Montecito Bank & Trust℠

estate planning briefs®

August 2018

In This Issue

- Executor's fees remain deductible
- Dueling legislation
- SALT workaround nixed
- Take off the cap?
- Timely disclaimer
- An informal will
- More time for electing alternate valuation
- TCJA impact

Wealth Management

Santa Barbara:
1106-E Coast Village Rd.
Montecito, CA 93018
(805) 564-0298

montecito.bank

Executor's fees remain deductible

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 a July 13 notice, 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.

—Notice 2018-61

COMMENT: 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.

Dueling legislation

Under the status quo, the personal income tax changes made by the Tax Cuts and Jobs Act last year will expire at the end of 2025. Two competing visions for a more permanent resolution have been introduced in Congress.

House Ways and Means Committee member Kenny Marchant (R-Texas) authored H.R. 6228, which would make the enlarged federal estate tax exemption permanent. Senator Martin Heinrich (D-N.M.) in contrast, proposes in S. 3018 to retroactively repeal the larger exemption from the alternative minimum tax and to repeal the doubled estate tax exemption, effective upon the date of enactment.

Neither of these bills is likely to see much action this year. 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.

SALT workaround nixed

In August the IRS provided regulatory guidance regarding qualified business income under new IRC §199A, adopted in the Tax Cuts and Jobs Act last year. The regulations include anti-abuse provisions that prohibit the use of multiple identical trusts for gaming the income tax system. That section of the proposed Regs. applies to using multiple trusts for any purpose, not just §199A. As such, it would likely apply to the suggestion from some quarters that multiple trusts might be used to work around the $10,000 limit on the deduction for state and local taxes (SALT). Such trusts would be treated as a single trust, in accordance with IRC §643.

Reportedly, the IRS also developed new Regulations addressing the “charitable workaround” that some states have implemented to avoid the $10,000 SALT cap. Those Regs. are being reviewed by the Office of Management and Budget as of this writing, and they have not been made public. The theory is that high-income taxpayers will be permitted to make a contribution to a government-operated foundation in lieu of a state income tax payment, and that contribution will be fully deductible as a charitable gift. The IRS’ dim view of the practice was announced earlier this year, in which it warned that a substance-over-form approach will be used. Any “gift” that relieves a taxpayer of a legal obligation is not likely survive IRS scrutiny.

—REG-107892-18; Notice 2018-54

Take off the cap?

In a letter to President Trump, Jason Isaac, a Republican member of the Texas House of Representatives, applauded the recent doubling of the amount exempt from the federal estate tax as a boon to family farm operations around the country. But that is not enough, according to Isaac. The ceiling on the benefit of the election of special use valuation under §2032A ought to be eliminated. Present law limits the reduction in value attributable to the election to $1,140,000 in 2018. This is not enough, and the pressure of death taxes continues to cause family farms to be “dismembered or dissolved.”

“The local property tax systems across the nation allow for tax to be imposed for productive value on agricultural based businesses, not on fair market value without limitation. Section 2032A attempts to do the same thing, but the effectiveness is destroyed by the limitation cap,” Isaac concluded.

COMMENT: If Rep. Isaac wants to expand the protections for small businesses generally, he might shift focus to repealing the federal estate tax entirely.

Timely disclaimer

Grantor created a trust before 1977 for Beneficiary and Beneficiary’s issue. Beneficiary had a limited testamentary power of appointment to direct trust assets to the descendants of Great-Grandfather and Great-Grandmother. Beneficiary died without issue, and exercised the power of appointment in favor of the descendants of Great Uncle (Great Grandfather’s son).

A grandchild of Great-Uncle has just learned about his potential inheritance, and proposes to disclaim it. The grandchild has received no trust benefits, was not aware of any of the specific trust terms, and never even had a copy of the trust during Beneficiary’s lifetime. He knew only that family trusts existed, but he had no more specific knowledge than that.

The IRS holds that the taxable transfer occurred when the trust was created, when the grandchild became a contingent beneficiary. Nevertheless, under Reg. §25.2511-1(c)(2) the grandchild has nine months “after the disclaimant obtains knowledge of the transfer creating the interest” in which to make a qualified disclaimer. The disclaimer must be irrevocable and in writing. If the requirements are met, the IRS holds that the gift tax will not apply.

However, the Service warns “We express or imply no opinion as to when Taxpayer first obtained the requisite knowledge of the transfer creating the interest.”

—Private Letter Ruling 201831003

An informal will

Before he committed suicide, Duane Horton wrote in his journal, "I am truly sorry about this . . . My final note, my farewell is on my phone. The app should be open. If not look on evernote." Among the thoughts in that final note was a paragraph that purported to leave Duane's property to his half-sister and other relatives. It explicitly stated that he wanted none of his property to pass to his mother. The note was not in Duane's handwriting, but his full name appeared at the end of it.

Duane was subject to a conservatorship during his life, and he was the beneficiary of a trust. The conservator offered the journal entry and the electronic note for probate. The disinherited mother objected, arguing that Duane had died intestate. In that case, she would be the sole heir under intestacy.

The journal and the electronic note do not meet the requirements for a valid will (no witnesses), nor do they meet the requirements for a holographic will. (The electronic note was not in the decedent's own handwriting.) Nevertheless, the probate court admitted them for probate, and the Michigan Court of Appeals now affirms. "The nature of decedent's relationship with his mother, when read in conjunction with his clear directive that none of his money go to his mother, supports the conclusion that decedent intended for the electronic note to govern the posthumous distribution of his property to ensure that his mother, who would otherwise be his heir, did not inherit from him."

—In re Estate of Duane Frances Horton II v. Jones, No. 339737

COMMENT: Does this case open the door to an affirmative duty for executors to search for electronic evidence that a decedent changed his or her mind about testamentary documents?

More time for electing alternate valuation

Executor hired Attorney to prepare a Form 706 for the estate. Attorney did so, but did not make an election of alternate valuation under IRC §2032. That provision allows an estate to value assets six months after the date of death, instead of on the date of death, provided that the election will reduce the value of the estate. No reason was mentioned in the ruling for the failure to make the §2032 election, but now Executor would like an extension of time to make it.

Because the initial Form 706 was filed within a year after the due date (including extensions), the IRS granted the request for still more time to file an amended return with the election made.

—Private Letter Ruling 201820010

TCJA impact

According to The Tax Foundation's analysis, the expansion of the standard deduction coupled with new limits on itemized deductions, will simplify tax filings for millions of American households. Some 28.5 million filers will be better off with the enlarged standard deduction. The IRS had determined that the average time for completing an individual tax return will go down by from 4% to 7%. The Tax Foundation translates that into an annual savings of $3.1 billion to $5.4 billion in compliance costs.

—Tax Foundation Fiscal Fact No. 604, July 2018

© 2018 M.A. Co. All rights reserved.