Estate Planning Briefs

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Use It or Lose It?

Speaking at the American Institute of CPAs' annual ENGAGE conference, as reported by Tax Notes, estate planning attorney Andrew Katzenstein warned that 2020 is starting to feel like 2012. That wasthe year that planners encouraged their clients to make large taxable gifts to "lock in" the larger unified credit against the federal transfer tax before its scheduled drop in 2013. (In the event, the drop didn't happen, and the credit was instead enlarged at the last minute.)

Katzenstein warned that in the event of a Biden victory, the federal exemption might go as low as $3.5 million, although as noted above the campaign has not taken that position. More ominously, he believes that the tax rate would be very likely to go up, so that today's 40% estate and gift tax rate "will seem like a bargain basement sale." The top rate was 60% not so long ago, and, noting the antipathy the Democrats generally are showing toward the wealthy, Katzenstein speculated that an 80% tax rate might be possible, given the government's great need for cash to address the pandemic.

Should Biden win in November, there may not be sufficient time to implement a major gift plan before the end of the year, Katzenstein warned. Some wealthy families are therefore making sales of assets to trusts, taking back a note at today's low interest rates. There is no gift tax on a bona fide sale. If it looks like a Democratic sweep in November, the families can then forgive the note, triggering the gift tax and locking in both the larger 2020 exemption and the 40% tax rate before the close of the calendar year.

COMMENT: On the other hand, if there is no sweep, it is possible that major transfers might be deferred to 2025, just before the scheduled drop in the unified credit to pre-TCJA levels. On the third hand, should the Republicans unexpectedly take control in Washington, President Trump has already stated his desire to make the larger federal exemption amount permanent.

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Fictitious Loan

Ron Van Den Heuvel's father founded VHC in 1985 to provide services to the paper manufacturing industry. Ron worked at VHC and founded two of its subsidiaries. Between 1997 and 2013, VHC advanced $111 million to Ron and his companies. The debt grew to $132 million, including interest, and only $39 million would ever be repaid.

As the prospects for the profitability of Ron's ventures began to fade, in 2004 VHC began writing off its payments to Ron as "bad debts," ultimately writing off $95 million by 2013. On audit, the IRS rejected all but $3 million of the deductions.

The Tax Court agreed with the IRS, saying that Ron and VHC lacked a bona fide debtor/creditor relationship, so there were no "debts" to be written off.

In 2004, VHC's banker had insisted that VHC itself join in guaranteeing Ron's debts to the bank. VHC did so. In the Tax Court, VHC argued that to protect its lines of credit its forgiveness of the loans to Ron was essential, an ordinary and necessary business expense. The Tax Court determined that VHC had neither met its burden to substantiate its claimed business expenses nor established that the claimed business expenses, if substantiated, qualified for the deduction.

The Seventh Circuit Court of Appeals now affirms the Tax Court's judgment in every respect.

—VHC Inc. v. Commissioner, CA-7, No. 18-3717

Biden's Tax Platform

In July, a comprehensive outline of priorities for a Biden presidency was released by the Biden-Sanders Unity Task Force. Key tax ideas in the release:

- eliminate the preferential tax rates for capital gains, so that labor and capital income is taxed at the same rate;
- reduce "tax expenditures," such as the exclusion of employers' contributions for employees' medical insurance premiums and medical care, benefits for tax-qualified retirement saving accounts, basis step-up at death, and deductions for charitable contributions, because studies show 60% of the tax expenditure benefits goes to the top 20% of income earners;
- increase the corporate tax rate from 21% to 28%; and
- return the federal estate and gift tax exemption equivalent to pre-TCJA levels, cutting it roughly in half.

More Taxes for the Rich

A new wealth tax has been proposed in the House by Rep. Ilhan Omar, D-Minn., and in the Senate by Sens. Bernie Sanders, I-Vt., Edward Markey, D-Mass., and Kirsten Gillibrand, D-N.Y., embodied in the Make Billionaires Pay Act (S. 4490). The legislators seem concerned that the recovery in the stock market means that the wealthiest are not sharing in the pain of the pandemic as most Americans are. Funds raised by the wealth tax would be used for health care. The idea is to apply a one-time 60% tax to the gains in wealth in 2020. But rather than use January 1, 2020, as the baseline, the legislation calls for a March 18, 2020, start date, when the stock market was at or near its low for the year. Increases in net worth from then to the end of this year would be hit by the 60% levy.

COMMENT: Observers do not expect the proposal to get much traction this year, but it could be a harbinger for tax priorities should the Democrats come to power in November.

The press release from the Senators cites a study that claims some $421 billion would be raised by this tax on 467 American billionaires. Jeff Bezos, for example, would owe $42.8 billion. Presumably this estimate simply is derived from the change in Amazon's stock price, but the tax is not limited to publicly traded securities. How exactly a billionaire is supposed to accurately determine his or her net worth last March 18 remains a bit of a mystery.

Email is Writing

The Marine Corps Manual requires all marines to support their families. In the event of marital separation, a marine is expected to abide by any written separation agreement. In the absence of a written agreement, the marine must pay his or her ex-spouse half of his housing allowance, or two-thirds of it if there is a child.

Adam and his wife separated in late 2014, and the wife took custody of their child. Two-thirds of Adam's housing allowance came to $1,980 per month, which he rounded up to $2,000. In December the ex asked Adam via email for $3,671.95 for financial support. Adam responded via email that he had already deposited $5,000, which covered his obligation for November, December, and half of January.

During 2015, Adam continued to pay family support of $2,000 per month. On his tax return Adam deducted that amount as an alimony payment. The IRS denied the deduction because there was no written separation agreement, as required by the tax law. An additional $5,853 in tax was due, said the Service.

The Tax Court now holds that the email exchange was sufficient to be regarded as a written separation agreement, because it clearly spelled out the obligation that Adam had undertaken. However, while alimony is deductible, child support is not. Only a portion of the $2,000 monthly payment could be characterized as alimony. That portion, the Court concluded, was the one-half of monthly housing allowance stipulated by the Marine Corps Manual.

— Adam Jordan Winslow v. Commissioner, T.C. Summ. Op. 2020-22

COMMENT: Note that alimony is not presently deductible after the Tax Cuts and Jobs Act of 2017. Whether it might become so in the future is an open question.