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PLANNING THOUGHTS

The "lock-in" question returns

In 2012 an unusual deadline loomed, as the amount exempt from the federal estate and gift tax was scheduled for a precipitous drop. Many estate planners advised their clients to make irrevocable gifts so as to "lock in" the larger exemption before it was taken away. Some took that advice. In the event, Congress did not allow the larger exemption to lapse, but instead enlarged the exemption still further and made the change permanent. Afterwards there were CLE seminars on how to unwind those transfers that were now regretted by some.

The lock-in question is raised again, because the doubling of the federal exemption by TCJA 2017 will expire in 2026 unless further action is taken by Congress to extend it. The federal estate tax exempt amount never has been reduced in the past, but there is a first time for everything.

Estate planners Martin Shenkman, Jonathan Blattmachr, Joy Matak, and Sandra Glazier addressed this topic, among others, in "Estate and Tax Planning Roadmap for 2019-2020," published by Leimberg Information Systems [https://leimbergservices.com/collection/LISIShenkmanBlattmachrMatakGlazierPDF9_3_2019.pdf, subscription required]. The foursome conducted a webinar in October, and the PowerPoints and other materials for it may be accessed at shenkmanlaw.com/webinars.

Timing

Although 2026 is a long way off, the webinar participants suggested that there is a possibility of a "blue wave" in 2020. They stopped well short of predicting such a wave, but warned that if such a wave does happen the reduction in the federal exemptions could materialize soon after. They framed the issue in this way: Is it prudent to assume now that a 2020 blue wave can't happen? Even if the probability is low, now is the time to raise the possibility with clients to get them considering what actions might be undertaken.

The Regulations confirmed that under existing law, there will be no clawback of the tax benefit for taxpayers who make large gifts before 2026. That's a relief. However, when one considers the expansive nature of the wealth taxes that some Democrats have proposed (see "Washington Talk" in this issue), caution is required. New legislation to increase estate taxes might well include a provision reversing the clawback rule.

Tactics

A wide variety of strategies were offered in the webinar:

• For married couples, have only one spouse make irrevocable transfers to use the transfer tax credit, so as to minimize the chance of "buyer's remorse."

• Domestic Asset Protection Trusts (DAPTs) have been authorized in 19 states, and so have gone "mainstream."

• Spousal Lifetime Access Trusts (SLATs) may be used to consume the transfer tax credit, while keeping access to the assets.

• A Special Power of Appointment Trust (SPAT) may permit the fiduciary to appoint property back to the trust grantor.

• Some Democrats have proposed cutting back on the annual gift tax exclusion. That suggests that Irrevocable Life Insurance Trusts (ILITs) should be funded sooner rather than later.

• Credit shelter trusts may seem unnecessary for many with today's high exemption, but the better course may be to keep those trusts against the pos-

sibility of more stringent future taxes. Some have considered terminating an existing credit shelter trust so as to capture the chance for basis step-up at the death of the surviving spouse. Depending upon the size of the estate, this move could prove costly.

• GRATs are not recommended if one expects the tax environment to turn more hostile in the near future.

• New grantor trusts may be created for freezing estate values and enhancing generation-skipping transfer tax exemption benefits.

• Non-grantor trusts may be considered for moderately wealthy clients. Such a trust may be used to save net investment income taxes, though the law is less than perfectly clear.

Staying abreast

When the exemption was doubled in 2017, there was some thought that estate planning would fade in importance. The webinar made clear that there is still plenty to talk about with clients, and that estate planning will remain vital for some years to come.

CASES AND RULINGS

Hidden fraud does not alter taxable value.

Elizabeth R. Carter v. United States; No. 5:18-cv-01380

Francis Roper's estate consisted largely of $17.6 million worth of Colonial Bancgroup stock. She died in 2007. Unfortunately, the value of the stock sank like a stone, and it was worth only $8.5 million on the alternate valuation date, six months later. That was the value used on the estate tax return filed in 2008. But in 2009 the federal government undertook a fraud investigation that, upon its resolution in 2010, rendered the bank stock completely worthless. The estate asked for a refund in 2013 of the estate taxes that had been paid on the now valueless stock.

No refund is allowed, the District Court ruled. In the first place, the refund request is so late that the Court no longer has jurisdiction over it. The taxpayer-executrix claimed that the tardiness was due to her disability, and she had the medical documentation to back up the assertion. Unfortunately, while that excuse may be available to individuals, it is not permitted for estates. But even if the Court looked at the case on the merits, no refund would be allowed. The market for the bank stock had not yet collapsed on the alternate valuation date, even if the stock would have been worthless based upon nonpublic information. It is valued on the date of death and alternate valuation dates that must control the determination of tax obligations.

