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ESTATE PLANNING REPORT®

July/August 2018

PLANNING THOUGHTS

Selling the benefits of estate planning

As important as estate planning is, that has long been a hard sell for most Americans. A 2017 survey by Caring.com revealed that only 42% of U.S. adults had a will or a living trust in place. In part, it's an age thing, as the table below shows.

Who has made a will?

Age cohort	% with a will or living trust
18-36	22%
37-52	36%
53-71	60%
72 and older	81%

Source: www.caring.com/articles/wills-survey-2017

When asked why they hadn't done their estate planning, 47% of survey respondents said that they "just hadn't gotten around to it." Some 29% felt that "they didn't have enough assets to leave anyone."

Interestingly, more people have attended to their end-of-life medical issues than to creating a plan for their property. Fully 53% of respondents reported having a health care power of attorney in place.

The hot buttons

As difficult as motivating people to take care of planning their estate has been in the past, it may become even trickier in the future. The temporary doubling of the amount exempt from the federal estate and gift tax, to $10 million for singles and $20 million for married couples (plus inflation adjustments), means that the vast majority of Americans no longer need to plan to achieve tax savings. There are exceptions in states that continue to levy their own death taxes (estate tax, inheritance tax, or both), because states typically have much lower thresholds for taxation. Still, only a minority of states have held on to their death taxes.

In the last century, trust departments could encourage their customers and prospects to establish marital deduction trusts for very major tax savings, to motivate them to see an estate planning attorney promptly. No longer. The advent of the portable federal exemption means that the basic tax benefit of such a trust may be had simply by filing an estate tax return and electing the Deceased Spousal Unused Exemption Amount (DSUEA). The election is permitted whether the decedent had an estate plan in place or not.

With the elimination of tax savings as an estate planning goal, the benefit that has been most important all along comes to the front: disposing of property in an orderly way, according to one's wishes. Failure to have an estate plan means that the state's intestacy statute takes over. Intestacy rules are the government's best guess of what someone would have chosen had they taken the time to plan. Even so, settling an estate via intestacy can be costly and time consuming—take the example of the musician Prince, who died without a will. Reportedly, over 1,900 documents have been filed in that case as of May 2018.

Will registration

When someone appears to have died without a will, there are questions, especially if substantial assets are involved. Was a will executed, but then lost? Where should one look for a will? If someone has executed a will, how can he or she be confident that the heirs will find the will?

Stacey Jerome-Miller is the President of The US Will Registry. That organization provides a secure and comprehensive database for the locations of wills that have been registered with it. There is no charge for the service. Ms. Jerome-Miller lays out the details of the

operations of her organization in "Where's There's a Will, There's a Way," 32 *Probate & Property* No. 4 (July/August 2018).

The registry does not hold any of the estate planning documents, only the information on the draftsman and the document location. It provides an avenue of inquiry when there is a question about whether someone really died intestate.

WASHINGTON TALK

Permanence on the agenda. At a July press conference, House Ways and Means Committee Chair Kevin Brady (R-Texas) promised action on "phase 2" tax legislation. "We anticipate the House voting on this in September and the Senate setting a timetable as well," he said.

The focus of phase 2 is expected to be on making the TCJA personal tax reforms permanent, eliminating the expiration date. Further lowering of the corporate tax rate, which President Trump has advocated, will be left for the future. *The Wall Street Journal* reported that the Retirement Enhancement and Savings Act (H.R. 5282) promoting retirement savings may be gaining traction in Congress, so it might be included as well. Apparently, TCJA technical corrections will not be included. Draft legislation was promised by the end of July.

On the other hand, Sen. Martin Heinrich (D-N.M.) has introduced S. 3018, the "Degrees not Debt Act of 2018." The bill would expand access to Pell grants, and it would fund that spending by repealing the increases in the AMT exemption and the federal estate and gift tax exemption.

In tax year 2016, total deductions for conservation easements came to $6 billion, according to a letter sent to the Senate Finance Committee by Acting IRS Commissioner David J. Kautter. There is a real concern about syndicated conservation easement transactions, in which investors in a pass-through entity are promised charitable deductions for conservation easement donations that are substantially larger than their investments. The value of the deduction may be premised upon a valuation statement that significantly overvalues the property.

Accordingly, of the 248 entities that claimed the $6 billion in deductions in 2016, 40 already are being audited, according to the letter.

