estate planning briefs®

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Some extenders made permanent

Fights over the "tax extenders"—those temporary tax provisions that have explicit expiration dates to lower their revenue "cost"—haven't been eliminated, but they will be much different in the future. That's because Congress made many of the extenders permanent last December.

The piece most likely of greatest interest to wealth managers is the provision for tax-free withdrawals from IRAs. Taxpayers who are 70½ and older are permitted to transfer up to $100,000 per year directly from their IRAs to qualified charities. Such transfers won't be included in income, so the taxpayer's AGI won't be increased, which can cause other negative tax consequences. The transfers do count toward meeting required minimum distributions that apply to taxpayers at this age.

—Protecting Americans from Tax Hikes Act of 2015

COMMENT: The Republicans managed to get their political licks in with several provisions in the "Tax Administration" section of the bill. For example:

• Section 402 of the legislation bars IRS employees from using their personal e-mail accounts for any official business;

• Section 404 requires the IRS to publish procedures for appealing an adverse determination of tax-exempt status under IRC §501(c); and

• Section 407 requires the IRS to terminate any employee who undertakes official action, or fails to act, with respect to a taxpayer for political purposes.

Taxpayer takes the Fifth on Schedule B

Filing an income tax return is not the act of being a witness against oneself within the meaning of the Fifth Amendment. Those who file blank tax returns and attempt to invoke the Fifth Amendment as a defense have been routinely penalized for filing frivolous returns.

However, recently a taxpayer filed a numerically accurate return but redacted some information on the Schedule B. He omitted the names of certain financial institutions, but he accurately reported (and paid the tax) on the income received from those institutions. The taxpayer was concerned about running afoul of the requirements for reporting foreign bank accounts, which can involve severe criminal penalties for mistakes.

The IRS took the position that there is no Fifth Amendment privilege for any tax return questions, offered no rationale for

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1106-E Coast Village Rd.
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(805) 564-0298

requiring the omitted information, and imposed the penalty for frivolous returns. The Tax Court refused to enforce the penalty, because the tax return was substantially accurate and because the taxpayer had a legitimate, narrow fear of self-incrimination.

—*Youssefzadeh v. Commissioner, No. 14868-14*

The wrong way to amend a will

Esther Sullivan executed her will in January 2006. The will was properly notarized and had the required two witnesses. Esther divided her estate between her grandson, Joseph, and a former employee, Tara Jean. The nature of the employment was not disclosed by the court, but Tara Jean was named as personal representative of the estate. She would be responsible for collecting the estate's assets, filing the tax and probate forms, and distributing the assets.

By 2008 Esther had a change of heart. On a photocopy of the original will, she wrote across the top "[t]he Will dated January 19, 2006 is void and to be replace[d] with this and all written in changes." A variety of alterations were penciled in, the most consequential of which was naming Joseph the personal representative instead of Tara Jean.

Not yet completely satisfied with her handiwork, in October 2010 Esther downloaded a will form and completed it by hand. This time, in addition to naming Joseph as personal representative, she made him the sole heir of all of her property, "after her debts are payed (sic)." Interestingly, Tara Jean witnessed Esther's signature on the 2010 will.

After Esther died, Tara Jean offered the 2006 will for probate. Joseph objected, and he submitted the 2008 and 2010 alternatives as being more consistent with Esther's final intentions for her property.

Both the lower court and then the appellate court held that the statutes governing wills must be strictly adhered to. The same formalities that apply to creating a will apply equally to its revocation. Neither the 2008 nor the 2010 will was executed with witnesses to Ester's signature, so they failed the test. Alternatively, the appellate court held, a will may be revoked by a "revocatory act on the will," including "burning, tearing, canceling, obliterating, or destroying the will or any part of it" Such an act must be done to the original will, not to a photocopy of it.

Without the required witnesses, the 2008 and 2010 documents amounted to nothing more than notes for making a future will.

During the appeal, Joseph argued that Tara Jean had breached her fiduciary duty to the estate by offering the 2006 will for probate when she herself was a witness to the 2010 attempted revocation. Unfortunately, the Court held, he brought that argument up too late to be considered.

—*In re Estate of Sullivan, 868 N.W.2d 750 (Minn. Ct. App. 2015)*

Unnecessary QTIP election is void

Decedent's will created a family trust (income to Surviving Spouse, with a limited testamentary power of appointment) of sufficient size to reduce his estate taxes to zero. The trust was so funded, and the balance of the estate passed to Surviving Spouse outright. Spouse, as the executor of the estate, prepared the federal estate tax return. She listed the trust assets on Schedule M, thereby making a QTIP election for them.

That election was not needed to bring estate taxes down to zero. In accordance with Rev. Proc. 2001-38, the IRS will treat the election as void for purposes of estate, gift and generation-skipping transfer taxes. Accordingly, the trust won't be included in Spouse's estate when she dies (and there will be no future basis step-up), nor will she be treated as making a taxable gift if she disposes of her income interest.

