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ESTATE PLANNING **REPORT**®

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CASES AND RULINGS

Allocation of GSTT exemption is void.

Private Letter Ruling 201536012

After Child died, Grandparents began a program of annual, outright gifts to Grandchildren (the children of Child). This program continued for four years. Each year a gift tax return was filed, and each year the generation-skipping transfer tax exemption was allocated to these gifts. Apparently, the person who prepared the gift tax returns for Grandparents forgot that, with the death of Child, the Grandchildren were no longer "skip persons," with respect to transfers from Grandparents, and so no generation-skipping transfer had occurred.

After Grandfather died, his estate's personal representative noticed the mistake, and he attempted to correct it with a private ruling request. The IRS agreed that under these circumstances the attempted GSTT exemption allocation is void. The ruling does not state why the clarification was needed, but presumably the estate included beneficiaries who really were skip persons. In that situation, it would be important that the exemption not be wasted.

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Can a divorce decree turn a taxable bequest into a deductible claim against the estate?

Marcia Billhartz v. Commissioner; No. 14-1216

The terms of Warren Billhartz' 1978 divorce decree required him to leave half of his estate to the four children from his first marriage (one son, three daughters), divided equally. He remarried a year later. Most of Billhartz' assets were owned jointly with Marcia, his second wife, or were held in a living trust. Marcia and Ward, the son from the first marriage, were co-trustees of the trust.

Warren died in 2006, leaving a substantial estate. In accordance with the divorce decree, the trust obtained a lifetime annuity for the first wife. Ward received 16% of the balance of the trust, and each of the daughters 6%. In other words, the divorce decree requirement that the children be treated equally was ignored, and the four received only 34% of the net trust assets instead of 50% of the estate.

The distribution to the children totaled $14 million. The executor characterized that payment as a claim against the estate, and took a deduction for the full amount under IRC §2053(a)(3). The IRS disallowed the entire deduction, creating a tax deficiency of $6.6 million. The estate took the case to the Tax Court. However, after a series of negotiations, the estate and the IRS reached a settlement in which the Service agreed to allow 52.5% of the deduction. No rationale for that partial deduction is provided in the court opinion.

Next, it appears that the daughters were not aware that, under the terms of the divorce decree, they were entitled to the same share of their father's estate as their brother, and that the four siblings should have had 50% of the estate. The daughters first learned of the terms of the decree when the Tax Court litigation was filed. The sisters filed a state lawsuit alleging fraud. Curiously, the brother resigned his trusteeship and joined their lawsuit, alleging that Marcia had concealed key documents from them.

With the possibility that additional payouts would be due to the children, the estate moved to void its settlement agreement with the IRS. Litigation with the children was settled, with an additional distribution to each of the daughters of $1.45 million. Perhaps the estate hoped to apply the 52.5% deduction to the additional payouts.

The Tax Court refused to set aside the settlement, and entered a decision for the IRS. On appeal, the Seventh Circuit Court of Appeals agrees. The estate contended that the settlement was based upon a mistake of fact, that the distributions to the children already had been finalized. The Circuit Court notes that "a mistake of fact" does not extend to a failure to anticipate future developments. The estate also alleged that counsel for the IRS had learned from one of the daughters that a lawsuit was being contemplated and should have relayed that information to the estate. The Court stated that the estate itself was in a better position to judge the future actions of the beneficiaries than was the IRS.

In a footnote the Court notes that no opinion has been expressed on the appropriateness of the IRC §2053 deduction for the bequests to the children.

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Extension granted to make portability election.

Private Letter Ruling 201536005

Decedent died after the advent of the portability election for unused federal estate tax exemptions. The estate was small enough that no estate tax return was needed, and Decedent never made any taxable gifts during his life. Accordingly, the executrix of the estate, Decedent's wife, did not file an estate tax return.

Later, after the due date for an estate tax return, the executrix learned of the need to file a return just to make the portability election. This ruling does not specify just how late this realization came. In any event, the IRS holds that the tax code does not specify a due date for the portability election for estates smaller than the filing threshold. Accordingly, this is a regulatory election over which the IRS has considerable discretion. The spouse was granted another 120 days to file the return to make the portability election.

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Regs. proposed on special tax on gifts and bequests from expatriates to U.S. citizens and permanent residents.

