Estate Planning Briefs

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New Grantor Trust Rules Coming?

Treasury Secretary Janet Yellen spent three hours before the House Ways and Means Committee on June 8. The primary focus was on inflation—how serious is it; did the $1.9 trillion American Rescue Plan Act cause it; does she regret her support of that legislation? Although she admitted that the legislation may have contributed to inflation, Yellen said that as 2021 began the economic outlook was uncertain, and she feels the legislation was "hugely successful."

A colloquy between Yellen and Rep. Bill Pascrell Jr. (D-NJ) was noteworthy for estate planners. Pascrell has advocated regulatory changes to decrease the tax benefits of grantor trusts. The Build Back Better Act would have required estate tax inclusion of grantor trusts, but that legislation is stalled. On March 8, Pascrell wrote a letter to Yellen asking that the status of grantor trusts at death be clarified by new regulations with respect to grantor trusts and basis step-up at death. He wondered how that project was going.

PASCRELL: "Can you tell me specifically how and when the Treasury Department and the Internal Revenue Service will implement the guidance?"

YELLEN: "We are working very hard on that."

PASCRELL: "Yeah, I heard that before, but when?"

YELLEN: "Very soon, very soon."

COMMENT: In June 2021, internet publisher ProPublica released "The Secret IRS Files" based upon 15 years of tax returns of the top 0.001% of taxpayers. After reviewing data from an anonymous leaker, the report purported to show that wealthy Americans are undertaxed. There was an immediate uproar over the violation of taxpayers' confidential information, and a full investigation was promised. After nearly a year, we are no closer to understanding how the IRS data was compromised or stolen.

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COMMENT CONT: Asked about the progress of the investigation, Secretary Yellen said, "The leak of this type of information is a crime and we take it very seriously, and I will not interfere with those investigations." Investigations are underway at the FBI and TIGTA.

Divorce Alters Estate Plan

When Joseph and Sally were married in 1993, Sally had an eight-year-old daughter, Katelyn. Joseph treated his stepdaughter as his own child, but he never adopted her. When Joseph executed his will in 2005, he identified Katelyn as his stepchild. His assets were to pass to a family trust for Sally, remainder to Katelyn. However, there was also a default provision in favor of Joseph's mother and sister.

Joseph and Sally divorced on April 3, 2019. He died three months later, on July 2, 2019. The reasons for the divorce after 26 years of marriage were not explained. However, by operation of local law [Michigan], an inheritance for a spouse is revoked by divorce. Katelyn was named personal representative of the estate, and she filed the will and the trust with the probate court, asking for an order determining heirs. The probate court held that the divorce revoked both Sally and Katelyn's status as trust beneficiaries. Thus, the takers in default, Joseph's mother and sister, will inherit the entire trust.

Katelyn appealed the decision, but the Michigan intermediate appellate court affirmed. The statute is clear that, in the absence of specific contrary language in the will or trust, inheritances for an ex-spouse and any relatives of the ex-spouse are revoked by divorce.

- In re Joseph and Sally Grablick Trust, Nos. 353951 & 353955, 2021 WL 5976582

Healthy Collections

Individual income tax collections are on track to reach a record $2.6 trillion in the current fiscal year ending September 30, according to a Congressional Budget Office (CBO) projection reported in The Wall Street Journal. The income tax will represent a record 10.6% of the economy, up sharply from 9.1% in 2021 and well above long-term averages.

The boom is unexpected and unexplained so far, and may be a mixed blessing. Much of the surge is outside of paycheck withholding, suggesting that it represents realizations of capital gains. There is some thought that many wealthy taxpayers sold appreciated property in 2021 to avoid the tax increases threatened in the now-stalled Build Back Better legislation. As such, those revenues are advance payments that, in the normal course, would have been received in the future, and now may not be.

Another possibility is that the hot stock market in 2021 encouraged more trading, resulting in a greater share of short-term capital gains taxed at a top rate of 40.8%, as opposed to the long-term rate of 23.8%.