Celebrated author and journalist Tom Wolfe died in May at the age of 88. He wrote *The Electric Kool-Aid Acid Test* and *The Bonfire of the Vanities*, among many other notable works.

Wolfe was survived by a wife and two children. His will left his tangible personal property to his wife, and his residuary estate to a revocable living trust. The wife was named executor, and successor executors also were identified.

That is all we know about the Wolfe estate, and all we are likely to know. The revocable trust can do many things, and one of the most important—especially for celebrities—is to provide a zone of financial privacy.

The case of the missing computer. The IRS IT inventory is estimated to be worth $612 million. According to the Treasury Inspector General for Tax Administration (TIGTA), a lot of it has gone missing. Specifically, 5,808 laptop computers, 4,813 network printers, 4,089 desktop computers, and more than 1,000 each of personal digital assistants, computer servers, and switches could not be accounted for in a recent inventory check.

TIGTA made a number of recommendations to improve the management of IT assets. The IRS reportedly accepted all the recommendations, contingent upon getting more funding to implement them.

Speaking of security. The IRS has provided advice for tax professionals on steps for keeping client tax data secure (IR-2018-150). There isn't much news in the advice, but nevertheless it is sound, worth careful consideration.

The "security six" safeguards recommended by the IRS are:

- anti-virus software;
- firewalls;
- two-factor authentication;
- backup software or services;
- drive encryption; and
- a written data security plan.

The number of taxpayers who obtained refund anticipation loans more than tripled in 2017, growing from 470,000 such loans in 2016 to 1.7 million in 2017, according to Federal Reserve research. The change in taxpayer behavior may be traced to legislation enacted in 2015 to give the IRS more time to evaluate claims of the earned income tax credit, which was being claimed improperly about 25% of the time. Tax refunds were statutorily delayed until at least February 15. Some attribute the increase in the number of loans to reliance by the working poor on the refunds to meet their daily expenses.

However, the research reported that EITC recipients spend just 14% of their refund within two weeks, with the balance going for longer-term purchases.

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Ambiguity removed on deductibility of fees for executors and trustees.

Notice 2018-61

Following the enactment of the Tax Cuts and Jobs Act in 2017, there was considerable concern that fees for administering trusts and estates might no longer be deductible on fiduciary income tax returns. New IRC §67(g) eliminates miscellaneous itemized deductions, and there were concerns that it might affect administration expenses in IRC §67(e). In Notice 2018-61, issued July 13, the IRS said that the fears were groundless. Non-grantor trusts and estates will continue to be able to deduct expenses under section 67(e), including the appropriate portion of a bundled fee, the IRS said.

However, the question of what happens when the trust or estate has excess deductions is not settled, and the IRS asked for comments on that question. Should the beneficiaries be able to claim any unused deductions? These have been treated as miscellaneous deductions in the hands of the beneficiary in the past.

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A fixed GRAT is estate includible if the grantor dies before the end of the term of the trust.

Badgley, Judith v. United States; No. 4:17-cv-00877

On February 1, 1998, Patricia Yoder created a Grantor-Retained Annuity Trust, keeping for herself a fixed annuity for 15 years. The annuity was set at 12.5% of the trust's initial value. The trust was funded with investment real estate, and the annuity came to $302,259 per year. Although the value of the trust's income varied from year to year, the annuity payments to Patricia did not change, and they were timely paid.

Patricia died November 2, 2012, three months shy of the expiration of the GRAT's term. Her estate tax return reported a total taxable value of $36.8 million, including the value of the GRAT. Some $11.1 million in estate taxes was paid. Someone then had second thoughts, and believed that including the GRAT in the taxable estate was a mistake. A refund of $3.8 million was sought, and when the IRS did not respond, the matter went to District Court.

The estate argued that a fixed annuity is not a "right to income" within the meaning of IRC §2036(a)(1). It is the right to receive payments from transferred property, regardless of the income earned by the property. The Court acknowledged that there is no case directly on point, but using a substance-over-form reasoning held that IRC §2036(a)(1) does apply in this situation. In *Helvering v. Hallock*, 309 U.S. 106 (1940), the U.S. Supreme Court held that the grantor's reservation of any interest, however remote, was sufficient to bring the conveyance within the code's "possession or enjoyment" language.

Had Patricia chosen a 14-year trust term, or if she had lived just three more months, the $3.8 million tax would have been avoided.

