Estate Planning Briefs

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SECURE hits a snag

The Setting Every Community Up for Retirement Enhancement (SECURE) Act [H.R. 1994] passed the House on a bipartisan basis and appeared headed for quick approval in the Senate. However, just before the House voted, the House Ways and Means Chair Richard Neal (D-Mass.) removed a provision that would have permitted using 529 plan funds for certain home schooling expenses. That late change caused Senator Ted Cruz (R-Texas) to object to unanimous consent on the bill. What's more, some GOP Senators reportedly are not happy with a special provision that was made for pensions of community newspapers. They believed that the relief should be extended beyond that narrow industry.

The result may be that the SECURE Act will have to pass through the Senate Finance Committee, where its provisions could be harmonized with the Retirement Security and Savings Act (S. 1431), which also has bipartisan support.

COMMENT: The SECURE Act includes substantial restrictions on stretch IRAs as a means to pay for new tax breaks for retirement savings. The fact that it passed the House overwhelmingly, on a bipartisan basis, suggests that there are few if any defenders of the stretch IRA strategy left in Congress. This tool may soon no longer be available to estate planners.

Taxpayer First Act passed

The Taxpayer First Act (H.R. 3151) on changes to IRS policies and procedures was approved by the House by voice vote, and three days later sailed through the Senate, also on a voice vote. Finance Committee ranking minority member Ron Wyden (D-Ore.) said: "Our bill includes critical provisions to improve customer service, protect personal data, preserve tax preparation services, and shield low-income taxpayers from abusive private debt collectors."

An earlier version of the bill would have codified an agreement made between the IRS and the Free File Alliance in 2002 under which major software vendors such as Quicken and H & R Block would provide a free version of their tax filing programs to lower-income taxpayers, which they have done. However, a story in ProPublica suggested

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that the companies had hidden those programs to some extent by preventing indexing bots from seeing them. Thus, the free filing programs might not show up in response to a Google search. After the controversy erupted, the codification was removed from the legislation.

Paternity not waived by annulment

Keira Ripple was pregnant, and she was not certain who the father was. She then met Franklin Osborn; they developed a relationship; and they decided that Franklin would be the baby's father. Franklin was named as the child's father on the birth certificate. For good measure, the day after the birth Franklin and Keira executed a "Paternity Consent Form For Birth Registration" to create a permanent father-child relationship that could only be altered by court order.

Franklin and Keira married, but the romance did not last. Keira filed for an annulment, citing as a reason the fact that Franklin was unable to father children. He did not contest the annulment.

Keira then began living with a new boyfriend. The Department for Children and Families (DCF) was notified of suspected abuse of the child, but they took no action. Eventually, the boyfriend killed the child, a crime for which he is now incarcerated.

Franklin then filed a wrongful death lawsuit against Keira, the boyfriend, the DCF, and its Secretary. The defendants moved for dismissal, arguing that Franklin concededly was not the child's biological father, that the paternity consent was revoked by the annulment, and, therefore, Franklin had no standing for the lawsuit.

The District Court found for the defendants, but the Kansas Court of Appeals now reverses. The annulment set aside the marriage; it did not set aside the paternity of the child, no matter what reason was given. Franklin remained the child's legal father (and therefore heir) because a court never ruled to alter that status.

—Osborn v. Anderson, 431 P3d 875, Kansas Court of Appeals

Who gets the 529 plan?

In the course of the divorce of Michael and Melissa Berens, a novel question came up. Is a 529 plan for college savings for the couple's children marital property? Melissa believed that it is not. In the divorce court's order, Melissa was awarded 57% of the marital estate, including the couple's home and the 529 plan account. She appealed, arguing that the 529 plan is not part of the marital estate, so that her 57% should be computed without regard to that account balance.

The Court of Appeals of North Carolina rejected the argument. Although transfers to a 529 plan may be thought of as conditional gifts by the parents to the children, the children do not acquire control over the funds. The parents may withdraw the money and use it for any purpose, provided only that they pay a tax penalty for doing so. The law requires that such an asset be included in the marital estate subject to division in divorce.

—Berens v. Berens, 818 S.E. 2d 155, North Carolina Court of Appeals

COMMENT: Melissa also made a potent public policy argument that the Court found persuasive. Treating the 529 plan assets as part of the marital estate increases the chance that the funds will have to be diverted to a noneducational use. Unfortunately, the proper forum for making that point is before the legislature, not the Court.

Being yourself is a business

K. Slaughter began her writing career in 1999. Over the years she invested heavily in developing her personal "brand" by making public appearances and participating in the marketing of her books. Her income has grown markedly, although the time needed to write a manuscript has not changed.

Slaughter's accountant suggested that to some degree that increase in income was attributable to her brand, rather than to her writing. As such, the brand-related income would be taxed as investment income, and it would be exempt from the self-employment tax. The accountant devised a plan to apportion the payments Slaughter received from her publishers between her writing and her brand-building services. All of the royalties and advances for tax years 2010 and 2011 were reported on Schedule E, Supplemental Income and Loss. Because Slaughter spent roughly 12 weeks on writing a book, a proportionate amount was subtracted from the Schedule E and transferred to Schedule C, Profit or Loss from Business. The self-employment tax was paid on the Schedule C amount, not on the total of royalties and advances.

The IRS was not happy with this approach, and it assessed self-employment taxes of $155,931 for 2010, $110,670 for 2011, and penalties for the two years of over $53,000.

The Tax Court upholds the IRS on this one. Slaughter's brand is an essential part of her business, one that cannot be separated from her work writing. The argument that Slaughter "is not in the trade or business of being herself" was rejected. "Petitioner's brand and her writing combined are monetized, first, by the selling of books, and second, by providing petitioner with the leverage to negotiate for higher advances and royalty rates," the Court concluded.

However, the Court did remove the penalties for negligent underpayment, given Slaughter's reasonable reliance on professionals for her tax advice.

— K. Slaughter v. Commissioner; T.C. Memo. 2019-65

COMMENT: To owe more than $100,000 in self-employment taxes is extraordinary, given the cap on the wage base. The shortfall comes from the unlimited exposure to Medicare taxes. The opinion does not identify the amount of Slaughter's royalty income each year, but it must have been well over $1 million annually to generate so large a self-employment tax.

Withholding checkup

The average refund this year was $2,700 according to the IRS. In June the Service issued a reminder that a web page has been created to help taxpayers adjust their withholding to come closer to the correct amount [https://www.irs.gov/paycheck-checkup]. People who should go through the exercise of checking their withholding include:

- two-income families;
- someone with more than one job;
- someone who claims the child tax credit;
- those who itemized in earlier years;
- those who have high income or a complex tax return.

Anyone who owed a substantial amount or who had a large refund could benefit from the checkup.

—IR 2019-111