First Bankers Trust Services

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Newman's Own tax exception

When Paul Newman died in 2008, he left his ownership of Newman's Own food company to Newman's Own Foundation. The food company is a for-profit venture, but it gives all of its after-tax profits to charity. The problem is that the tax code prohibits private foundations from owning more than 20% of a for-profit company (35% in some circumstances). The Foundation had until November 2018 to divest 80% of its ownership of the food company, or it would face crippling excise taxes.

A measure to create an exception to avoid this problem for Newman's Own was originally attached to the Tax Cuts and Jobs Act, but it was excised by the Senate parliamentarian under the budget rules because it lacked budget impact. A separate bill was enacted in February, saving the status quo. Foundations now may own 100% of a company that is independently controlled and operated, and that gives 100% of its profits to charity, among other requirements.

Progress report

One of the early actions taken by President Trump was the issuance of Executive Order 13777, "Enforcing the Regulatory Reform Agenda," on February 24, 2017, with the purpose of reviewing and reducing the federal regulatory burden on the economy. In April the Treasury Department reported on the successes that it has had to date in complying with this order:

- 305 Treasury Regulations eliminated or proposed to be eliminated or modified;
- net reduction of 94 regulations made on Treasury's regulatory agenda; and
- more than 250 specific recommendations presented for reform and burden reduction.

For the estate planning community, the most significant action under this program was the revocation of proposed regulations under IRC §2704, concerning the valuation effects of certain restrictions on interests in family businesses. The proposal was strongly criticized in a December 2016 hearing, and it was revoked on October 20, 2017.

The Service is combing through the regulations for deadwood, regulations for statutory provisions also that have been repealed or substantially altered. To date some 298 regulations have been identified as obsolete under this initiative.

—https://home.treasury.gov/sites/default/files/2018-04/20180423%20Regulatory%20Reform%20Report_0.pdf

Beneficiary as co-trustee

Grantor created an irrevocable trust for Child and Grandchildren before September 25, 1985, so the grandfather rules for the generation-skipping transfer tax apply. Grantor and Child have both died, so the trust has been split in two, one for each Grandchild.

All of the initial trustees of Grandchild's trust have died. Grandchild would like to be a co-trustee, but is concerned about the tax consequences.

The trust provides that if a beneficiary is acting as a co-trustee, the beneficiary "shall not have any right to participate in any manner which would shift any beneficial interest in the trust to or from such beneficiary Co-Trustee. All such discretionary power shall be exercised solely by the other trustees." What's more, under governing state law, discretionary distributions of income or principal to or for the benefit of beneficiary who is a co-trustee may be made only to provide for his or her health, education, support, or maintenance, an ascertainable standard.

Good news for this beneficiary. The IRS holds that becoming a co-trustee will not make the beneficiary the holder of a general power of appointment, nor will it cost the trust its exempt status for the GST tax.

—Private Letter Ruling 201817002

Follow the broker

Mason Foertsch's 2005 will created a QTIP trust for his girlfriend, Debra Pund, to be funded with "all funds held in Legg-Mason, Oakmark, Advest and Spencer County Bank." A 2006 codicil to the will noted that the couple was now married, so "Debra Pund" now was "Debra Foertsch." A second codicil that year was needed when Advest was acquired by Merrill Lynch. "Merrill Lynch" was substituted for "Advest" in the funding clause for the QTIP trust.

In 2008 Mason's broker left Merrill Lynch to work for Raymond James. Shortly afterward, Mason shifted his investments "in kind" to a Raymond James account. However, he never amended his will to reflect the change. His will made no mention of the Raymond James account.

Was the specific bequest of the Merrill Lynch account adeemed? The lower court held that it was not, but Debra appealed the decision. The Court of Appeals holds that the change was of form only, not of substance. Mason intended the QTIP trust to be funded by the investment account, regardless of where it was situated.

—In re The Estate of Mason R. Foertsch, 88 N.E.3d 785 (Ind. Ct. App. 2017)

COMMENT: Why would Debra argue for ademption when she was the beneficiary of the QTIP trust? Presumably, she believed that she would have fared better had those assets passed via intestacy.

