

Trust & Estates

Taxes and Planning

TM Financial Services

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§642(c)(5)

Pooled income Funds

A pooled income fund is a trust that is established and maintained by a public charity as a way to attract contribution from donors who lack the sufficient funds required to establish and maintain a charitable remainder trust. The pooled income fund receives contributions from individual donors that are commingled for investment purposes within the fund. Each donor receives "units of participation" in the pooled income fund that are based on the relationship of their donation to the overall value of the fund at the time of the donation.

On an annual basis, the fund's entire net investment income is distributed to the participants of the fund according to their units of participation. These distributions are made to each participant for their lifetime and upon his or her death, the portion of the fund assets attributable to the participant is removed from the fund and used by the charity for its purposes.

The requirements of IRC §642(c)(5) include:

- Donor must make irrevocable transfer of the remainder interest in the property to the organization.
- Property is to be comingled with property of other donors who have made similar contributions.

Administrative Expenses - Effect on the Marital Deduction

Funeral costs are only deductible on the decedent's estate tax return. Medical expenses can be taken on the estate tax return or the decedent's final 1040. Neither are ever permitted as deductions for fiduciary income tax purposes. Administrative expenses, on the other hand, can be deducted on either the decedent's estate tax return or on the estate's income tax return (or split between the two – this is commonly done when the estate has tax-exempt securities and a portion of the administrative expenses must be allocated to them on Form 1041. The non-deductible portion can be taken as a deduction on the federal estate return, Form 706).

To take administrative expenses as an income tax deduction, an irrevocable election is made on a yearly basis as the 1041 is filed, which must include a statement that the expenses were not taken as an estate tax deduction.

Usually, where no estate tax is due it makes sense to elect to deduct the expenses on the estate income tax return. However, this election can effect the amount of the marital share depending

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upon what type of administrative expenses are involved.

Estate Management expenses are expenses incurred in connection with the investment of estate assets or with their preservation or maintenance. Examples include custodial fees, investment advisory fees and brokerage commissions.

Estate Transmission expenses are expenses that would not have been incurred but for the decedent's death. They are generally incurred in the collection of assets, the payment of debts and taxes and the distribution of the decedent's property to the beneficiaries. Examples include executor's commissions, legal fees, probate costs and appraisal fees.

The **General Rule for Estate Management** expenses is that the value of the marital share **is not** reduced by the expenses attributable to and paid from the marital share.

Exceptions:

- 1) The marital share is reduced for any management expenses deducted on the 706.
- 2) The marital share is reduced if management expenses are paid from the marital share but are attributable to a property interest not included in the marital share.

The **General Rule for Estate Transmission** expenses is that the value of the marital share **is** reduced by the amount of expenses paid from the marital share regardless of whether they are paid from income or principal or whether they are deducted on the 706 or the 1041.

Exceptions:

- 1) The marital share is not reduced if the estate uses income to pay the transmission expenses if the marital share is not entitled to income during the administration of the estate.
- 2) The marital share is not reduced if the transmission expenses are paid out of the non-marital share.

Pooled Income Funds (continued from page 1)

- Fund can neither accept nor make investments in tax-exempt securities.
- Fund is maintained by the organization to which the remainder interest is contributed.
- Each non-charitable beneficiary must hold an income interest for life.

The fund is required to distribute income at the latest by the first 65 days following the close of the taxable year in which the income is earned. Such payment made after the close of the taxable year are treated as paid on the last day of the prior taxable year.

Income Tax Consequences

A donor does not typically recognize gain or loss on the transfer of property to a pooled income fund which assumes the basis and holding period of the property transferred to it as determined in IRC §1015(b) and §1223(2).

In general, a deduction for a remainder interest in property is not allowed for income, gift, and estate tax deduction purposes unless the contribution takes the form of a charitable remainder annuity trust, charitable remainder unitrust, or pooled income fund. For gift, estate and income tax purposes, the deductible portion of property transferred to a pooled income fund is based on the present value of the remainder interest. The computation is made by taking the present value, at the date of transfer, of the life income interest and then subtracting that value from the FMV of the transferred property on the valuation date.

