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Tax Newsletter

Follow Directions for Car Deductions
Twists and turns in tax rules

Generally, if you itemize deductions on your return, you can deduct charitable contributions of property in addition to cash donations made to qualified organizations. For instance, you might gift a car or other vehicle that will be used to further the charity's tax-exempt function. In fact, some charities specialize in vehicle donations.

However, the tax rules in this area can be tricky. If you are not careful, you could wind up with a deduction for an amount that is much less than the car's fair market value (FMV).

Starting point: Under prior law, all you had to do was to arrange for the charity to receive the car, drop it off and then claim a deduction based on the FMV for the make and model listed in a car-buying guide. But the IRS suspected that some donors were being overly aggressive in their valuations, so Congress clamped down on the rules for vehicle donations.

Currently, if you use a guide to establish the vehicle's FMV—such as the Kelley Blue Book (KBB), CarMax or Edmunds—the deduction may be reduced if the charity then sells the vehicle. For example, if the FMV of a car is $5,000 in the KBB when you donate it and the charity subsequently sells it for $3,000, your deduction is limited to $3,000. If the charity sells the car for $500 or less, the deduction is equal to the lesser of $500 or the FMV.

The charity must provide you with a written substantiation of the deduction value within 30 days of your contribution or, if it sells the vehicle, within 30 days of the sale. Save this documentation as proof in case the IRS ever challenges the deduction amount. If you have not heard from the charity within 30 days of a vehicle donation, contact them immediately to obtain the written statement.

The current rules have reduced the deduction for vehicle donations in many cases. One consolation: If the charity "materially improves" the vehicle for its own use—say, it installs a backup camera—you can still deduct the vehicle's FMV. Depending on your situation, you might search for a charitable organization that is willing to fix up the vehicle for its own use.

Other special rules apply to charitable donations of property. For 2024, your deduction usually cannot exceed 30% of your adjusted gross income (AGI). Any excess above 30% of AGI may be carried over for up to five years.

End of the road: Make sure you maximize the charitable deduction for a vehicle donation. Contact your professional advisor before you hand over the keys.

Supreme Court Rules on Business Valuation
COLI included in taxable estate

The U.S. Supreme Court has just handed down its decision on the estate tax consequences of a business valuation involving corporate-owned life insurance (COLI). This new ruling, which has drawn criticism from some tax commentators, could have a major tax impact in the future (Connelly, U.S. S. Ct. No. 23-146, 6/6/24).

Background: The value of a business interest is included in a deceased owner's taxable estate. Generally, the valuation is performed by an expert who typically takes into account numerous factors, including (but not limited to) the following:

- Appraisal of assets
- Dividend-paying history
- Earnings history
- Financial prospects
- Goodwill and reputation
- Location
- Management skills
- Value of similar businesses

Frequently, business owners will draft a buy-sell agreement to facilitate the transfer of the business interest upon an owner's death or retirement. The buy-sell agreement establishes a price for the sale of the business interest. This may take the form of an entity purchase by the business, a cross-purchase where a co-owner acquires the business or a hybrid. The payment is often funded by life insurance.

Of course, any estate liability may be partially or wholly sheltered by the estate tax exemption. The exemption for 2024 is $13.61 million (scheduled to revert to $5 million, plus inflation indexing, in 2026).

Facts of the new case: Two brothers were the sole owners of a building supply company, a closely-held corporation, in Missouri. To keep the business going upon the death of either one, they created a buy-sell agreement allowing the survivor to purchase the deceased owner's shares. If the survivor declined, the corporation would redeem the shares by using COLI proceeds from a $3.5 million policy purchased on the life of each brother.

After one brother died, the surviving brother declined to purchase the shares, so the corporation used $3 million from the COLI to purchase the deceased brother's interest. The corporation reported the value of the shares at $3 million. But the IRS said that the value of the COLI should be added to a $2.3 million value of the deceased brother's interest in the business, for a total of $5.3 million. This triggered an additional estate tax liability of almost $900,000. The Eighth Circuit Court agreed with the IRS.

Now the Supreme Court has upheld the Eight Circuit's decision. It reasoned that the obligation of the corporation to redeem the shares represented value to a hypothetical buyer.

