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Uncashed check is taxable

Employee was due a $900 distribution from his employer's qualified plan. The plan withheld income taxes and sent Employee a check for the balance. For unknown reasons, Employee never cashed that check, nor did he attempt to roll the distribution into an IRA.

Failure to cash the check during the tax year that the distribution occurs does not avoid any income taxes, the IRS holds. Nor does it relieve the employer of withholding or reporting responsibilities.

— Rev. Rul. 2019-19; 2019-36 IRB 1

COMMENT: A footnote provides that the result would be the same if Employee kept the check, sent it back, destroyed it, or cashed it in a subsequent year.

Reversal of fortune

Norman created two irrevocable trusts for his children, the Kevan Millstein trust in 1988 and the Al-Jo trust in 1987. Kevan was the trustee of both trusts. Perhaps to maximize the amount passing to the children free of federal estate and gift taxes, these were designed as grantor trusts, which meant that Norman remained responsible for paying the income taxes associated with them. Although the payment of income tax relieves the children of a liability, it is not an additional taxable gift to them.

All was well until 2010, when Norman's wealth was diminished to the point that he could no longer pay the income taxes. He asked Kevan for reimbursement of the tax payments, which was refused. Kevan did arrange for a modification of the Kevan Millstein trust to relieve Norman of future income taxes, but the beneficiaries of the Al-Jo trust were not similarly generous.

Norman filed suit, asking for equitable reimbursement of federal and state income taxes. He had paid over $5.2 million in taxes for the Kevan trust in 2013, and $1.2 million for the Al-Jo trust in 2013-2015.

The lawsuit was dismissed for failure to state a cause of action upon which relief could be granted. Ohio trust law is clear that such relief is

not permitted without the cooperation of the beneficiaries or the trustee. What's more, said the Court, "Even if we were to allow appellant to use equity to circumvent the clear intent of the legislature, it is well established that equity will not aid a volunteer." Norman brought this on himself.

—Millstein v. Millstein, 110 N.E.3d 674 (8th Dis. App. 2018)

COMMENT: Could the irrevocable trust have included an escape hatch to protect Norman from this result without jeopardizing other tax benefits?

Zeroing out with a CLAT

Taxpayer's estate plan includes a marital deduction trust should his spouse survive him. At the spouse's death, the trust becomes a charitable lead annuity trust (CLAT). The annuity will be 5% of the initial value of the trust. The term of the trust will be the number of years required to create a charitable deduction large enough to bring federal estate tax obligations down to zero.

Should the spouse die first, the CLAT will be created by Taxpayer's estate, with the same formula—a 5% annuity for the number of years needed to zero out the federal estate tax then due. (Separate trusts were created to use the value of the unified transfer tax credit.)

The IRS holds that the formula will provide numbers that are determinable as of the date of creation of the CLAT, and therefore the charitable deduction will be allowed.

—Private Letter Ruling 201933007

COMMENT: If this element of the estate plan is not earlier amended, there will be no estate tax due for either Taxpayer or spouse, regardless of the order of death.

Retroactive clarification, please

According to the "Blue Book" explanation of the Tax Cuts and Jobs Act of 2017, the doubling of the federal transfer tax exemption creates an opportunity for those who created an irrevocable generation-skipping trust before the passage of the legislation. They are permitted to make a late allocation of the GSTT exemption to those earlier created trusts. This is consistent with the treatment when the federal exemption equivalent was lifted from $2.0 million to $3.5 million.

However, if this were the Congressional intention, it was not expressed very well in the legislation itself. Accordingly, members of the American Bar Association's Section on Taxation asked the IRS for clarification in an August 13, 2019, letter. "Analyzing the allocation rules, the statutory provisions of section 2632 do not restrict the late allocation of GSTT exemption to the maximum amount of exemption available at the time that the transfer was made." The literal language of TCJA would appear to preclude that, with a reference to taxable gifts and estate transfers after December 31, 2017. Additional regulatory guidance is needed to resolve the question.

Special actuarial factors

Taxpayer had a lifetime income interest in three irrevocable trusts. After taxpayer was diagnosed with cancer, she decided to disclaim her income interests, as provided in the trusts. The disclaimer was a taxable gift to the trust remaindermen.

On the date of the disclaimer, according to her doctors Taxpayer had a 50% chance of dying within one year. In the event, she died five days after making the disclaimer.

Taxpayer's estate representatives asked the IRS for a special actuarial factor valuing the disclaimed income interest instead of the usual IRS table. Citing Reg. §25.7520-3(b)(3), the Service holds that a special factor is required when a donor is near death, as is the case here. A special factor of 0.00043 was provided for this case.

—Private Letter Ruling 2019280037

A disappearing fortune remains taxable

Francis Roper's estate consisted largely of $17.6 million worth of Colonial Bancgroup stock. She died in 2007. Unfortunately, the value of the stock sank like a stone, and it was worth only $8.5 million on the alternate valuation date, six months later. That was the value used on the estate tax return filed in 2008. But in 2009 the federal government undertook a fraud investigation that, upon its resolution in 2010, rendered the bank stock completely worthless. The estate asked for a refund in 2013 of the estate taxes that had been paid on the now valueless stock.

No refund is allowed, the District Court ruled. In the first place, the refund request is so late that the Court no longer has jurisdiction over it. The taxpayer-executrix claimed that the tardiness was due to her disability, and she had the medical documentation to back up the assertion. Unfortunately, while that excuse may be available to individuals, it is not permitted for estates. But even if the Court looked at the case on the merits, no refund would be allowed. The market for the bank stock had not yet collapsed on the alternate valuation date, even if the stock would have been worthless based upon nonpublic information. It is value on the date of death and alternate valuation dates that must control the determination of tax obligations.

— Elizabeth R. Carter v. United States; No. 5:18-cv-01380

Extension OK'd for portability election

Decedent's estate was small enough that no federal estate tax return was required. However, he did have unused federal estate tax exemption amounts, and these are portable to the surviving spouse upon making the election on an estate tax return. For "various reasons" no estate tax return was filed at the time. Now the surviving spouse would like to have that additional protection from federal transfer taxes so a request for an extension of time to file the return has been made.

The IRS is fine with that. Because the estate was so small, and no estate tax return was required by law, the Service has greater administrative flexibility in such a case. The contents of the affidavits and representations submitted to the IRS explaining the tardiness were not revealed in the ruling, but they were held sufficient to meet the requirements of Reg. §§301.9100-1 and 301-9100-3. Accordingly, the estate was given another 120 days to file the return.

—Private Letter Ruling 201929017

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