—*Private Letter Ruling 201603004*

Post-death events and art valuation

Bernice Newberger died in July 2009. Her estate included three valuable pieces of art, for which it obtained appraisals from Sotheby's and Christie's. The valuation was complicated by the fact that the market for fine art took a steep dive in 2008, as the economy slipped into recession. For example, in October 2008 some 44% of pieces put up for auction failed to attract minimum bids, double the rate of a year earlier. They had to be returned to their owners. In 2009 Sotheby's revenue declined by 53% and Christie's by 46%. Bernice's death came at the trough of the slump.

Based upon the advice of appraisers, the estate valued two lesser pieces at $450,000 and $500,000. The real prize was a Picasso. Sotheby's offered a $3.5 million guaranteed price. Christie's offered the estate better guarantees and a professional estimate of date-of-death value of $5 million, which the estate duly included on its estate tax return, timely filed in October 2010.

The IRS challenged all three valuations. Perhaps to create some liquidity for paying taxes, the estate had accepted the terms from Christie's and put the Picasso up for auction in February 2010. The expected sale price was $4.7 million to $6.3 million, consistent with the appraisal. In the event, including the buyer's premium, the painting fetched over $12 million. The IRS cited that fact as it claimed that the Picasso had been undervalued by the estate.

Although events occurring after death are not to be taken into account to determine date-of-death values, the Tax Court held that the later sale may be used as *evidence* of value. The estate's argument that the high price was "a fluke" that was unforeseeable at the date of death was rejected. The Court accepted the IRS' downward adjustment to $10 million to reflect the changing market conditions. The estate's values for the two lesser pieces were sustained.

—Estate of Newberger v. Comm'r, T.C. Memo. 2015-246

COMMENT: Had Newberger lived another seven months, her estate would have avoided all estate taxes, as 2010 was the year when the federal estate tax was optional. In the absence of estate tax, carryover basis would apply. In that event the heirs would have been exposed to a very large capital gains tax upon the sale of the art, as Newberger had acquired the Picasso for just $195,000 in 1981.

Late portability election permitted

Decedent died after Congress provided for the portability of a deceased spouse's unused exemption amount (DSUE). Because Decedent's estate was below the filing threshold, no federal estate tax return was filed. Accordingly, the DSUE election was not made.

Perhaps the surviving spouse was doing some new estate planning, and the new advisor inquired about the election. The Ruling does not provide the back story; all we know is that an extension of time was requested to file the estate tax return for the sole reason of making the DSUE election. The IRS gave the estate another 120 days to make the filing, given the fact that no estate tax return was ever required for the small estate.

—Private Letter Ruling 201603007

COMMENT: There has been a spate of similar private rulings recently. For example, see *Private Letter Ruling 201549022 and Private Letter Ruling 201548004*.

Very late gift tax assessment upheld

A conflict broke out in the Redstone family in 1971. Patriarch Mickey Redstone and his two sons, Edward and Sumner, were co-owners of the family business, each owning 100 shares. However, when the business was incorporated, Mickey put up 48% of the capital, and the boys each contributed roughly 26%. In 1971 Edward decided to leave the business, and he demanded that his 100 shares be redeemed or he would sell them to outsiders. In the squabble that ensued, Mickey claimed that a portion of Edward's shares were subject to an oral trust in favor of Edward's children, the amount in excess of Edward's capital contribution. The same conditions applied to Sumner's share, in Mickey's eyes.

A lawsuit was filed, and a settlement was reached in 1972. Under the terms of the settlement, one-third of Edward's shares were transferred to a trust for his children, and his remaining shares were redeemed by the company. Three weeks later, Sumner transferred a third of his shares to an irrevocable trust for his children. He was not required to do so by the terms of the settlement, but it seems likely that Mickey insisted upon the equal treatment.

Upon advice of counsel, neither brother filed a gift tax return reporting the transfers to the trusts. Nearly 40 years later, the IRS became aware of the transfers as a result of publicity from other litigation. Gift taxes were assessed against Edward's estate and Sumner.

In Edward's case, the Tax Court held that because the transfers were the result of a bona fide settlement reached at arm's length, there was no taxable gift [*Estate of Edward S. Redstone v. Comm'r,* 145 T.C. No. 11 (2015)]. Although Sumner was a party to the settlement, it imposed no similar duty upon him. Accordingly, his transfer was not protected from gift tax.

Sumner's attorneys argued that imposing a gift tax 41 years late, was an "unprecedented abuse" of the rule that the statute of limitations remains open if no gift tax return has been filed. The Tax Court disagreed. However, the Court negated the penalties that the IRS had assessed for failure to file, given Sumner's reliance on counsel at the time. Still, the gift tax deficiency was $737,625, plus 40 years' worth of interest.

—Sumner Redstone v. Comm'r,
T.C. Memo. 2015-237

COMMENT: The IRS apparently became aware of the transfers to the trusts as a result of litigation in Massachusetts over the management and funding of the trusts [*O'Connor v. Redstone,* No. 2006-4606 (Mass. Sup. Ct. Nov. 25, 2009)]. That suit did not succeed, but it did produce this testimony from Sumner Redstone in a deposition: "Nobody sued me. I gave my kids a third of the stock voluntarily, not as the result of a lawsuit. In [s]o doing, I did what I wanted and appeased my father too." The Tax Court pointed to that statement as evidence of Sumner's donative intent in making the transfer.