of risk. Some have wondered if the donation of appreciated assets and the subsequent sale while the charity owns 99% of the LP (a blatant attempt to avoid the capital gains tax) in a pre-arranged form would cause the donor to pick up the gain on his return. It does feel a bit aggressive.

5. Use of Charitable Planning, including CRTs to Spread Gains and Avoid or Minimize NIIT

As discussed above, the rising importance of income tax planning was unmistakable at the Institute. And the desire of many clients to avoid or minimize the 3.8% NIIT surtax was also unmistakable.

Thus, a few of the presenters (including **Prof Hoyt** in his general and special session and **John Goldsbury** and **Robert Keebler** in a special session) suggested the use of CRTs as a means to avoid or at least minimize the NIIT impact on clients.

For example, in a Special Session Thursday afternoon entitled "Practical Issues in Planning for the 3.8% Tax on Trusts/Estates", **John Goldsbury** and **Robert Keebler** addressed a number of scenarios/cases as a means to express the

impact of the NIIT, and a few touched on charitable planning. Case 3 addressed the effect of charitable contributions on a client's 1040 vs on a trust's 1041. They noted the distinction between charitable gifts reported on a Form 1040 and those reported on a Form 1041. On a 1040, charitable gifts are deducted generally on Schedule A (below-the-line deductions) and are subject to the 50%/30%/20% of AGI Limitations. On a 1041, the deduction is above-the-line and there are no percentage limitations. So charitable trusts are very powerful, because the deduction can shift NII from the trust to the tax-exempt charitable beneficiary. The takeaway from this example is that the charitable deduction is much more valuable at the trust level than on an individual's Form 1040. Case 4 dealt with a "very charitable" client. Certain clients (typically the very wealthy clients) are expressing frustration with the phase-out and the charitable deduction limits. So they presented ideas on how advisors can take advantage of the result discussed in case 3 above. One option presented is a non-grantor CLAT. With a non-grantor CLAT, the settlor does not receive an up-front deduction, but the CLAT receives a charitable income tax deduction for the annual annuity payments to charity. Because the CLAT is reporting income on its 1041 and is governed by IRC 642(c) instead of IRC 170, there are no AGI limitations, and the trust will pay tax only to the extent its annuity payments to the charity are less than the income generated. It also has the effect of reducing NIIT. Note: CLATs may be more popular for our wealthier clients who may be frustrated by (i) the AGI limits on charitable deductions, (ii) the return of the phase-out of itemized deductions, and (iii) the NIIT tax.

Similarly, in his general session presentation, Professor Hoyt highlighted that individuals with AGI over $200,000 (married filling joint $250,000) will not be able to avoid the 3.8% NIIT with the charitable deduction; because the 3.8% NIIT is assessed on a person's modified AGI. The charitable deduction does not reduce AGI since the charitable deduction is an itemized deduction.

One way he suggested that higher income individuals can reduce their modified AGI for the charitable gifts that they make is to shift their net investment income to charities (for example, by making an outright gift to a donor advised fund currently) and/or to utilize charitable vehicles like trusts - rather than claiming charitable income tax deductions for gifts that were made from their income.

In Chris' example, a client may have a $100,000 investment that generates $4,000 of investment income each year, which the client annually gives away. Assuming the client has AGI well over $200,000. Currently, the client

reports the $4,000 of income and claims a $4,000 itemized charitable income tax deduction. Although this reporting is essentially a wash for his income tax, the $4,000 still triggers the 3.8% NIIT tax. Now, that's not the world's biggest liability (the tax is $152 in that example), but if the numbers increase and if you figure it annually over a lifetime, some planning to avoid the NIIT may make sense.

In this case, the client might consider donating the $100,000 asset to a donor advised fund now. The client will get a current charitable deduction for the $100,000, plus he will avoid the NIIT on the income every year.

6. The Potential Return of the IRA Charitable Rollover.

A few of the panel presenters (**Professors Hoyt** and **Donaldson** in particular) ventured to guess which of the expired tax laws might be reinstated or extended retroactively (or otherwise). And at the forefront of the lists was the charitable IRA rollover. It seems there is enthusiasm for the technique, logic for its use and support generally to continue it.

There was even some talk that it might not return until 2015, but even then perhaps retroactively to January 1, 2014. I'm not sure I'd risk it but some clients may be so inclined.

