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NOVEMBER 2015

More lump sum offers expected

Every ten years the IRS is supposed to update mortality assumptions behind pension calculations. The current table was adopted in 2001. Earlier this year the Society of Pension Actuaries released a new table, based upon its studies of recent plan experiences. People are living longer, to no one's surprise. Life expectancy for men age 65 grew from 84.6 to 86.6 years; for women age 65, it is 88.8, up from 86.4.

The IRS announced in July that the new numbers will not be used for purposes of calculating lump sum distributions until 2017. That gives plan sponsors an incentive to offer more pension buyouts to participants before then. A longer life expectancy translates into a larger lump sum.

Participants, on the other hand, may want to think long and hard before accepting such an offer.

—Notice 2015-53

COMMENT: Moody's Investors Services calculated that the one-year delay will save plan sponsors some $18 billion next year. The total pension obligations of $2.1 trillion will increase by $126 billion when the new mortality tables are adopted.

Choice of trust

Son is the beneficiary of an irrevocable trust, Trust 1. Son receives all the net trust income each year, except that when he is married, his wife receives half, and he receives the other half. If son dies leaving a surviving spouse, she then receives all the net income for life. Son has adult children from an earlier marriage, and they are contingent future beneficiaries of Trust 1. Trust 1 principal eventually will pass to Foundation.

Son began cohabiting with Taxpayer. Unbeknown to Taxpayer, Son created Trust 2 for her benefit. She is entitled to a fixed dollar amount, paid monthly and subject to adjustments based upon an index, so long as they remain cohabiting. After Son dies, the principal of Trust 2 will be distributed to Taxpayer over a period geared to her age.

There's just one catch in Trust 2. In the event that Taxpayer and Son should marry, her interest in Trust 2 will terminate, unless she disclaims the interest that she receives in Trust 1 because of the marriage.

The couple has married, and Taxpayer proposed to disclaim her interest in Trust 1. The dollar values of the trusts are not given, but evidently the prospect of eventually having 100% of Trust 2 is better than the lifetime

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income of Trust 1. She turned to the IRS to confirm the tax consequences.

Because taxpayer will make her disclaimer within nine months of the marriage, when her interest vests, the Service holds that the disclaimer will be timely, made within a reasonable time of the "knowledge of the existence of the transfer." The fact that she knew of the trust interest for some time before the marriage does not affect this result. When she makes the disclaimer, the disclaimed interests will pass to other Trust 1 beneficiaries pursuant to the trust terms, not by her direction. Accordingly, she will not make a taxable gift with the disclaimer.

Because Taxpayer was kept in the dark about Trust 2 and had no control over the conditions included in that trust, the IRS holds that her Trust 2 interest will not be consideration provided to induce her to make the disclaimer. Therefore, there will be no adverse tax consequences to the disclaimer.

—Private Letter Ruling 201540006

COMMENT: The ruling does not discuss the Son's tax liabilities for creating Trust 2. Presumably, he filed a gift tax return, because the marital deduction would not have been available to protect the trust from taxation. Taxpayer was not then his spouse, and the termination provisions in Trust 2 also would have barred the marital deduction.

The net net gift

Jean Steinberg was the beneficiary of a marital trust, established by her late husband, worth $122,850,623. Her will divided her residuary estate equally among her four daughters. In 2007, when Jean was 89 years old, the daughters asked her to terminate the trust in order to accelerate their inheritances. She agreed to do so, subject to three stipulations. First, she reserved $10 million for herself. Second, the daughters would have to pay the gift taxes. That creates a "net gift," which reduces the value of the gift and, in turn, the amount of the gift tax.

The third stipulation was that the daughters would assume any federal or state estate tax liability associated with this gift. Under IRC §2035(b), a decedent's gross estate is increased by the amount of any gift tax paid within three years of death. Despite the fact that the estate and gift taxes have a single unified credit and are imposed at the same tax rates, gift taxes are cheaper than estate taxes, because they are determined on a tax-exclusive basis. Estate taxes are tax inclusive. The "gross-up" rule of IRC §2035(c) defeats this advantage for gifts made within three years of death, making those gift taxes effectively tax inclusive.

Thus, Jean was insisting upon a double net gift, a burden that the daughters accepted. The additional discount to the gift value came to over $5 million. The IRS accepted the basic net gift, but rejected the additional discount for assuming the burden of potential estate taxes. The Service argued that under the relevant state's estate tax apportionment law, the daughters' obligation had not changed by making that agreement, so an additional $1.8 million in taxes was due.

The Tax Court soundly rejected the IRS' position. The value of the gift is what a willing buyer would pay for it. The contingent estate tax liability would, of course, depress that value. Jean provided an expert witness to value the possibility, using IRS mortality tables and interest rates. The IRS did not offer an effective rebuttal, so the taxpayer's valuation of the gifts was sustained.

—Jean Steinberg v. Comm'r, 145 T.C. No. 7

Latest Marshall milestone

The estate of J. Howard Marshall, who died in 1995 at age 90 after a brief marriage to Anna Nicole Smith, may set a record of some sort for litigation. Dickens' fictional *Jarndyce versus Jarndyce* comes to mind. The latest case concerns a gift tax on indirect gifts made by Marshall in 1995. After several years of negotiation, the estate stipulated as to the value of the indirect gifts at some $84 million, but did not pay the $47 million gift tax.

The IRS sought to collect the gift tax from the various donees who benefitted from the indirect gift. The District Court held that there was no limit to such liability. On appeal, the Fifth Circuit holds that donee liability for gift taxes and interest on unpaid gift tax is capped at the value of the gift received.

—United States v. Elaine T. Marshall et al.; CA-5, No. 12-20804

No allocation of GSTT exemption

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.

—Private Letter Ruling 201536012

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

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 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.

—REG-112997-10; 80 F.R. 54447-54468

> COMMENT: At a September Practicing Law Institute event in New York, Catherine Hughes from the Treasury Office of Tax Legislative Counsel reported that work is also under way on a Revenue Procedure in this area. Under the proposed regulations, if the expatriate has died, the taxpayer may submit a request to the IRS for information about gifts, including what was on the Form 8854, "Initial and Annual Expatriation Statement," and whether the gift was on a timely filed return. The coming Revenue Procedure will provide details on making that request.

Postscript on the mega-*Crummey* trust case

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 the 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.

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