Corporate tax receipts are also beating expectations, though not by as much as the income tax. The CBO had projected corporate taxes to be about 1.3% of GDP after the Tax Cuts and Jobs Act (TCJA), but in 2021 they came in at 1.7%, and are projected to hit 1.8% in 2024. CBO calls this outcome "unexplained" as well. Kevin Hassett and Tyler Goodspeed, former Council of Economic Advisers chairs in the Trump administration, credited TCJA with the increase, but others have argued that the strong economy is chiefly responsible.

- https://www.cbo.gov/publication/58147

COMMENT: Although the burst of federal tax revenue may be welcome, it will not be enough to keep up with spending, the CBO reports. Over the last 50 years, total federal tax revenue has averaged 17.3% of GDP. CBO projects that figure will reach 18.1% over the next ten years, and possibly markedly more if the TCJA personal tax provisions are allowed to expire on time in 2026. But that will not be nearly enough, says CBO, to cover the projected 23.2% of GDP that the federal government plans to spend during the same period (up from the 50-year average of 20.8%). These projections do not take into account interest rate hikes that may be needed to combat inflation. Such rate increases could sharply increase the cost of servicing the national debt.

Student Loans and Tax Refunds

Between 1981 and 2002, Jeffrey Seto borrowed nearly $100,000 to fund his higher education. As of 2018, all the loans were in default, and interest and fees had ballooned his debt to more than $170,000. Mr. Seto began a repayment program, but soon fell behind.

In July 2019, Mr. Seto purchased a rooftop solar energy system for his home for $26,939. When he filed his 2019 income tax return, he claimed a credit for the solar installation of $7,994 and a total refund of $9,288. He was notified that the entire refund would be applied to his student loan debt.

Mr. Seto filed a lawsuit with the Federal Claims Court for recovery of his tax refund, acting as his own attorney. Unfortunately for him, that Court does not have jurisdiction to recalculate his loan obligations. What's more, the Department of Education had warned him that failure to keep up with his loan payments could result in wage garnishment or offsetting the student loan against tax refunds.

- *Silver v. Horneck, No. 1-20-1044, 2021 WL 4931871*

Better Late Than Never

Decedent's revocable trust provided for a "GST marital trust" and a "Non-GST marital trust." An attorney was hired to file the Form 706 for Decedent. The attorney mistakenly listed the assets for those trusts in the "all other property" section of Schedule M instead of the "QTIP" property section. The unfortunate result is that the QTIP election did not apply to either GST trust.

When the mistake was discovered, the executor asked for an extension of time to correct it. In private advice, the IRS granted the extension.

- *Private Letter Ruling 202223010*

When It's Too Good To Be True, It Isn't True

Samuel Wegbreit founded Oak Ridge LLC, a financial services company. The firm prospered, and in 2003 Wegbreit met with a tax planning attorney to reduce his tax liabilities. The attorney persuaded Wegbreit to create a trust for his wife and children, to transfer the business to it, and to have the trust acquire life insurance from an off-shore company. From 2004 to 2008 the Wegbreits took out over $3 million in policy loans, none of which was reported as income. In 2005 Oak Ridge was sold for $11.3 million. The Wegbreits did not report that sale as income, and neither did the trust. IRS conducted an audit in 2008, and found some $15 million in unreported income.

The Wegbreits contested the deficiency in Tax Court. Unfortunately, their paperwork was a mess. There were three different trust agreements, and no one was certain which one controlled. One of the trusts was dated the year before Wegbreit met with his attorney. The records for the insurance policies were equally confused.

An appeal was filed with the Seventh Circuit Court of Appeals. Unfortunately, the appellate argument was as incoherent and confused as the trust paperwork. The Court stated: "The Wegbreits raise a bevy of legal topics wholly irrelevant to the Tax Court's decision, from statutory diversification rules for life insurance portfolios to the grantor trust doctrine. When they do address germane issues, their brief flagrantly violates Rule 28's requirement to support each argument 'with citations to the authorities and parts of the record on which [they rely].'" The only relevant arguments the Court could discern were matters that had been waived in the earlier proceedings.

- *Samuel Wegbreit et al. v. Commissioner; No. 20-1306; 21 F.4th 959*

COMMENT: The Court was so unhappy with the waste of its time that the appellate attorney was sanctioned with a $5,000 fine for bringing a frivolous appeal.