If it is reinstated, some hope that Donor Advised Funds might be added to the permissible recipients of such donations.

7. Potential Repeal of IRA Stretch-outs: Obviously Increasing the Benefits of CRTs

Some panelists presented the potential legislative repeal of stretch-out IRAs for most beneficiaries. **Natalie Choate**, in particular, speculated this legislative change may be possible, if not probable. And **Prof. Hoyt** basically said it is coming – it is a matter of when not if this change will be made. In some corners it is even considered a logical step (see **Steve Leimberg's** Employee Benefits and Retirement Planning Newsletter #599**,** by **Jeff Baskies "Maybe the Highway Bill Has It Right - Perhaps Congress Should Adopt a 5 year Payout for IRAs"** where the author herein already posited such).

If stretch-out IRAs are repealed for all but spousal roll-overs (and perhaps a few other exceptions), then the increase in IRA charitable planning will be exponential. More clients will inquire about gifting their IRAs outright to

charity and more clients will obviously consider CRTs for their "stretch-out-like" impact.

In his special Session, "Planning for Estates Under $10 Million: A Rubik's Cube of Simplicity" Prof. Hoyt posited we are likely to see the end of the stretch IRA. He suggested Sen. Baucus wants to limit the payout of any inherited retirement plan to a 5 year payout (unless the beneficiary qualifies under and exception) and President Obama included this proposal in his 2013 budget. Thus the panel thinks there is a good chance this could pass. If this becomes law, charitable trusts will become much more attractive to clients with large IRA.

8. Charitable Gifts by S-Corporations

In his basic income tax session for estate planners, **Prof. Sam Donaldson** reviewed the manner in which S-corporations make charitable gifts and the favorable income tax treatment they have enjoyed.

From his program "Income Tax Planning for Estate Planners: A Three Hour Tour", Prof. Donaldson presented the following: While ATRA includes many permanent changes to federal income tax, it also contained a number of "extenders" that postponed the sunset of many important rules until the end of 2013, one of which dealt with the contributions from S corporations. As of this writing, all of these items expired at the end of 2013, but it is suspected some – perhaps including the S corp provision - many will be once again extended into 2014 and beyond. The issue of the Stock Basis Adjustments for Charitable Contributions By S Corporations, was labeled by Sam as "as close to a 'grab and steal' as we have seen in this world of great deductions." For any property donated, shareholders take a pro rata deduction for 100% of the fair market value (FMV), but only need to recognize a reduction in basis that is a pro rata share of the adjusted basis of the contributed property (up to 10%).

9. Gifts to Charity using Single Member LLCs: A Current Development – Turney Berry

In his presentation, "Charitable Giving in the New Estate Planning Environment", **Turney Berry** discussed the useful tip set out in Notice 2012-52, clarifying that a charitable organization may take title to a donated property in the name of a single member LLC for purposes of segregating any liability associated with the property, without jeopardizing the donor's deduction,

provided the donation complies with all the requirements of IRC §170. This Notice was a practical, positive development that can benefit our clients who wish to donate real property to charities, where the property may come with potential environmental or similar liabilities.

10. Remainders in Personal Residences and Farms

Finally, **Turney Berry** also addressed the opportunities for clients to make gifts of remainder interests in family farms, "ancestral homes" and vacation properties. Due to the very low interest rate environment, he noted that gifts or remainder interests in real property are particularly timely and valuable. The donor receives a present income tax deduction even though the donor retains a life estate (which may be for more than one life). The deduction is based on the remainder value of the residence or farm donated. However, the tables to compute the value of the remainder make it more valuable (and thus the deduction higher) the lower the current AFR is.

Since the AFR is still at historically low levels, gifts of remainder interests are more valuable than in the past.

I'm sure there were many other charitable mentions during the Institute, but obviously and by necessity this summary was just meant to touch on some of the highlights. Also, I wish to note the wonderful and detailed summaries of the Heckerling Institute offered by the ABA-PTL list-serve which available on their website. For sessions I did not attend, I liberally relied on their summaries, and I want to acknowledge and thank the authors.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Jeff Baskies

CITE AS:

LISI Charitable Planning Newsletter #207, (January 31, 2014) at http://www.leimbergservices.com/ Copyright 2014 Leimberg Information Services, Inc. (LISI). Reproduction in Any Form or Forwarding to Any Person Prohibited – Without Express Permission.