Estate Planning Briefs

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SECURE Act still stuck

H.R. 1994, the Setting Every Community Up for Retirement Enhancement (SECURE) Act, remains stalled in the Senate. A few Republican Senators have blocked passage of the bill by unanimous consent, unhappy over last-minute changes made in the House version. The bill enjoys bipartisan support, and some Republican Senators asked in an October 15 letter to Senate Majority Leader Mitch McConnell, R-Ky., that the bill be taken up on its merits.

Finance Committee member James Lankford, R-Okla., said that the Senate will likely need to permit votes on about five amendments to the bill, including a provision allowing 529 plans to fund home schooling. Should any of the amendments pass, the bill would have to go to a Conference Committee to reconcile the two versions.

—H.R. 1994

COMMENT: The SECURE Act would substantially curtail the ability to use stretch IRAs in estate planning, and so its fate is quite important to estate planners. In general, inherited IRAs would have to be distributed to heirs within ten years, which would enlarge the tax bite in most cases. An exception is provided for a surviving spouse, and for minor children the ten-year period would not start until they are adults.

A mistake accidentally saves taxes

Husband and Wife made transfers in trust for their grandchildren. They reported the gifts on Form 709, and characterized them as indirect generation-skipping transfers. They also opted out of the automatic allocation of the GSTT exemption to the transfers.

Wife has died, Husband is the executor of her estate. Someone has realized that Wife's GSTT exemption should be applied to the trusts. Fortunately, the IRS holds that the transfers to trust were direct skips, not indirect skips, so the opting out of automatic allocation was ineffective. Accordingly, the exemption was allocated to Wife's transfers to trust.

—Private Letter Ruling 201921012

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Fairness is not the issue

Alexander's 1999 will left all his property to his wife, but she died first. In that event, the will provided that his estate would be divided equally among his four children.

One son, Dimiter, had a power of attorney over Alexander's property. He exercised that power to make advancements to himself and two sisters before Alexander's death "in recognition of their care for the Testator" during his lifetime. When he died, the only remaining asset was a brokerage account worth some $143,000.

The child who had received nothing, Peter, brought a lawsuit to remove Dimiter as executor of the estate and alleging mismanagement of estate assets. The lower court denied the removal, but awarded Peter the entire remaining estate, holding that the estate plan evidenced an intention to treat the four children equally.

That is not the test, the appellate court holds. Courts may not look beyond the four corners of a will unless the document is ambiguous. Alexander's will had no ambiguity, and it did not call for taking lifetime transfers into account. Accordingly, the remaining estate must be divided equally among the four siblings.

—In re estate of Tscherneff, 203 A3d 1020 (Pa. Super. Ct. 2019)

COMMENT: The appellate court also chastised the lower court for including a certain bank account in the calculation of the probate estate. Neither party to the case had raised that issue. In adding the bank account to the estate, the lower court "deprived the Executor of an opportunity to be heard and inappropriately acted as an advocate for Peter."

Dubious decanting of grandchildren's trusts

A wealthy Ohio grandmother celebrated the birth of her grandchildren by funding a generation-skipping trust for each new arrival. She served as trustee, with Merrill Lynch as custodian.

When grandmother resigned as trustee because of age, the children's father took over. Decades later, when the grandchildren learned they were old enough to draw upon their trust funds, they found their mother had been named co-trustee. And, according to the childrens' lawsuit in federal court, she had moved trust assets into a new trust that entitled her "to all net income and as much principal from the trust property as the trustee determines is necessary."

—https://financialadvisoriq.com/c/2553393/299473/merrill_lynch_caught_family_feud_over_grandma_trusts

COMMENT: For other wealthy grandparents the moral is obvious: Naming a reputable bank or trust company is worth the trustee fees.

How the rich respond to incentives

Do the rich change domiciles in order to save taxes? Intuitively, one would think that taxes are a factor in choosing a state of residence, though perhaps not the most important one. The question has been studied more rigorously by economists at the National Bureau of Economic Research (NBER).

A bit of background is in order. For decades the federal government allowed a credit for state death taxes in the determination of federal estate tax obligations. This was a dollar-for-dollar credit, subject to a cap at 16%. The practical effect of this structure was that every state imposed an estate tax at least equal to the amount of the allowable federal credit. Should any state not have an estate tax, their citizens would be no better off, as the IRS would keep the money that the state left on the table.

That structure was changed in 2001, when the credit was converted to a deduction for state death taxes. The nominal reason for the change was to offset the costs of tax benefits enacted in the same legislation. But the effect was that states that repealed their inheritance and/or estate taxes would provide a real tax benefit to their residents. Federalism allows the states to be diverse policy laboratories. A few states killed their death taxes, then many more followed, until today only 12 states impose taxes related to death time transfers.

The NBER researchers wanted to know how billionaires responded to this new incentive to relocate to an estate tax-free state. They used the Forbes 400 list to track that movement. The basic results were not surprising:

- The number of billionaires in state with estate taxes fell by 35% after 2001.
- Billionaires' sensitivity to estate taxes increases with age.
- When a billionaire dies in a state that has an estate tax, the average contribution to state tax revenue is $165 million.
- In looking at the distribution of billionaires in 2001 and in 2010, nine years later, 21.4% of those in states with estate taxes had moved to a state without death taxes, while only 1.2% had done the reverse.

However, the authors' conclusions were much more surprising. They compared the lost income taxes when a billionaire moves away to the lost estate taxes when a billionaire dies resident in the state, and concluded that in most cases the state will be better off keeping the estate tax! This analysis was done on a state-by-state basis. The only state that is better off without a death tax, they determined, is California. That is because income taxes are so high in that state.

— Moretti and Wilson, "TAXING BILLIONAIRES: ESTATE TAXES AND THE GEOGRAPHICAL LOCATION OF THE ULTRA-WEALTHY," Working Paper 26387

COMMENT: There is a huge caveat in this analysis, which the authors concede. When a billionaire moves out of a state, much more is lost than the stream of income tax revenue. The study "does not include potential indirect effects on states if billionaire relocation causes relocation of firms and investments as well as a reduction of donations to local charities." Those intangibles are much harder to measure.

Saving amendment to a life insurance trust

Settlor created an irrevocable trust for the benefits of Child and Child's descendants. Child was the trustee. The trust was permitted to own life insurance on Child's life, but also included saving provisions to prevent inclusion of the trust in Child's estate. After Settlor's death and before the trust acquired any life insurance, Child petitioned a court to amend the trust, creating a special trustee for life insurances and removing other trust provisions that might be problematic. The court complied. It is stipulated that Child has made no additions to the trust.

The IRS holds that, given the modifications, the trust will be the owner of the life insurance, and Child will have no incidents of ownership. Accordingly, the trust will not be included in Child's estate under IRC §2042 at his death.

—Private Letter Ruling 201919002