

# Estate Planning Briefs

December 2021

## BBB in the Home Stretch

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The Senate is spending December on the Build Back Better Act (H. R. 5376), with a hard deadline of December 28 for action by both Houses. That's because the IRS has reported that the monthly child tax credit must be extended by then or the January 15 checks will not go out on time.

There's much work ahead for this to happen. The Senate parliamentarian has not yet ruled on which sections from the House bill need to be scrubbed to meet the requirements for a reconciliation bill. The price cap on insulin and changes to immigration law, for example, may be ruled to not have the requisite budget effects. Senate Finance released its section of the bill on December 11, all 1,180 pages of it. At this writing, the tax provisions have yet to be scored by the Congressional Budget Office.

However, the debate continues over what to do about the deduction for state and local taxes. The House bill lifted the deduction cap from \$10,000 to \$80,000. That benefit flows overwhelmingly to the top 5% of taxpayers, primarily to those living in the states of New York, New Jersey, and California. Some of the progressive Senators believe the deduction should be curtailed for those with more than \$400,000 of income. "It would be bad policy and very bad politics if the bulk of the benefits went to the top 5 percent and some of it went to the top 1 percent," said Senator Bernie Sanders of Vermont.

Early drafts of the House bill included taxes on tobacco products projected to raise \$97 billion over ten years. Critics pointed out that most smokers earn far less than \$400,000 per year, and candidate Biden promised there would be no tax increases for those whose income was below that threshold. The tax increase on cigarettes was dropped in the House bill, but a tax on vaping products was retained, raising a projected \$8.6 billion over ten years. Finance Committee member Catherine Cortez Masto of Nevada insisted that the vaping tax hike be



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dropped as well, because making vaping more expensive would encourage the use of cigarettes, the opposite of good health policy.

The major revenue raiser in the bill is a new 15% corporate alternative minimum tax on book profits, scored at \$319 billion over ten years. Senator Rob Portman of Ohio pointed out that the House version of the bill had the potential for unintended adverse effects at firms that maintain pension plans. As such plans are liabilities of the company, the value of the pension assets are included in determining book income. A stock market surge in plan asset values could be hit by the 15% tax, which in some cases could swamp the firm's profits. Accordingly, the Senate version provides that the income subject to the new 15% minimum tax be "adjusted to disregard any amount of income, cost, or expense" from a covered defined benefit plan.

Although the private sector has developed tax preparation software at no cost to the government, and such software is offered free to lower-income taxpayers, some legislators are not satisfied. Both the House and Senate bills include \$15 million in funding for a task force to design tax preparation software to be provided by the IRS, primarily to replace the currently available free filing options.

The Senate is not rubber-stamping the House version of BBB. Normally, after the Senate completes its work a Conference Committee is convened to hash out the differences between the two bills. If Congress is going to make that December 28 deadline, it seems that the House will have to rubber stamp whatever the Senate is able to pass.

*COMMENT: Transfer tax changes are no longer under consideration, nor are changes to the grantor trust rules. It seems that the doubled federal transfer tax exemption may continue until 2026, when it is scheduled to fall in half.*

## A Prince Settlement

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The March 2022 trial concerning the estate tax obligations of Prince's estate has been cancelled, as the estate and the IRS have reached a settlement. Initially the executor of the estate had reported its value to be \$82 million, and the IRS countered with taxable value of \$163 million. Terms of the settlement were not announced.

## Close, But Not Close Enough

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On January 1, 2004, Parents decided to make gifts of LLC units to each of their four children. The gifts were defined so as to use up Parents' \$1 million federal gift tax exemption and the \$11,000 annual gift tax exclusion available in that year. The LLC was valued by an independent appraiser, and an appropriate percentage of membership units was found to satisfy the dollar value of the intended transfer. Upon audit, the IRS increased the value of the membership units by roughly 30%, triggering a gift tax liability.

The change in value did not change the value of the gift, the Tax Court held. The reallocation of LLC interests is not the same as returning a portion of the gift to the donor, so this defined value clause was not a "tax savings" clause, bringing it outside the reach of Proctor. The Court specifically noted the absence of charitable organizations as parties to the transaction [*Wandry v. Commissioner*, T.C. Memo. 2012-88].

Now a similar case has been decided with the opposite outcome. Mr. and Mrs. Nelson were the general partners of an LLC whose subsidiaries were in oil field service and a Caterpillar dealer in Oklahoma and West Texas. On December 31, 2008, Mrs. Nelson made a gift in trust of her "right, title, and interest in a limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS (\$2,096,000.00) as of

December 31, 2008 \* \* \*, as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.” On January 1, 2009, she sold \$20 million worth of the limited partnership interest to the same trust, taking back a promissory note paying 2.06% interest.

The independent appraiser was hired, and it was determined that to reach the identified gift value, exactly 6.1466275% of the LLC was the amount transferred. Upon audit, the IRS concluded that the appraiser had undervalued the company, and that 6.1466275% came to much more than \$2 million. The Tax Court agreed, the increased value of the gift was taxable. The difference between Wandry and Nelson outcomes was ten magic words, missing from the Nelson defined value transfer: “as finally determined for federal estate and gift tax purposes.”

The Fifth Circuit Court of Appeals has now affirmed the Tax Court’s decision.

—*Nelson v. Comm’r, T.C. Memo 2020-81, aff’d No. 20-61068 (CA-5, Nov. 3, 2021)*

*COMMENT: It was not a complete loss for the taxpayers, as the courts did allow a 60% discount to the transfers.*

### Inflation Adjustments

The IRS has reported that for 2022, the amount exempt from federal estate and gift tax will be \$12,060,000. The annual gift tax exclusion grows to \$16,000.

—*Rev. Proc. 2021-45*