IN THIS ISSUE

Trust planning

Special Needs Trusts: The basics

Charitable giving

Trends in charitable giving

Tax currents

An online portal for IRS?
Taking the Fifth with the IRS
Taxman

Trust UPDATE

Stillman BANK

Special Needs Trusts: The basics

Providing support without jeopardizing benefits

Parents and grandparents of a child with a lifelong disability, such as autism, have a special estate planning challenge. On the one hand, they want to provide the financial support that the child never may be able to provide for himself or herself. On the other hand, they want to protect the child's eligibility for the full range of government support programs, including health care.

Distributing assets outright to a special needs person is likely to result in a disqualification for government benefits. Completely disinheriting the child is not a good idea, because government benefits alone may not be enough. Giving property to other family members with the "understanding" that it will be used for the benefit of the special needs person may work for some families, but there are risks. For example, such assets will be vulnerable to creditors, including potential ex-spouses should there be a divorce.

The better course, for many families, is to establish a "third-party" special needs trust. A "first-party" special needs trust is one established for oneself, with one's own assets. The assets of first-party trusts must be used to repay state Medicaid agencies that have paid for medical services. No such requirement applies to third-party trusts that are created for others.

This is a complicated area of law, and the rules vary from state to state, so the advice of a lawyer well-versed in special needs trusts will be essential.

Funding the trust

A special needs trust has to be fit into the estate plan as a whole. Very often the parents of a special needs child will provide that child with an enhanced share of the estate. For example, if there are three children, the estate may be divided 40-30-30, or 50-25-25.

Another approach is to divide the estate equally but supplement the provision for the special needs child with a life insurance policy, perhaps a second-to-die policy if both parents are living. This can be an affordable way to be confident that the special needs trust

will be funded at an adequate level for the child's entire life.

Choosing the trustee

In general, a family member should not be the sole trustee of a special needs trust. A professional trustee or a corporate trustee, such as a bank trust division or a trust company, is a better choice. The trustee will be given sole and absolute discretion in making distributions. Therefore, the trustee needs to be familiar with the legal requirements of special needs trusts and with government benefit programs. Investment management skills are a must if the trust is intended to last for many years. It's also important that the trustee be free of conflicts of interest, which someone who is a remainder beneficiary of the trust would have.

To provide guidance for the trustee, the parents should prepare a letter that explains the purposes of the trust and the needs of the child. This can cover the child's likes, dislikes, needs and preferences, and other information that will be essential to make the trust plan a success. Special needs organizations have prepared samples of such "letters of intent" to provide a starting point for parents taking this path.

ABLE Accounts

A tax bill enacted last year also included the Achieving a Better Life Experience Act (ABLE), a permanent expansion of Sec. 529 savings accounts for the benefit of disabled young people. The purpose is to encourage private savings to support disabled individuals in a manner that supplements, but does not supplant, other benefits that may be provided by private insurance, Medicaid, the Supplemental Security Income program, or the beneficiary's employment.

Qualified ABLE programs. ABLE programs will need to be established in each of the states, as with Sec. 529 college savings plans. ABLE accounts will be available only to residents of the state establishing the program. A disabled person will be limited to a single ABLE account, except that creating a successor account for rollover purposes is permitted.

Contributions to an ABLE account generally must be made in cash; an exception allows for the rollover of funds to another ABLE account for the same beneficiary or an eligible individual who is a family member of the beneficiary. As with 529 college savings plans, there is no deduction for making a contribution to an ABLE account. Investment changes are limited to twice each year.

More than one donor may contribute to an individual's ABLE account, but the aggregate of such contributions may not exceed the amount of the gift tax annual exclusion in any calendar year ($14,000 in 2015).

The beneficiary of an ABLE account must have become disabled or blind before reaching age 26.

Amounts accumulated in ABLE accounts generally will not be counted for purposes of means-testing eligibility for federal programs. However, amounts distributed for housing expenses will not be disregarded for the Supplemental Security Income program. In the event that the ABLE account balance exceeds $100,000, SSI benefits may be suspended, but Medicaid benefits will not be.

Tax treatment. In contrast to a conventional special needs trust, which has the same broad goals as an ABLE account, these accounts offer the potential for freedom from income tax. No taxes are imposed upon the investment earnings of ABLE accounts. Similarly, there are no income taxes on distributions for qualified disability expenses. Qualified disability expenses are defined quite broadly and include "education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative expenses, legal fees, expenses for oversight and monitoring, funeral and burial expenses," and any other expenses as may be provided in future Regulations.

On the other hand, distributions not used for qualified disability expenses are taxable to the beneficiary, and a 10% penalty tax applies as well. The distribution may not be treated as a taxable gift.

There is a price to pay for the tax favors accorded to the ABLE account. At the death of the ABLE account beneficiary, the state may make a claim on the account up to the total medical assistance paid for the beneficiary after the establishment of the account.

The states have moved swiftly to adopt enabling legislation for ABLE accounts. As of November 20, 2015, 33 states and the District of Columbia have done so [http://www.thearc.org/what-we-do/public-policy/policy-issues/able-legislation-by-state].

Special considerations

We can serve as the trustee for a special needs trust. We bring all the resources of a corporate fiduciary to the task. However, this complicated area of wealth management planning requires the supervision of an experienced attorney. If you are considering a special needs trust for someone in your family, we would be pleased to meet with you and your attorney to discuss the matter in more detail. ☐

© 2015 M.A. Co. All rights reserved.

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 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 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. 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 to 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 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 that 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 their reports is a compilation of charitable bequests. Table 1, below, shows a summary of the last five years (amounts are thousands of dollars).

The table 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.

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 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*

An online portal for IRS?

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.

Taking the Fifth with the IRS

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 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. Apparently, 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 question, 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.

Taxman

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!

Give your family the gift of lasting financial security.

See one of our investment and trust professionals today.

Scot Kunkel, CFP®, CFA
Senior Vice President & Trust Officer
(815) 332-8864
scotk@stillmanbank.com

Jeffrey Hartle
Vice President
(815) 332-8843
jeffh@stillmanbank.com

Stillman BANK
Trust & Asset Management
8492 E. State Street • Rockford, IL 61108
815-332-8100
www.stillmanbank.com