Fixed GRAT held taxable

On February 1, 1998, Patricia Yoder created a Grantor-Retained Annuity Trust, keeping for herself a fixed annuity for 15 years. The annuity was set at 12.5% of the trust's initial value. The trust was funded with investment real estate, and the annuity came to $302,259 per year. Although the value of the trust's income varied from year to year, the annuity payments to Patricia did not change, and they were timely paid.

Patricia died November 2, 2012, three months shy of the expiration of the GRAT's term. Her estate tax return reported a total taxable value of $36.8 million, including the value of the GRAT. Some $11.1 million in estate taxes were paid. Someone then had second thoughts, and believed that including the GRAT in the taxable estate was a mistake. A refund of $3.8 million was sought, and when the IRS did not respond, the matter went to District Court.

The estate argued that a fixed annuity is not a "right to income" within the meaning of IRC §2036(a)(1). It is the right to receive payments from transferred property, regardless of the income earned by the property. The Court acknowledged that there is no case directly on point, but using a substance-over-form reasoning held that IRC §2036(a)(1) does apply in this situation. In Helvering v. Hallock, 309 U.S. 106 (1940), the U.S. Supreme Court held that the grantor's reservation of any interest, however remote, was sufficient to bring the conveyance within the code's "possession or enjoyment" language.

—Badgley, Judith v. United States; No. 4:17-cv-00877

COMMENT: Had Patricia chosen a 14-year trust term, or if she had lived just three more months, the $3.8 million tax would have been avoided.

Hurricane season brings new scam warnings

The IRS has issued a new warning about con artists who prey on public sympathy after a natural disaster. The scams may include:

- impersonation of a charity to get money or private information from well-intentioned taxpayers;
- bogus websites using names similar to legitimate charities to trick people to send money or provide personal financial information;
- claims to be working for or on behalf of the IRS to help victims file casualty loss claims and get tax refunds; and
- bogus charities soliciting money or financial information by telephone or email.

Apparently the IRS has seen upticks in such practices after hurricanes in the past. To learn whether a purported charity is legitimate, the IRS provides a web-based tool for searching its database: https://www.irs.gov/charities-non-profits/tax-exempt-organization-search.

The Service reminds taxpayers to donate by check or credit card, not cash, so as to have a record of charitable contributions, and to never provide a Social Security number to someone soliciting a donation.

—IR-2018-132

Two are barred from helping to file tax returns

Shameka Wells and Elizabeth Stephens helped taxpayers file their tax returns. Unfortunately, these were, in many cases, false and fraudulent returns. The pair would include a Schedule C to create bogus business losses, so as to allow the filer to claim the earned income tax credit. Over a four-year period, they prepared 5,410 tax returns, and many—if not all—of the returns were fraudulent. The total revenue loss was unknown, but it might have run into the millions.

The IRS sought a permanent injunction to bar both defendants from assisting taxpayers with their tax return filings. They were personally served, but did not appear before the Court in their own defense. Nevertheless, the Court found adequate grounds for issuing the permanent injunction.

—Wells, Shameka N. et al. v. United States; No. 5:17-cv-00140

Federalism and marijuana

Senator Elizabeth Warren (D-Mass.) and Sen. Cory Gardner (R-Colo.) have introduced the Strengthening the Tenth Amendment Through Entrusting States (STATES) Act. The purpose is to allow states to make up their own minds about marijuana usage, without the threat of federal interference. Forty-six states have legalized cannibis in some form, and nine now allow recreational use. A companion bill in the House was introduced by Representatives David Joyce (R-Ohio) and Earl Blumenauer (D-Ore). States that want to keep "weed" illegal would be free to do so, the bill does not amount to legalization at the federal level.

But what the bill would accomplish is that those in the marijuana business would finally have legal access to banks. The lack of bank access hampers the business, but just as important, it makes it tricky for states to accept the associated tax payments, because they must be all in cash.

Senator Gardner said that President Trump has signaled support for the bill.

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