The computation is generally based on the following factors:

- The date of birth of the income beneficiary
- The FMV of the property transferred
- The highest rate of return earned by the fund during the three years

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An estate continues in existence until the period of administration ends as a result of the payment of debts, taxes & bequests and the distribution of assets. An estate can be considered terminated by the IRS if the administration period exceeds what is thought to be a reasonable period after the distribution of its assets. Although the IRS has not issued rulings on whether an estate has been unduly prolonged, there is a 2 year presumption rule or safe harbor for executors.

Reasons considered valid by the IRS for keeping an estate open beyond 2 years:

- Taking advantage of a §6166 election to pay estate taxes in installments.
- Keeping it open to resolve disputes, for example, among beneficiaries.
- Posting a surety bond in probate court by the executor.

Reasons not considered valid for delaying the termination of the estate:

- A state court order approving delay.
- Unnecessary and unreasonably incurred loans.
- Continued payment of federal income taxes and legacies.

For estates that are open beyond 2 years, the fiduciary is required to check the box on line 8 in the “Other Information” section on page 2 of Form 1041 and attach a statement explaining why the estate has remained open beyond 2 years.

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preceding the transfer.

As far as contributions to pooled income funds go, they are treated for purposes of the charitable contribution income tax deduction similar to a public charity, i.e. total contributions are limited to 50% of adjusted gross income.

Taxation of Pooled Income Funds

A pooled income fund is a taxable trust and although the income of the trust is paid to the grantor, the grantor trust provisions of §677(a) do not apply as specified by Treas. Regs. §1.642(c)-5(a)(2).

Additionally, even though the entire income must be distributed, the allowance of a charitable set-aside deduction mandates tax treatment as a complex trust. As all income of the trust is distributed, the trust is allowed a §661 distribution deduction for all of it's income – only capital gains are taxed to the trust. Because it is not a charitable trust, a pooled income fund is required to use a calendar year.

Pooled income fund beneficiaries are required to include in their gross income all amounts

properly paid, credited, or required to be distributed to them during the taxable year or years of the fund ending within or with their taxable year.

Gift and Estate Tax Considerations

A pooled income fund consists of a charitable gift of a remainder interest with a retained income interest. Gifts made to charity via a pooled income fund qualify for unlimited gift and estate tax deductions for the present value of the remainder interest. A donor makes a transfer to a pooled income fund naming herself as the sole life income recipient. The transfer qualifies for the charitable gift tax deduction in an amount equal to the present value of the remainder interest in the year the transfer is made. Because the donor retains the income interest, there are no further gift tax consequences. Upon death, the full value of the fund units is includible in the estate. However, the full value of the fund units will be deductible from the taxable estate via the estate tax charitable deduction.

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IRS	General Information	800-829-1040
	EINs	800-829-4933
	Form 706 & 709	866-699-4083
NJ	General Information	609-826-4400
	Estate & Inheritance	609-292-5033
NY	General Information	518-457-5181
	Estate Tax	518-457-5387
CT	General Information	860-297-5962
PA	General Information	717-787-8201

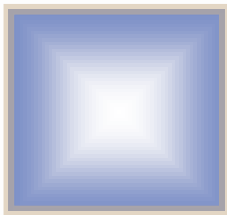
2010 Form 706 Released

On September 3 the IRS released the final version of 2010 Form 706. Five days later on September 8 the instructions for Form 706 were released. Based on the amount (or lack) of changes from the old form, one has to wonder why it took so long. The due date for filing is still September 19 but it is hard to imagine that this won't be changed.

Form 8939, Allocation of Increase in Basis for Property Acquired from a Decedent, is still due Nov. 15, 2011. However, the final version of Form 8939 has not been released, nor have its instructions, which will explain what documentation must be attached. In a letter to the IRS on August 8, the AICPA, asked that the due dates for Forms 706 and 8939 be postponed until 90 days after the release of whichever of these forms and instructions is issued last. This would allow a reasonable period of time for the preparation and filing of either 2010 Form 706 or 2010 Form 8939. The AICPA has not received a reply to this request.

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