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Late portability election permitted.

Private Letter Ruling 201929017

Decedent's estate was small enough that no federal estate tax return was required. However, he did have unused federal estate tax exemption amounts, and these are portable to the surviving spouse upon making the election on an estate tax return. For "various reasons" no estate tax return was filed at the time. Now the surviving spouse would like to have that additional protection from federal transfer taxes, so a request for an extension of time to file the return has been made.

The IRS is fine with that. Because the estate was so small, and no estate tax return was required by law, the Service has greater administrative flexibility in such a case. The contents of the affidavits and representations submitted to the IRS explaining the tardiness were not revealed in the ruling, but they were held sufficient to meet the requirements of Reg. §§301.9100-1 and 301-9100-3. Accordingly, the estate was given another 120 days to file the return.

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Cert. denied in long-running case.

Smith v. United States, Sup. Ct. Dkt. No. 19-10 (2019), 920 F.3d 639 920 F.3d 639 (10th Cir. 2019)

When Anna Smith died in 1991, her estate's main asset was a trust that she had created. The trust held 9,994 shares of stock in State Line Hotel, Inc., a Las Vegas hotel and casino, valued at $11,508,400. The total value of Smith's estate was some $15 million, triggering an estate tax liability of $6.6 million. The liquid assets of the estate were used to pay $4 million of the tax, and the balance was deferred for five years and then was to be paid over ten years when the estate made the IRC §6166 election.

Under Nevada law the trust could not continue as the owner of the hotel beyond 1993 without going through additional regulatory hoops. Therefore, the trust was dissolved, and the shares were divided among Anna's four children.

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In 1995 the IRS decided that the estate had low-balled the value of the shares in the hotel, and it assessed additional estate taxes of $2.4 million. The estate contested the deficiency, and eventually it settled for an increase in the estate tax due of $240,381.

In 1997, about a week before the first installment of the deferred tax was due, an IRS agent contacted the executors of the estate to suggest "an alternative to your continued personal liability for the unpaid estate tax." The alternative was to execute a special lien for the estate tax, using the shares in the hotel as security. The four beneficiaries agreed to the arrangement. Shares worth some $6 million (based upon the 1995 settlement) secured the tax debt of some $1.8 million.

However, after the IRS agent submitted the agreement to the District Counsel, she was advised that the IRS would not accept closely held stock as collateral because of potential problems with securities laws. The executors responded, through their lawyers, that any securities laws issues were the IRS' problem, not theirs.

To cut to the chase, the hotel went bankrupt in 2002, rendering the shares owned by the children worthless—in fact, they took deductions of over $1 million for their losses. That also rendered worthless the collateral that the IRS held for the tax debt.

Next, the IRS filed suit against Anna's four children to collect the balance of the estate tax due, under trustee, transferee, and beneficiary liability theories. By the time that the lawsuit commenced, two of the children had died. Their estates could have been substituted as parties to the action, but the IRS never made the necessary motions, so the suit against them was dismissed. Ultimately, the beneficiaries prevailed on most of the issues before the District Court.

The beneficiaries then asked the IRS to pay half of their attorney's fees, specifically fees related to the discharge of fiduciary duties, to the liability of the trustees, and to the attempt to foreclose the tax lien. The District Court concluded that the government's position on these issues was not substantially justified, and it awarded the estate fees totaling $316,206.

The IRS appealed, and the Tenth Circuit Court of Appeals reversed that judgment. The taxpayers had relied upon the six-year state law statute of limitations, when the federal ten-year limitation is what should apply in this case.

The taxpayers appealed that decision to the U.S. Supreme Court, which denied certiorari in an October order. After 28 years, the estate tax obligations of Anna Smith's estate are finally resolved.

WASHINGTON TALK

SECURE Act still stalled. The SECURE Act (H.R. 1994) provides a number of taxpayer benefits in the retirement planning area, at the cost of eliminating the stretch IRA as an estate planning strategy, with exceptions for spouses and minor children. The bill enjoyed overwhelming bipartisan approval in the House last May, and there is similar support in the Senate. However, tax legislation is not moving in the Senate. According to Finance Committee Chair Chuck Grassley (R-Iowa): "The only way it's going to be brought up on the floor . . . is to get the Democrats to have a very restrictive debate and amendment process. We haven't had any luck on working that out."

The bill could be attached to the next spending bill, which must be enacted by November 21. Other candidates that might be considered are technical corrections to the Tax Cuts and Jobs Act of 2017, several dozen tax extenders, and a possible delay or even repeal of the "Cadillac tax" on high-value health insurance plans.