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With the proper limits in place, a beneficiary may become a co-trustee without risk of adverse tax consequences.

Private Letter Ruling 201817002

Grantor created an irrevocable trust for Child and Grandchildren before September 25, 1985, so the grandfather rules for the generation-skipping transfer tax apply. Grantor and Child have both died, so the trust has been split in two, one for each Grandchild.

All of the initial trustees of Grandchild's trust have died. Grandchild would like to be a co-trustee, but is concerned about the tax consequences.

The trust provides that if a beneficiary is acting as a co-trustee, the beneficiary "shall not have any right to participate in any manner which would shift any beneficial interest in the trust to or from such beneficiary Co-Trustee. All such discretionary power shall be exercised solely by the other trustees." What's more, under governing state law, discretionary distributions of income or principal to or for the benefit of beneficiary who is a co-trustee may be made only to provide for his or her health, education, support, or maintenance, an ascertainable standard.

Good news for this beneficiary. The IRS holds that becoming a co-trustee will not make the beneficiary the holder of a general power of appointment, nor will it cost the trust its exempt status for the GST tax.

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A prohibited transaction accidently saves a taxpayer from a big tax bill.

Marks v. Comm'r, TC Memo 2018-49

In 2005 Stacey arranged a $40,000 loan from her IRA to her father. Another IRA loan was made in 2012, this time $60,000 to Stacey's friend. In 2013 Stacey arranged for a rollover of her IRA to a new custodian. For some reason, the promissory notes for the loans

were not rolled into the new account.

The IRS spotted the transaction, and it charged that the failure to roll the notes into the new account created a taxable distribution to Stacey of $98,000. (Why the distribution was less than $100,000 was not explained; perhaps $2,000 of principal had been repaid?) Taxes on the distribution, coupled with the penalty for failing to report it plus a 10% penalty because Stacey was not yet 59½, brought the total assessment to some $42,000.

At trial Stacey initially argued that the notes were rolled into the new account. The Court then ordered both sides to prepare additional memoranda on whether the loan to Stacey's father was a prohibited transaction under IRC §408(e)(2)(A), and what the tax consequence of that would be.

Both parties concluded that the loan was a prohibited transaction, with the result that the IRA ceased being an IRA the year that the loan was made. Accordingly, the distribution of the notes, even if it occurred, would not result in additional taxable income to Stacey in 2013. Because the IRA terminated so long ago, the statute of limitations for collecting additional taxes that should have been paid in 2005 has expired.

Stacey may not be entirely off the hook. Presumably, she needs to refile her returns for all open years to report the investment income from the account that became an ordinary investment account in 2005.

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Extension is granted for making the portability election.

Private Letter Ruling 201827003

The year of death is not given in this private letter ruling, but it was at a time when any unused federal estate tax exemption amount could pass to a surviving spouse. The requirement for securing this tax benefit is to file an estate tax return to make the election, even if the return is not otherwise required because the estate is so small.

The surviving spouse in this ruling failed to make a timely election. No reason was given for the failure; evidently the executor simply overlooked it. Importantly, the decedent's estate was below the threshold for filing an estate tax return.

Because no return was required to be filed, the IRS has discretionary authority to grant an extension of time for making the election under Reg. §301.9100-1(c). The request for an extension was granted.

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A change in the method of determining trust income is held to not affect GSTT status.

Private Letter Ruling 201825007

A trust established before the advent of the generation-skipping transfer tax (GSTT) provided income to Daughter and three grandchildren. Upon the deaths of all four beneficiaries, the trust will continue for 21 more years, paying income to great-grandchildren, if any. Grandchild 1 is the sole survivor, and has no issue. Grandchild 2 had three children.

At some point in the past, the trustee petitioned a state court to alter the method for determining trust income. The new formula was to be the greater of all the trust's net income or a fixed percentage of the value of the trust assets on the first of the year. This change was found by the IRS to not affect the trust's "grandfathering" exemption from the GSTT.

Now the trust is being administered in another state, and the new trustee wants to convert the income interest to a pure unitrust interest. In addition, the trustee seeks an ordering rule for determining the income tax treatment of the distributions, as follows: (1) from net accounting income determined as if Trust were not a unitrust; (2) from ordinary income not allocable to net accounting income; (3) from net realized short-term capital gain and then from net realized long-term capital gain; and (4) from principal.

Because these changes are in accord with state law, they will not impair the trust's GSTT-exempt status, the IRS holds.

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