Montecito Bank & Trust℠

estate planning briefs®

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Tax reform off to a slow start

The Tax Council Policy Institute held a symposium in February titled "Tax Policy in Transition: Diverging Views in a Converging World." The panelists discussed the full spectrum of ideas for reforming business taxes, including the destination-based cash flow tax advocated by House Ways and Means Chair Kevin Brady (R-Tex.) and the corporate integration regime supported by Senate Finance Committee Chair Orrin Hatch (R-Utah). They also discussed the process of getting tax reform done in today's political environment.

Rep. Brady was the keynote speaker. Unfortunately, he made it clear that no legislation had been drafted as of that time, and none was expected before the summer.

Separately, JPMorgan CEO Jamie Dimon was quoted as doubting that tax reform could be completed this year, especially if Obamacare reform takes priority. On the other hand, Treasury Secretary Steve Mnuchin has promised tax reform by August.

That would track the timeline of ERTA in 1981—Congress seems to like getting tax legislation buttoned up by the August recess.

Although a few stand-alone bills have been filed to repeal the federal estate tax, such as H.R. 631, the "Death Tax Repeal Act of 2017," few observers expect any movement on that score without comprehensive tax reform.

No excuses

Virginia Escher died on December 30, 2008, at age 92, with an estate worth some $12.5 million. Her cousin, Janice Specht, was named executor of the estate. She had no experience at being an executor, never had owned stock, and, in fact, never had been in an attorney's office. Nevertheless, she accepted the job. Ms. Escher's lawyer was Mary Backsman, who had 50 years of experience in estate planning. Ms. Specht retained Ms. Backsman as the estate's attorney.

Backsman did not reveal that she was battling brain cancer at the time.

Specht knew that a substantial estate tax was going to be due, and she knew the due date. She also knew that shares of UPS stock

would have to be sold to raise the needed cash. Specht followed up with Backsman concerning progress on administering the estate, and she was assured that everything was fine. The assurances continued after Specht received notices from the probate court that estate accountings had not been timely filed. When the deadline for the estate tax went by, Backsman reported that she had filed for an extension, but she had not. Additional irregularities piled up, but Specht did not act.

Fourteen months after the estate tax should have been paid, Specht obtained a new attorney, who filed an estate tax return within 90 days. IRS assessed some $1.1 million in penalties and interest, which the estate paid. The estate in turn sued Backsman for malpractice, a suit that was settled about a year later.

Next the estate sought a refund of the penalties and interest, because the estate had relied upon the advice of counsel. No such relief is available, the District Court held, even if the attorney involved were incompetent. Specht had many warning signs of trouble. Her failure to act sooner amounted to willful neglect of the problem. The disability of the attorney did not render Specht disabled.

The Sixth Circuit Court of Appeals now affirms. “We acknowledge that Specht was the victim of staggeringly inadequate legal counsel and there is no evidence of purposeful delay,” the Court stated. However, that does not excuse her failure to fulfill her own obligations as executor of the estate.

—Janice C. Specht et al. v. U.S., CA-6, No. 15-3095

Retroactive tax relief for same-sex married couples

Before the U.S. Supreme Court decided in *Windsor* [133 S. Ct. 2675 (2013)] that the marital deduction must be available to same-sex married couples, some such persons may have made transfers to their partners that were subject to the federal gift tax and the federal generation-skipping transfer tax. In so doing, they would have reduced the amounts that would be excluded from estate tax at their deaths.

In this *Notice*, the IRS provides a special administrative procedure for recalculating the exclusion, in effect giving retroactive effect to the gift tax marital deduction for same-sex married couples.

—Notice 2017-15; 2017-6 I.R.B. 1

COMMENT: Because the relief is available without regard to the statute of limitations on the gift tax, for years to come it will be important to ask same-sex couples about their prior gifts when preparing their estate plans.