"Degrees Not Debt." Representative Salud O. Carbajal (D-Calif.) has introduced H.R. 4638, the "Degrees Not Debt Act," to expand access to Pell Grants. The new largesse would be paid for by accelerating the expiration of the enlarged federal estate and gift tax exemptions and alternative minimum tax exemption. Those are currently scheduled to expire in 2026.

Although the federal estate tax has sometimes been justified as a means to prevent the concentration of wealth, it has not been very effective at achieving that goal. The alternative proposed by Vermont Senator Bernie Sanders is a "Tax on Extreme Wealth." The definition of "extreme" is likely to be contentious, as it is just $16 million in the Sanders plan. At that level of wealth, an annual tax of 1% on an individual's total net worth would kick in. The threshold is doubled for married couples.

Rates rise with net worth, topping out at 8% on net worth exceeding $10 billion. The 5% rate kicks in at $1 billion. The new tax is projected to be paid by 180,000 American households, and it would raise an estimated $4.35 trillion in ten years.

Nothing would be exempt from the application of the tax. Thus closely held businesses, real estate, and fine art would have to be revalued annually to pay the tax accurately.

According to economists. Emmanuel Saez and Gabriel Zucman of the University of California, Berkeley: "The Sanders wealth tax would reduce the wealth of the typical billionaire in half after 15 years relative to a situation with no wealth tax. This would substantially break up the concentration of wealth and power of billionaires."

Two assumptions seem to underlie that observation. First, that the wealth of the billionaires does not grow enough to meet the tax obligation, so that the total value of their holdings declines over time. Second, that the economy as a whole remains unaffected by the new tax draining out over $4 trillion for the federal treasury. Both of those thoughts deserve further study.

The Sanders plan envisions beefing up the IRS considerably. An audit rate of 100% is projected for the billionaires filing their wealth tax returns, 30% for the rest who are affected. Should any wealthy family feel unwelcome in the USA and decide to move abroad to escape these taxes, the Sanders plan includes an expatriation exit tax of 60% on the total value of assets over $1 billion (40% on the first billion).

There is some doubt about whether a wealth tax would be constitutional absent an enabling amendment. But if one is enacted and passes muster, it could be a bonanza for estate planners. *Tax Notes* recently surveyed a number of leading practitioners for their thoughts on a wealth tax.

Austin Bramwell of Milbank LLP: "This would be like doing an estate tax return, which is a mammoth effort that typically involves a protracted audit with dozens of issues coming up in just the ordinary course of an audit—and this would become routine work!"

Brad Dillon, a wealth manager with Brown Brothers Harriman: "[An exemption for charities is] just one example of one of these things on the fringe, like, 'Oh, well maybe there needs to be this tiny exemption over here'—but there's going to be a million of those."

Carlyn S. McCaffrey of McDermott Will & Emery LLP: "The thought of administering this every year is horrendous. It would be lots of good work for appraisers I wonder if there are any appraisal firms that are publicly traded that I can start investing in."

The IRS has requested comments on the Regulations concerned with qualified disclaimers and their avoidance of federal gift taxes. No changes to the Regs. have been proposed, but the IRS will be accepting comments until December 10, 2019. According to the notice in the Federal Register, about 2,000 comments are expected.

The future of charitable giving. Law professors Roger Colinvaux and Ray D. Madoff are concerned about two recent developments in the field of philanthropy. The first is the inequitable distribution of tax benefits for making charitable gifts. Those in the highest tax brackets always have had the greatest tax reward for making such gifts, but the disparity has become more pronounced with the enlargement of the standard deduction. There is effectively no tax reward at all for charitable gifts if one uses the standard deduction. They note that the proportion of taxpayers claiming a deduction for charitable gifts has fallen from 25% to 8.5% as a result of this change. (However, total giving fell only 1.7%, they note.)

Their remedy for this problem is to convert the deduction to a tax credit and make the credit allowable only for gifts that exceed a certain threshold. The financial benefit then would be available to all, and would no longer be skewed toward top-bracket taxpayers.

Their second concern is over the explosion of donor-advised funds (DAFs). "DAFs have grown from obscurity to dominance in charitable giving. In 2017 (the most recent year for which data are available), Fidelity Charitable was the largest charitable fundraiser in the United States, raising $6.83 billion, more than twice as much as United Way. In 2017 the top four DAF sponsors raised more than the top 10 non-DAF public charities combined."

The professors are unhappy about the time interval that passes between the receipt of the tax benefit for the DAF donation and the date that a public charity gets the use of the funds. They also are concerned that DAFs may be used to circumvent the rules governing private foundations. Among their remedies is a partial delay in getting a tax benefit for giving to a DAF, linking it to the moment that the money goes to the charity or the donor relinquishes the power to give advice.

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