Estate Planning Briefs

May 2019

Retirement savings legislation

A bipartisan bill to expand tax benefits for qualified retirement plans has been introduced by Senators Rob Portman (R-Ohio) and Ben Cardin (D-Md.). The Retirement Security and Savings Act of 2019 [S. 1431] would, among other provisions:

- increase "catch-up" contribution limits for those 60 and older to $10,000 from the current $6,000;
- index the $1,000 IRA "catch-up" limit for inflation;
- increase the tax credit for small businesses that start a retirement plan;
- simplify "top heavy" rules for small business;
- expand the saver's credit income threshold;
- increase the age for required minimum distributions to 72 in 2023 and 75 in 2030;
- eliminate required minimum distributions entirely for taxpayers with less than $100,000 in aggregate tax-preferred retirement savings.

In a nod to the student loan crisis, the legislation would allow, but not require, employers to make matching 401(k) contributions to employees for repayments of their student loans. Presumably, this is an attempt to respond to students who complain that they can't afford to make 401(k) deferrals until their loans are fully paid off.

Finance Committee Chair Chuck Grassley (R-Iowa) stated on May 14 that passage of "common sense" elements of the retirement savings legislation will be a "top priority" for the Committee.

—S. 1431, The Retirement Security and Savings Act of 2019

COMMENT: The companion bill in the House is Setting Every Community Up for Retirement Enhancement (SECURE) Act [H.R. 1994]. The House bill is somewhat less generous to taxpayers, and includes a "pay for" of significant new restrictions on stretch IRAs. As a practical matter, stretch IRAs would only be allowed for surviving spouses, but there are narrow exceptions for minors and certain others

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No extenders this year?

Earlier this year Finance Committee Chair Chuck Grassley (R-Iowa) and Ron Wyden (D-Ore.) introduced legislation to extend 27 expired tax provisions, including credits for biodiesel. After a closed-door meeting with Ways and Means Chair Richard Neal (D-Mass.), Grassley reported that there does not appear to be a path to enacting such legislation this year. Democrats on the Ways and Means Committee are reportedly opposed to extending some of the tax breaks.

Bowling for dollars

Billy and Nancy Sue Hawk owned Holiday Bowl, a family bowling business. After Billy died, their two sons ran the business for a few years, but when that didn't work out, Nancy Sue decided to sell out. She faced the choice of an asset sale or selling the equity in the business. An asset sale generates potentially taxable gain at the corporate and individual level. A sale of the equity in the business generates less taxation for the seller but potentially more for the buyer down the road. Higher future taxes translate into a lower purchase price. Nancy Sue chose an asset sale, selling the bowling alleys to Bowl New England. After the sale the company had $4.2 million in cash, and it owed $1 million in federal income taxes and $200,000 in state income taxes.

In hindsight, the company should have paid those taxes. However, the broker for the transaction was approached by another company, Midcoast, that claimed it had large tax-loss carryforwards, and that it was looking to purchase a company with tax obligations so as to get some economic benefit from losses. Midcoast paid $3.4 million for Holiday Bowl, and assumed its tax liabilities. Nancy Sue stood to gain several hundred thousand dollars through the transaction.

The broker warned Nancy Sue that "if it seems too good to be true, it probably is. But maybe this is the exception." It was not. Midcoast never paid the taxes due and never used any carryforwards to offset them. What's more, the IRS investigated Midcoast and discovered some 60 similar transactions on its books. Indictments followed. One defendant pleaded guilty; the others left the country.

The IRS then came after Nancy Sue and Billy's estate as transferees for the unpaid $1 million. The Tax Court found them liable, and the Sixth Circuit Court of Appeals now affirms. "The problem is that the transaction lacked economic substance; it was nothing but misleading labels and distracting forms — trompe l'oeil from start to finish."