A coda for 2010

The year 2010 started out as the first year without a federal estate tax. But the offset to the elimination of that burden was the implementation of carryover basis for inherited assets. As it turned out, the estate tax was made optional for the 2010 calendar year, and it returned in full force in 2011. Most estates preferred the basis step-up. But the largest estates of 2010 decedents, such as that of George Steinbrenner, likely opted for the carryover basis rules. Although they are complex to administer, carryover basis has the distinct advantage of deferring tax payments indefinitely into the future, until an asset is sold.

In January the IRS issued the Final Regs. on carryover basis. A very small number of decedents’ estates from 2010 are likely to be affected.

—T.D. 9811; 82 F.R. 6235-6243

COMMENT: This is another example of a Regulation that could have continuing vitality even if the federal estate tax is repealed. Unless Congress decides to make death a realization moment for capital gains on appreciated property, we are likely to have carryover basis for larger estates.

Estate tax repeal?

Two bills have been introduced in Congress to repeal the federal estate tax.

In the House, H.R. 451, the “Permanently Repeal the Estate Tax Act of 2017,” simply repeals Chapter 11 of the tax code, effective retroactively to January 1, 2017. No change is made to basis step-up at death, and the gift tax and generation-skipping transfer tax are left untouched by the bill.

The Senate has a more fully developed piece of legislation, S. 205, the “Death Tax Repeal Act of 2017.” This law would take effect upon passage, so only those estates of decedents who died afterward would avoid estate taxes. The GST tax

also would be repealed, and the gift tax would be retained and modified. The top gift tax rate would by 35% on taxable transfers over $500,000, and the current inflation-adjusted lifetime exemption of $5 million would be retained.

The Family Business Estate Tax Coalition, which represents some 63 different lobbying groups, has endorsed the Senate bill.

Get it right the first time!

Mother executed a series of Grantor Retained Annuity Trusts (GRATs) in Year One. Unfortunately, Mother's attorney failed to include language prohibiting the trustee from issuing a note, other debt instrument, option or other similar financial arrangement in satisfaction of the annuity obligation as required by §25.2702-3(d)(6) of the Gift Tax Regulations. In Year Two, Son had a different attorney review Mother's estate planning documents, and the error was noted. A judicial reformation of the trusts so as to comply with the gift tax Regs. was done in Year Three, made retroactive to the creation of the trust.

In this private ruling, the IRS confirms that it will respect the reformation, and the trusts, therefore, satisfy all federal requirements.

—Private Letter Ruling 201652002

Portability relief limited to small estates

There has been a deluge of private rulings granting extensions of time to make the portability election for the federal estate tax. A recent advisory from the IRS made very clear the circumstances in which the IRS will look favorably on an application for relief:

"If the taxpayer had a GROSS ESTATE of more than $5 million— no relief is available to him at all, even if the estate is nontaxable due to the marital deduction. The taxpayer had an absolute obligation to file a Form 706 within 9 months of date of death and having failed to do so, the election for portability is missed.

"If the taxpayer had a GROSS ESTATE of less than $5 million, having missed the ability of timely filing a Form 706, the taxpayer's only recourse for obtaining the portability election is to seek relief through the private letter ruling process. The relief will likely be granted. Merely filing a late Form 706 would be ineffective in making this election and the election will not be respected."

— ECC 201650017

Estate tax filings grow

In February the IRS reported that there were 11,309 estate tax returns filed for those who died in 2013, compared to 9,447 returns filed for those who died in 2011, an increase of nearly 20%.

The largest asset class for these estates was publicly traded stocks and bonds, at $45 billion. Some $14.4 billion of assets were closely held stock, and $5.4 billion was in tax-sheltered retirement plans. Interestingly, $5.3 billion was in farm assets. The federal estate tax has long been argued to be a major impediment to the sustainability of family farm operations.

A majority of the estate tax returns in 2013 were nontaxable, continuing a trend. Some 6,610 returns owed no estate tax, either because of the marital deduction, the charitable deduction, or the fact that the estate was too small to be taxable and the return was filed solely to make a portability election.

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