Estate Planning Briefs

March 2021

The Biden Administration's Coming Tax Hike

Now that the COVID-19 relief package has been enacted, the Biden administration is expected to turn to an infrastructure spending program coupled with major tax hikes. *Bloomberg* reports that key tax increases could include:

- a 33% increase in the corporate tax rate, going from 21% to 28%;
- higher income tax rates for those earning more than $400,000;
- for those earning more than $1 million, taxing capital gains as ordinary income;
- expanding the reach of the estate tax.

The estate tax could be expanding by cutting the federal exempt amount, or some interests that are currently not included in the federally taxable estate might become included. The administration has stated that it does not favor the wealth tax ideas being put forward by some in Congress.

— https://www.bloomberg.com/news/ articles/2021-03-15/ biden-eyes-first-major- tax-hike-since-1993-in-next-economic-plan

COMMENT: The last major federal tax increase was in 1993.

Retroactivity Worries Recede

With the Democrats taking control of the Senate following the Georgia run-off election, there was concern that major tax increases would be coming for "the rich," and the tax increases could be retroactive to the first of the year.

The key case on retroactive changes to estate tax law is *U.S. v. Carlton*, 512 U.S. 26 (1994). Congress too hastily added an estate tax break for a sale of shares by an estate to an ESOP. Because the statute did not require the shares to be owned by the decedent at death, one canny executor purchased some $10 million worth of MCI shares with estate assets and sold the shares to MCI's ESOP, generating a $5.3 million deduction for the estate.

That's not what Congress had in mind, and the reforming legislation was made retroactive, invalidating the deduction. The U.S. Supreme Court

Montecito Bank & Trust
Wealth Management

1106-E Coast Village Road
Montecito, CA 93108

sustained the retroactivity, saying that the legislation was "curative." Justice Blackmun announced: "Because we conclude that retroactive application of the 1987 amendment to § 2057 is rationally related to a legitimate legislative purpose, we conclude that the amendment as applied to Carlton's 1986 transactions is consistent with the Due Process Clause."

Thus, it appears that there is no constitutional impediment for a retroactive increase in estate and gift taxes.

However, the speakers at an American Law Institute Continuing Legal Education webcast in February downplayed the risk of retroactive changes. All tax changes are likely to be taking a back seat to responding to the pandemic, getting the economy restarted, and addressing issues like climate change, racial inequality, and immigration during the next several months. What's more, the estate and gift taxes just don't raise significant revenue, and so are a weak source for bolstering spending. The further along we get in the year, the less likely it is that any changes will be retroactive.

— Tax Notes, February 19, 2021

COMMENT: Repealing the basis step-up at death, as advocated by both Presidents Biden and Trump, would raise more revenue. However, such a move might prove controversial unless it is paired with a repeal of federal transfer taxes, as happened temporarily in 2010.

POD Pledge as a Security for a Loan

Jerry had an account with Wells Fargo that was payable on death (POD) to his son Tony. When Jerry and his wife, Victoria, later borrowed $80,000 from Wells Fargo, he pledged the account as collateral. Jerry and Victoria sold property in Texas to a family member on an installment basis. The installment payments roughly matched the debt service on the loan, and were used for that purpose.

Jerry died, and Victoria became his estate's personal representative. She had her lawyer send a letter to Wells Fargo directing them to invade the POD account to pay off the $77,000 balance of the loan. Tony then filed suit alleging that Victoria had breached her fiduciary duties, that other estate assets should have been used to pay off the loan before his account was so used.

The trial court ruled that Victoria had acted reasonably, that Jerry's estate was worth only some $69,000, of which only

$2,425.61 was in liquid assets. The Colorado Court of Appeals now reverses that portion of the trial court judgment, holding that the executor should have used those liquid assets first, before going to the POD account. Tony had further argued that the installment payments should have continued to be used for the debt service, so that no invasion of the POD was warranted at all. The appellate court rejected that argument, as the trial court did, because doing so would have unduly delayed the settlement of Jerry's estate.

— In re Estate of Treviño, 474 P.3d 223 (Colo. App. 2020)

Extension for Portability Election

In this letter ruling, when D died his lifetime taxable gifts coupled with his estate at death were small enough that no federal estate tax return was required to be filed. In that case there would be a Deceased Spouse's Unused Exemption amount (DSUE amount). To claim the DSUE for the surviving spouse, an estate tax return must be filed (even though not required and no taxes will be due) in order to make the election for portability of the DSUE. No such return was filed for D's estate "for various reasons."

Some time later—the dates are not provided in the ruling—the oversight was discovered, and D's estate requested an extension of time to file his estate tax return. Because the estate was below the taxable threshold, the IRS granted the extension.

— Private Letter Ruling 202107003

COMMENT: The Ruling notes that no opinion is being expressed about the amount of the DSUE passing to the surviving spouse. What's more, if at a later time it is found that D's estate and lifetime taxable gifts were so large as to require the filing of an estate tax return, the ruling will be null and void.

For 2021, SECURE 2.0

In 2019 many estate plans were upended by the Setting Every Community Up for Retirement Enhancement Act, generally known as the SECURE Act. The Act's liberalizations of some rules were "paid for" by severe restrictions on the use of "stretch IRAs" in estate planning.

In 2020 Ways and Means Committee Chair Richard Neal and ranking Republican Kevin Brady introduced Secure 2.0. Observers believe it has a chance of passage in 2021. The key item of interest to estate planners is that required minimum distributions could be delayed until age 75.

— Securing a Strong Retirement Act of 2020

IRS Reports on Another TCJA Effect

The IRS released a one-sheet summary of highlights of the federal estate tax filings. As expected, the number of estate tax returns fell following the doubling of the amount exempt by the TCJA in 2017. In 2019, the year in which most returns for 2018 decedents were filed, the number of returns was 6,409, and the total estate tax revenue was just over $13.2 billion.

California had the most taxable estates in 2019, half again as many as runner-up Florida. But when one looks at the number of estate tax returns per 100,000 of population, a different picture emerges. Wyoming is the leading producer of estate tax returns by that metric, followed by the District of Columbia. Florida is third, California fourth, and South Dakota comes in fifth. Perhaps that explains South Dakota Senator John Thune's strong interest in repealing the federal tax at death.