As a result, the value of business interests may be increased for estate tax purposes. Accordingly, business owners may take steps to reduce estate tax exposure. Consider these four practical suggestions.

1. Review buy-sell agreements with respect to estate tax complications, It may be preferable to use a cross-purchase agreement where life insurance proceeds directly purchase shares without being included in the business.

2. Evaluate life insurance policies to accommodate the transfer of a business interest.

3. Set aside funds to cover potential tax liability arising from share redemptions or corporate obligations.

4. Keep good records of buy-sell agreements and other transactions to support your position if the IRS ever challenges a valuation claim.

Last, but not least: Obtain expert advice. Your professional tax advisors can provide the necessary guidance.

DOL Issues New Final Fiduciary Rule
Offers retirement planning protections

The Department of Labor (DOL) recently released a new final rule that is designed to provide greater protection to individuals who seek retirement planning advice from fiduciaries. This new rule updates definitions included in the Employee Retirement Income Security Act (ERISA) and accompanying rulings. It takes effect on September 23, 2024.

Background: ERISA affords protections to investors who use fiduciaries to provide retirement planning advice. Fiduciaries must observe certain minimum standards. Under the new final rule, someone is treated as an investment advice fiduciary if they provide a recommendation in either of these two situations.

1. The person directly or indirectly (e.g., through an affiliate) makes professional investment recommendations to investors on a regular basis as part of their business and the recommendation is made under circumstances that would indicate to a reasonable investor that it—

- Is based on review of the retirement investor's particular needs or individual circumstances;

- Reflects the application of professional or expert judgment to the retirement investor's particular needs or individual circumstances; and

- May be relied upon by the retirement investor as intended to advance their best interests.

2. The person represents or acknowledges that they are acting as a fiduciary under ERISA with respect to the recommendation. The recommendation also must be provided for a fee or other compensation.

Significantly, among other changes, the new final rule addresses a longstanding exception for "one-time advice" that has not kept up with other changes in the retirement planning arena.

How it works: For almost 50 years, a financial services provider was treated as an investment advice fiduciary only if the advice was provided on a regular basis relating to a mutual agreement, arrangement or understanding that it would serve as the basis for investment decisions. This effectively excluded advice doled out on a one-time basis such as recommendations regarding rollovers to IRAs upon retirement.

Thus, ERISA protections were often not available to investors at certain times when they were needed the most. The new final rule closes this loophole. It provides protections when a recommendation comes from an investment advisor holding themselves out to represent the investor's best interests even if it is a one-shot deal.

The new final rule also "levels the playing field" by replacing the quagmire of rules setting varying standards depending on the products that are recommended. The amendments under the final rule establish more uniform standards. Fiduciaries must provide advice that is prudent, honest and free from overcharges.

In addition, the changes under the new final rule are generally consistent with other guidelines and regulations reflecting conduct that is in the investor's best interests.

Finally, the determination of what constitutes a recommendation will turn on the facts and circumstances of the situation and whether it could be viewed as a call to action. "Hire me" communications and generalized information—including information about industry trends, performance history and detailed descriptions of services—should not subject the investment professional to being an investment advice fiduciary. The more that the communication is targeted to a specific customer or group, the greater the likelihood that it will be viewed as a communication by a fiduciary

Conclusion: This brief article only hits some of the highlights of the new final rule. More details are available upon request.

Facts and Figures
Timely points of particular interest

Scam Targets--As part of its continuing efforts to protect the senior community, the IRS has issued a warning about the rising threat of impersonation scams. Typically, con artists target older adults by pretending to be government officials, aiming to steal their sensitive personal information and money. Similarly, by posing as representatives from the IRS or another government agency, the fraudsters may use fear and deceit to exploit their victims. Remain vigilant.

No Frivolity—Here is a simple suggestion about making frivolous tax arguments in court: Do not do it! This includes claims that wages are not subject to income tax, that paying tax and filing tax returns with the IRS is strictly voluntary or that the imposition of federal income tax is unconstitutional. If you proceed to Tax Court with a frivolous case, you run the risk of civil or criminal penalties or both. Furthermore, you still owe the initial tax liability plus interest and other penalties.

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