—Billy F. Hawk Jr., GST Non-Exempt Marital Trust et al. v. Commissioner; No. 18-1534

Basis step-up targeted

There is no shortage of ideas for increasing taxes on "the rich" coming from the Democrats who have announced presidential campaigns. One of the more surprising recent ones came from former Vice President Joe Biden, who suggested that eliminating the basis step-up at death could provide enough funding to allow for free community college.

Said Biden in Pittsburgh on April 29: "We could send everyone in America to a community college for free . . . by doing one thing. Eliminating one loophole of the $1.6 trillion [of total federal tax expenditures]—it robs the country of $17 billion a year. It's called stepped-up basis. . . . If you eliminate that one [provision], you can cut college cost and you could, in fact, have $11 billion left to reduce the debt."

COMMENT: Carryover basis has been tried before, and it was repealed for being impossible to administer. However, that doesn't mean it can't be tried again.

No deduction for taxes not paid

Albert Schermer died in January 1999 owning substantial IRAs and annuities. His son, Robert, inherited those assets. When Robert died in 2002, those assets passed to his wife, Jill.

In 2014 Jill received total distributions of some $269,000 from these sources, which she reported as income in respect of a decedent. She then took a deduction for $156,789 in estate taxes paid on the IRD by Albert's estate.

IRS disallowed the deduction, and it tacked on some $60,000 in taxes and penalties for Jill. The matter went to the Tax Court.

The Tax Court held that Jill failed to meet her burden of proof. There was no estate tax paid on her husband's estate, and she failed to show that the distributions she received had been included in her father-in-law's taxable estate.

—Jill Schermer v. Commissioner; No. 12182-17; T.C. Memo 2019-28

Special use valuation extension

The date of D's death is not given in this ruling, but he owned farmland when he died. His wife was named the executor of his estate, but her attorney did not tell her about the election under IRC §2032A to value the farm property for its agricultural use rather than its fair market value. When the wife timely filed Form 706, the election was not made.

Wife was later removed as executor by the probate court, and an Administrator Ad Litem was appointed. He hired an accounting firm to review the tax filings, and that firm also overlooked the §2032A election. A supplemental Form 706 was filed to make corrections to the first filing, and still the election was not made.

The ruling does not make clear what event caused the realization that this overlooked election could have saved the estate considerable tax dollars, but now an extension has been requested to make the election. The IRS concludes that everyone acted reasonably and in good faith relied upon tax professionals, so an additional 120 days is granted to file another Form 706 making the special use valuation election.

—Private Letter Ruling 201908018

S corporation stock is hard to value

Green Bay Packaging Inc. was founded in 1933 by George Kress. The firm manufactures corrugated packaging, folding cartons, coated labels, and related products. It remains privately held, though it employs about 3,400 people in 14 states. The Kress family owns 90% of the stock, and the remaining shares are owned by employees and directors of the company.

In order to keep the family business in the family, members of the Kress family have engaged in systematic intrafamily gifts of stock. In 2007, 2008, and 2009, James and Julie Kress made substantial taxable gifts to their children and grandchildren, and they paid federal gift taxes of over $1.2 million each.

The IRS audited those gift tax returns and concluded that the shares were undervalued. For example, where the couple had reported a value of $28.00 per share in 2007, the IRS believed that $45.97 was closer to the true value. The couple paid the deficiency and sued for refund.

At trial the IRS did not provide a rationale for the $45.97 figure. Their expert concluded that $38.04 was the appropriate per share price. The Wisconsin Federal District Court picked apart the analysis, and rejected it. The appraiser had failed to take into account the worsening economy in the years that the gifts were made, and at least one of his "comparables" was not truly comparable at all.

However, the taxpayer's expert was not accepted in full either. The expert had applied a marketability discount of 30% to reflect the lack of liquidity in the holdings and the restrictions in place to keep the family holdings in the family. The Court believed that the appraiser failed to demonstrate the impact of the specific family transfer restrictions on value, and it reduced the discount to 27% The bottom line was that the share value in each of the three years went up by about $1.

—James F. Kress et ux. v. United States; No. 1:16-cv-00795