REG-112997-10; 80 F.R. 54447-54468

Section 301 of the Heroes Earnings Assistance and Relief Tax Act of 2008, Public Law 110-245 (122 Stat. 1624) (the HEART Act), added new section 877A to subtitle A of the Internal Revenue Code (Code) and a new chapter 15 and new section 2801 to subtitle B, effective June 17, 2008. The purpose of this change was to keep the tax code "neutral" with respect to gifts and bequests from expatriates to U.S. citizens or permanent residents.

Seven years later, the IRS has now proposed Regulations under this new law. Comments on the proposed Regs. are due by December 9, 2015.

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Postscript on the mega-*Crummey* trust case

Israel Mikel et ux. v. Commissioner; T.C. Memo. 2015-173; Nos. 16538-13, 16563-13

In 2007 Israel and Erna Mikel each transferred $1.6 million to a family trust. The trust had 60 beneficiaries, including minors, and each had a *Crummey* power of withdrawal. Accordingly, when they filed their gift tax returns, Israel and Erna each claimed $720,000 in annual exclusions ($12,000 per beneficiary in 2007). Each beneficiary was notified of his or her right to demand $24,000 from the trust, a right that lapsed after 30 days. The record does not indicate whether anyone exercised his or her demand right, and whether any such demand was satisfied.

The family trust provided that the trustees had "sole and absolute discretion" in making discretionary distributions for the health, education, maintenance, or support of any beneficiary or family member. The trustees also had "absolute and unreviewable discretion" to assist a beneficiary in defraying "reasonable wedding costs . . . purchasing a primary residence, or . . . entering a trade or profession." Then the trust had two unusual provisions.

In the event of a dispute over the trustee's decision, the dispute "shall be submitted to arbitration before a panel consisting of three persons of the Orthodox Jewish faith." The panel was directed to abide by New York law in its deliberations. Second, any beneficiary who challenged the trustee's decisions in court would cease to be a beneficiary of the trust, an *in terrorem* clause.

The IRS asserted that those two clauses rendered the *Crummey* power illusory, and it denied the annual exclusions. The Tax Court disagreed.

Both of those clauses apply to challenges to the trustee's discretionary decisions over income and principal, not to the *Crummey* powers, over which the trustees have no discretion. The *in terrorem* clause bars a beneficiary from enjoying benefits under the trust if he or she files suit in any court to oppose or challenge a decision by the trustees to distribute trust property to another beneficiary. That doesn't alter the beneficiary's right to exercise a *Crummey* power, or to seek judicial redress if the trustees resist such a demand [*Israel Mikel et ux. v. Commissioner*; T.C. Memo. 2015-64].

After succeeding on the merits, the taxpayers asked for costs, arguing that the IRS position had not been substantially justified. On this point they lost. The Tax Court held that, given the difficulty and ambiguity of interpreting the *in terrorem* clause, the Service acted properly in pursuing the case into litigation.

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PLANNING THOUGHTS

A new headache for executors

For several years President Obama proposed adding a requirement to the tax code for consistent basis reporting for estate and income tax reporting. There was a perception that basis mismatches were costing the Treasury considerable sums. The proposal never went anywhere.

Until this summer, that is, when it was attached to a temporary extension of highway funding. The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, signed by the President on July 31, 2015, includes a new requirement that taxpayers who receive property from a decedent use as their income tax basis the value of that property as finally determined for estate tax purposes. New reporting requirements have been created for executors of estates, who must advise both the IRS and the estate's beneficiaries of the values.

The requirement only applies to property that increases the amount of federal estate taxes due. That means it doesn't affect property from estates lower than the exemption amount or property excused from taxation via the marital or charitable deductions.

The new rule applies to estate tax returns due after July 31, 2015. Generally, the basis reporting is due 30 days after the estate tax return is filed. However, given the absence of regulatory guidance, the IRS already has extended to February 29, 2016, the due date for basis reports otherwise due in 2015 [*Notice 2015-57*; 2015-36 IRB 1].

According to the Congressional Joint Committee on Taxation, the new provision will raise $117 million next year, more than $1.5 billion over the next ten years. Note that although the highway funding is temporary, the sunset provisions don't apply to the new basis reporting portion of the law—that is permanent.

The highway bill also includes a reversal of the U.S. Supreme Court's decision in *U.S. v. Home Concrete & Supply LLC* [132 S. Ct. 1836 (2012)]. That case held that an overstatement of basis is not an understatement of gross income for purposes of triggering the six-year statute of limitations. Now it is.

Targets for guidance

There are plenty of open questions that merit guidance from the IRS. For example:

- Will mailing the Form 706 to beneficiaries be sufficient to put them on notice of the tax basis of their inheritance?

