Montecito Bank & Trust℠

estate planning briefs®

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Conference!

The pace has picked up in Congress, as tax reform hurtles toward the goal of passage in time for the Christmas holidays. The Senate passed its version of the Tax Cuts and Jobs Act, and the House has voted to begin a conference to reconcile the two bills.

Both bills double the amount exempt from federal estate and gift taxes, while retaining the inflation adjustments. If enacted, that would boost the exemption to $11.2 million in 2018, $22.4 million for couples. The House bill would repeal the estate and generation-skipping transfer taxes in 2025. The Senate bill not only does not repeal the estate tax, but it also sunsets all the individual tax changes after 10 years in order to satisfy the Byrd rule.

Harmonizing the transfer tax elements of the bill will be the least of the worries of the conference. The controversy over the deduction for state and local taxes looms large. The bills have radically different approaches to taxing pass-through income of small businesses. The Senate bill retains the Alternative Minimum Tax, and so fails the “simplification” promise. Retaining the corporate AMT while reducing the regular corporate income tax rate to 20% may throw many companies under the AMT umbrella, where they may lose the benefit of the R&D tax credit. Finally, the reconciliation process could be complicated by the looming deadline for funding the government.

COMMENT 1: The House bill retains full basis step-up after the repeal of the estate tax. Allowing large unrealized gains to avoid both the capital gains tax and a transfer tax may strike some as inappropriate.

COMMENT 2: The Senate bill provides for 100% bonus depreciation for property placed in service after September 27, 2017, and before January 1, 2023. At that point the bonus depreciation is reduced by 20% per year. The lower corporate tax rate doesn’t go into effect until 2019. That gives corporations a huge incentive to accelerate their investments into 2018, when they can write them off against the higher tax rate, while deferring income until the lower 2019 tax rate kicks in.

New priorities

On October 20 the IRS announced new project priorities for 2017-2018. At the top of the list this year were steps to identify and reduce regulatory burdens. The already-announced withdrawal of the §2704 regulations on valuing the transfer of an interest in a family-owned business was number one.

In the estate and gift area, three projects were identified:

- Guidance on basis of grantor trust assets at death under §1014.
- Final regulations under §2032(a) regarding imposition of restrictions on estate assets during the six-month alternate valuation period. Proposed regulations were published on November 18, 2011.
- Guidance under §2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate.

The number of projects in the plan fell to 197, from 281 the year before. Other projects have not been abandoned, the IRS warns, but, realistically, they are not likely to be completed in the coming fiscal year.

Mortality revised

Mortality tables for retirement plans have been updated by the IRS for plan years beginning on or after January 1, 2018. Lifespans have edged higher since the last update in 2008. Accordingly, the value of plan liabilities will go up, as will the value of lump sum distributions made to cash out a pension promise.

—T.D. 9826

Privilege preserved

Marion Levine was the co-founder of a supermarket chain in Minnesota. When she died in 2009, at age 89, her estate was substantial. The IRS audited it and in 2013 issued a notice of deficiency. The payment of some $6.5 million in insurance premiums before Marion's death was characterized by the IRS as a taxable gift, one that had gone unreported. Taxes, interest, and penalties totaled some $4 million.

The estate plans to argue that the penalties are not appropriate because Marion justifiably relied upon the advice of counsel. To bolster that defense, the estate served a subpoena on the lawyer who had prepared the estate plan and filed the estate tax return, and on his firm.

The IRS would like to see that information as well, and it subpoenaed all the firm's records for Marion Levine from January 1, 2007, through July 1, 2017. The estate objected, arguing that these files represented work product done by the attorney in preparing for litigation, and as such is immune from discovery.

The IRS argued that the work product privilege is waived when the estate claims reliance upon professional advice. The Tax Court acknowledged that in some cases some attorney opinion letters have been held to be outside the attorney-client privilege, such as "more-likely-than-not" opinions. In such cases, only documents created before the return filing were vulnerable. There is no authority for waiving the privilege as to documents created after litigation commenced. Accordingly, the Court held that the privilege was not waived.

—Levine, Estate of Marion et al. v. Commissioner; No. 13370-13

COMMENT: The IRS cast too wide a net in its subpoena. Said the Court: "The cliche is that subpoenas aren't for fishing expeditions, . . . but that's not quite true. A well-placed baited hook or cast net may well be okay; this kind of large-scale drift-netting is not."

Amateur lawyer loses

In 2009 Elizabeth Briggs amended her revocable living trust to disinherit her son, Thomas, leaving the trust assets to her daughter, Judith. The amendment stated that Thomas knew the reasons for his disinheritance.

After Elizabeth died in 2013, an attorney for the estate and trust advised Thomas that he had received no property from his mother's estate. The notice also advised Thomas that he had 60 days to commence any judicial proceeding against the trust.

Acting as his own lawyer, and within the 60 days, Thomas e-mailed the county clerk and the attorney a "Notice of Objection to the Trust Instrument of Elizabeth A. Briggs." The nature of objection was not specified, and no relief was requested. No court file was opened.

Some 611 days after Thomas received the 60-day notice, he commenced a judicial proceeding to contest the amendments to the trust. He also alleged undue influence over Elizabeth by Judith, as well as that Judith had breached her fiduciary duties.

In 2010 the relevant state law (South Dakota) was amended to create the 60-day window for lodging an objection to the validity of a trust or a trust amendment. That specific statute of limitations supercedes the more general state statute of limitations governing undue influence claims, the lower court held, and the South Dakota Supreme Court now agrees. Thomas' filing of an objection to the trust did not toll the statute; he had 60 days to commence his action, he did not, and so the current suit is untimely.

—In re: The Elizabeth A. Briggs Revocable Living Trust, Supreme Court of South Dakota

COMMENT: As to the alleged breach of fiduciary duty, Judith was not named as a defendant to the lawsuit. The trust is not liable for any of Judith's actions as her mother's caretaker, even assuming that she exercised undue influence. Accordingly, that claim was dismissed as well.

Divorce and insurance

Ronald and Heidi Lee had been married for ten years when Heidi sought a divorce. In their divorce proceedings, Heidi asked for and received $2,000 monthly maintenance and a lump sum of $35,384. To secure the payments, Ronald agreed to leave Heidi as the beneficiary of his $150,000 life insurance policy.

He didn't do that. Ronald changed the beneficiary to his daughter, Abriel. When he died two years after the divorce was finalized, Ronald was current on his maintenance payments but still owed some $32,000 on the lump sum.

Both Heidi and Abriel claimed the insurance proceeds, and the inevitable lawsuit began. The insurance company deposited the proceeds with the court and was released from the case. Abriel offered to pay Heidi the $32,000 still owed to her, but Heidi believed that the terms of the divorce decree meant that she should get all of the $150,000 insurance proceeds, because she should have been the sole beneficiary on the policy.

Examining the terms of the decree carefully, the trial court concluded that Abriel had the better argument. The insurance policy was meant to guarantee the payments to Heidi, not to provide a bonus in the event of Ronald's premature death.

The Washington appellate court now agrees with this judgment.

—Sun Life Assurance Company of Canada v. Lee, 2017 WL 3485058