Montecito Bank & Trust

estate planning
BULLETIN

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Not just for estate planners

IRC §1022 was in effect for just one year, 2010. That was the year without a federal estate tax, during which carryover basis applied to property received from a decedent. Even though that tax year is long closed, the application of IRC §1022 will continue for many years to property transferred during that year. In May the IRS released proposed regulations in this area.

Speaking at the American Bar Association Section of Taxation meeting in Washington, D.C., in May, Catherine Hughes, an attorney-adviser in the Treasury Office of Tax Legislative Counsel, noted that the new regs. will be important to many tax practitioners, not only estate planners. Some regulatory amendments are simple references to IRC §1022, but others are new sections explaining the application of carryover basis in a new context. Hughes said that she does not expect many comments from estate planners on these proposed regs.

The federal estate tax could be repealed

On April 16 the House of Representatives passed the Death Tax Repeal Act of 2015 (H.R. 1105) by a vote of 240 to 179. The vote came after substantial testimony before the House Ways and Means Committee about the continuing burden of the federal estate tax on family businesses and farms, including testimony by the Family Business Coalition, the National Federation of Independent Business, the National Cattlemen's Beef Association and the American Farm Bureau Federation. The recurring theme was that over the years family farms have been forced to sell off acreage to meet death tax duties at the federal and state level.

According to the Tax Foundation, the U.S. has the fourth-highest estate tax rate among developed nations—only Japan, South Korea and France have higher rates. On the other hand, the U.S. has a high exemption rate, which has resulted in much-reduced estate tax collections, falling from $38 billion in 2001 to an estimated $20 billion in 2015 (after inflation adjustments). Thus, the "cost" of estate tax repeal is lower than it used to be. The Joint Committee on Taxation estimates the revenue loss at $269 billion over ten years.

The drive to repeal the federal estate tax was spearheaded by Rep. Kristi Noem (R-S.D.). From a press release issued by her office after passage of repeal in the House:

"Shortly after my dad passed away in a farming accident, my family got a letter from the IRS telling us that we owed a tax because he had died," said Noem. "I have never understood why the federal government thought it was appropriate to go after families with this double tax – especially in a time of crisis. My dad had already paid taxes on the equipment, the land, and any money we had in the bank. Now, we had to pay taxes on it again because he had passed away. It's not right. No family should have to go through that. I am committed to repealing the death tax and today we took a big step toward accomplishing that."

A parallel bill, S. 860, has been introduced in the Senate.

Unexpected aspects of the repeal bill

The House legislation repealing the estate tax contained two provisions that surprised many tax observers. First, although both the estate and generation-skipping taxes would be repealed upon enactment, the gift tax was retained. The rationale may have been to protect the income tax by preventing the tax-free transfer of income-producing assets within wealthy families.

Second, the current step-up in basis at death would be retained. Thus, there would be a double tax incentive to hold on to assets until death. The effect on estate planning could be profound for larger estates.

Proponents of estate tax repeal acknowledge that there is little hope for success in the near term. They are unlikely to get 60 votes in the Senate to overcome a filibuster, and even if they did, the legislation faces a certain veto from President Obama.

Expats spike

A growing number of Americans are relinquishing their citizenship. The record for expatriation was set in 2014, at 3,417. In the first quarter of 2015, 1,336 Americans said good-bye forever, a third again higher than in the year-earlier quarter. The exact reasons for the surge in expatriation are not known, but it coincides with the advent of higher U.S. taxes on the "rich," coupled with the implementation of FATCA (the Foreign Account Tax Compliance Act). Compliance with FATCA is complicated, and the penalties for errors are severe—they may be larger than the balance in the offshore accounts. FATCA has proved so onerous that some foreign banks now decline to work with Americans altogether, to avoid IRS filing requirements.

Donor-advised funds surge

Surging stock prices have led to a parallel increase in donor-advised funds, which permit donors to dedicate assets to charity and take a corresponding tax deduction before the money reaches the charitable target. The money grows tax free until the account holder directs a distribution to a qualified charity. Donor-advised funds held $53.74 billion in 2013, according to **wealthmanagement.com**. There are more than 217,000 such funds, compared to 84,350 private foundations.

Donor-advised funds have drawn Congressional scrutiny, and the tax rules associated with such funds could be changed. In 2012 the Congressional Research Service found that 53% of such accounts made no charitable transfers one year, and 70% paid out less than 5% (the distribution percentage required of private foundations). Still, the average payout rate was 13.1%, and some estimates put the total of annual distributions from donor-advised accounts as high as 20%.

If Congress undertakes major tax reform, a cap could be put on contributions to donor-advised funds, with full distributions required over five years.

Do you have any questions about our estate settlement, trust or investment services? I'd be glad to tell you how we can work together with your clients to serve their long- or short-term planning needs.

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