- Will notification be required for beneficiaries who receive only cash or income in respect of a decedent? Although there is no basis issue presented for such bequests, they were not carved out in the legislation.

- What happens if, at the time that the filing is due, the executor hasn't determined the recipient of each estate asset?

How will tangible personal property be handled?

We will cover the answers to these questions as the IRS makes them available.

WASHINGTON TALK

Repeal of the federal estate tax was tucked into the tax reform plan announced by Presidential nomination candidate Jeb Bush. The more important elements were dramatic rate cuts, immediate expensing for capital investments, and elimination of the corporate deduction for interest expense. The top corporate income tax rate would be slashed from 35% (among the highest in the world) to 20% (below the world average). Many loopholes would be eliminated, but charitable gifts would remain deductible.

Minority discounts for gift and estate tax purposes would be modified under a new bill introduced by Presidential nomination candidate Senator Bernie Sanders. The Keep Our Pension Promises Act is aimed at multiemployer pension plans. The "pay fors" include restrictions on minority discounts and a cap of $1 million on the amount of deferral permitted under a §1031 like-kind exchange.

A dramatic drop in expatriation occurred in the second quarter of the year, and no satisfactory explanation has emerged. In the first quarter, 1,336 persons formally abandoned their U.S. citizenship or permanent resident status, and just 483 did so in the second quarter. In all of 2014, more than 3,400 Americans expatriated, a record, and we are on track to exceed that figure this year.

The spike in expatriations came with the implementation of FATCA, cracking down on foreign

bank accounts and assets. An estimated 7.6 million Americans are living abroad, potentially subject to the complexities and filing requirements of FATCA.

Deadline extended by snowstorm. Petitioner used FedEx to get his petition to the Tax Court on the final day for filing. Unfortunately, the Court was closed that day because of a snowstorm. The petitioner couldn't take advantage of the postmark rule because he had used FedEx.

The Tax Court ruled that the unscheduled closure of the government must be treated as a legal holiday for filing purposes. Accordingly, the taxpayer had one more day, and the petition was accepted [*Guralnik v. Commissioner*, Docket No. 4358-15].

What is acceptable tax planning for multinational companies? In a survey of 2,580 businesses, Grant Thornton LLP found that 75% of businesses want greater certainty in this area, so much so that they are willing to accept fewer tax planning opportunities in exchange for greater clarity. In the survey taken a year earlier, only 53% held that view.

An international project on base erosion and profit shifting (BEPS) has been under way for two years, and recommendations are expected in October. A majority of the survey respondents favored unilateral actions from their own governments if an international agreement can't be reached.

The good news for the 2013 tax-filing season was that the IRS spotted and prevented some $24.3 billion in identity theft refund fraud. The bad news was that over $5 billion in fraudulent tax refunds was paid in the same period, according to the Treasury Inspector General for Tax Administration, J. Russell George. The occasion was a Senate Budget Committee field hearing held in New Hampshire.

The identity theft problem was exacerbated when the IRS failed to secure its own computers, and hackers gained access to more than 300,000 records through fraudulent "get transcript" requests. The "get transcript" function remains disabled, as the IRS is developing enhanced identity authentication protocols.

Taxpayers snared in an identity theft have complained of a bureaucratic maze in addressing their problems. Commissioner Koskinen admitted that it had been taking the IRS as long as 300 days to resolve these situations, but now the cycle has been reduced to 120 days. The IRS has 3,000 employees dedicated to identity theft cases, and another 35,000 employees with regular taxpayer contact have been trained in this area.

National Treasury Employees Union under fire. Under current federal law, employee unions are prohibited at the FBI, CIA, Secret Service and Government Accountability Office. Senate Republicans have proposed adding the IRS to that list.

The idea was floated in the Senate report on the targeting of conservative groups by the IRS and the politicization of the agency. According to the report, in 2012 the National Treasury Employees Union (which represents IRS employees) gave 94% of its political action committee contributions to "anti-Tea Party Democrats." For many years, NTEU political contributions have skewed toward the Democrats. "The charge of the IRS is to administer the tax law in a fair and impartial manner. It is difficult, if not impossible, for that to occur when the union presence is so pervasive," the report concluded.

NTEU's president, Tony Reardon, noted in a statement that the key figure in the targeting controversy, Lois Lerner, was not a member of the union because she was in management. Lerner continues to invoke the Fifth Amendment in refusing to discuss her IRS job performance before Congressional committees.

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