estate planning briefs®

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Proposed §2704 Regs. going forward

Speaking to estate planners at the *Heckerling Institute on Estate Planning*, Catherine Hughes from the Treasury Office of Tax Legislative Counsel reported that the IRS will be moving ahead on finalizing the controversial proposed Regs. concerning the valuation of closely held businesses issued last August. She reported that more than 10,000 comments were received, and no doubt the vast majority were in opposition. The December hearing on the proposal lasted more than six hours, which Ms. Hughes thought to be a record for recent times.

Contrary to the reactions of many commentators, the proposed Regs. were not intended to eliminate all minority discounts, Ms. Hughes asserted. The final Regs. will make that point very clear, as well as addressing other misunderstandings identified during the comments period.

—*Tax Notes Today, January 11, 2017*

COMMENT 1: Elimination of the federal estate tax may not render the §2704 Regs. moot. They could come into play if the federal gift tax is retained, or if there will be a capital gains tax imposed at death.

COMMENT 2: A complete transcript of the December 1, 2016, hearing on the proposed Regs. is available at *Tax Notes* [2016 TNT 233-40].

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.

First Bankers Trust Services

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

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

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.

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

Is Form 706 OK?

The IRS has requested comments on the adequacy of the estate tax return, Form 706. Key concerns are

- Whether all requested information is necessary;
- The accuracy of the IRS' estimate of the burden for collecting the information;
- Ways to enhance the clarity or quality of the information;
- Ways to minimize the burden of collecting the information; and
- Estimates of the cost of compliance.

Comments are due by February 21, 2017.

— 81 F.R. 94483

Don't do this with your IRA

James Thiessen and his wife worked for Kroger or its subsidiaries for 30 years. They lived in Colorado, and in 2002 Kroger informed Mr. Thiessen that his job would be moved to Ohio. As the Theissens did not wish to move, they retired and rolled their 401(k) money into "his and hers" IRAs, totaling some $432,076.41.

Because Mr. Thiessen was interested in metal fabrication, he began shopping for a company to buy. He planned to use the IRA money to fund the purchase and let the IRA own the new company. A corporation was formed, Elsara, and the couple's IRAs purchased all the Elsara stock. A suitable metal-fabricating firm was found. The price was $601,000. The couple contributed $60,000 from their savings; Elsara paid $341,000; and Elsara also provided a promissory note for $200,000, to be paid over five years at 7% interest.

Unfortunately, the Thiessens also personally guaranteed repayment of the note.

Apparently, the note was properly repaid according to its terms. However, in 2010, six years after the transaction, the IRS challenged the financial structure used for the acquisition of the business. According to the IRS, the personal guarantee of the note was a prohibited transaction. It amounted to an extension of credit to the IRAs by the beneficiaries of the accounts.

Federal law has some very strict rules concerning transactions between qualified retirement plans, which includes IRAs, and those who are the beneficiaries of such plans. The public policy being served is the preservation of the money in the plan for retirement.

Before adopting this structure for their business purchase, the Thiessens consulted with a CPA firm and an attorney. They didn't come up with this idea on their own. Nevertheless, the Tax Court ruled that they had, in fact, committed a prohibited transaction when they personally guaranteed the loan. That caused two unfortunate consequences. First, the IRAs stopped being tax qualified in 2003. That meant the entire amount in them was deemed distributed to the Thiessens in that year and subject to ordinary income tax, which came to nearly $190,000. Second, because neither was yet 59½ at the time of the distribution, they owed an additional 10% penalty tax! Plus interest since 2003.

—Thiessen v. Comm'r, 146 T.C. No. 7

Gifts to foreign charities

Decedent, a U.S. citizen, owned substantial property in a foreign country. Her will left that property to a charitable organization in that country, founded 40 years ago. To date, the organization has raised all of its funding from non-U.S. citizens. The will stipulates that the bequest is dependent upon an IRS determination that the charitable deduction will be available; that is, that the organization meets the requirements of IRC §2055(a). If it does not, her personal executor is authorized to find alternative uses for the property that do satisfy the tax code for a charitable deduction.

The organization in question has a mission to improve the quality of life of the handicapped and elderly. Article 7 of its bylaws grants the organization extensive means for achieving the organization's mission, including the authority to support, promote, finance, and sponsor the training, preparation, and formation of people through aids, contributions, subsidies, and scholarships. It is run by a Board of Directors. All board members and officers are subject to the organization's Code of Ethics and Code of Good Governance, which prohibits the organization and its directors and employees from using any part of the net earnings of the organization for the benefit of any private stockholder or individual, and from engaging in or using the organization's assets for lobbying, attempting to influence legislation, or in any other manner involving political activities. The organization has received national and international recognition for its commitment to improving the quality of life of the handicapped and elderly, particularly those who are underprivileged or affected by conflict.

Those facts satisfied the IRS that the organization was legitimate and charitable in nature. In addition, because more than 85% of the funding the organization was from non-U.S. sources, some of the tax codes requirements did not apply.

—Private Letter Ruling 201702004

See next page for a listing of our trust team!

Our trust team is looking forward to working with you!

First Bankers Trust Services, Inc. is committed to providing personalized and responsive services to you and your clients.

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