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- “Skinny” tax reform?
- Budget scores
- Stranger-originated life insurance
- Secret adult adoption
- Opposition remains strong to IRS valuation proposals
- Procedure changed for late portability elections

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“Skinny” tax reform?

Based upon past experience, the odds are against tax reform this year. Usually, tax reform legislation has had a lengthy and public process as it moves from broad goals to specific, practical tax code language. None of that has yet occurred this year. Also, a general rule of thumb has been that Congress wraps up tax legislation by the August recess, which obviously hasn’t happened.

However, past experience may not be the most useful guide to what is currently developing in Washington, D.C. In late July, President Trump and Republican Congressional leaders announced an agreement on “skinny tax reform.” What makes the new approach “skinny”? The idea of a “border adjustable” tax has been dropped.

The problem now will be that the revenue from that tax won’t be available to offset the “costs” of rate cuts and other desired tax code changes. What will take its place? The mortgage interest and charitable donation deductions are apparently off limits. Reportedly, presidential advisor Steve Bannon would like to boost the top personal income tax rate to 44%. No other Republicans have signed on to that rate increase idea, but perhaps some Democrats might.

Speaker Ryan stated that it is “more important for us than anything that we get tax reform done because we think it’s absolutely critical for strong economic growth.” If that is true, perhaps the Republicans should have tackled tax reform before health insurance reform.

COMMENT: As a wise man reportedly once said, prediction is hard, especially about the future. But certainly we are living in interesting times.

Budget scores

The White House reportedly was pleased by the CBO’s analysis of President Trump’s budget plan, released May 23. The budget assumed that tax reform would be revenue neutral, and the CBO did not take the possibility of tax reform into account. Accordingly, there was

no economic growth attributable to possible tax law changes to be dynamically scored.

Nevertheless, the CBO concluded that the Trump budget plan would decrease the deficit by $3.28 trillion compared to current law. What's more, there would be a feedback effect from so large a deficit reduction, resulting in additional savings of $190 billion.

President Trump told an interviewer on *The 700 Club* that, compared to health care reform, "taxes are gonna be so easy, really." Tax reform "is simpler than healthcare, believe it or not." The President expects that tax reform will provide a major boost to the economy once enacted.

Stranger-originated life insurance

In a viatical settlement, the owner of a life insurance policy sells that policy to a third party for cash, perhaps to meet medical expenses or other financial needs. The buyer must continue to pay the premiums until the policy matures at the original owner's death.

A recent situation in Tennessee was ruled not to be a viatical settlement, but stranger-originated life insurance (STOLI), which is void as a wager on a person's life. Houchins, an insurance broker, paid a couple a referral fee to find elderly people for whom he could write life insurance policies (20% of the first-year premium). A suitable couple was found in 2008. Houchins paid the initial $27,000 premium to put a $2 million policy into force. An investor group then bought the policy from the insured's wife for $107,000—$60,000 for the insured, $47,000 for Houchins.

Conestoga Trust Services was the sixth assignee of the policy's ownership rights, acquiring them in 2013. They attempted to collect the proceeds when the insured died in 2014. Sun Life then raised the defense that the policy was STOLI.

Houchins argued that the money he paid to originate the policy was a loan to the insured. Unfortunately, there were no documents to support that theory. The court concluded that no person with an insurable interest funded any of the premiums paid. The life insurance policy was void from its inception.

—Sun Life Assurance Company of Canada v. Conestoga Trust Services, LLC (PLR1), USDC TN No.:3:14-cv-00539

COMMENT: The fact that Conestoga was an innocent bona fide assignee does not alter this conclusion. It was enough, however, for the court to order Sun Life to return to Conestoga the premiums that it had paid.

Secret adult adoption

Greg's parents divorced when he was three years old. He lived primarily with his mother, but he saw his father regularly. When Greg was six, his father began living with Betty, and the couple married five years later. Beginning at age 15, Greg began living with his father and stepmother.

Betty's parents created family trusts, of which Betty was a contingent income beneficiary and her children and grandchildren were remainder beneficiaries. Betty's mother died in 1989, and her will was admitted to probate. In 1990 Betty adopted Greg when he was 22 years old. To avoid strife, Greg's biological mother was not told about the adoption.

Betty's father executed his final will in 1996, specifically excluding Greg from inheriting. It did allow for inheritance by grandchildren adopted before they reached age 18. Betty died in 2005, and her trust income did not go to Greg.

The family trusts terminated in 2012. At that point Greg asserted his inheritance right to a portion of the remainder of the family trusts. He explained: "Betty came to me around that time [when he was 22] and said that she would really like to adopt me for estate reasons, and you know, Betty really loved me. I mean, you know, we shared a great I guess mother-son relationship the whole time, you know, I was growing up."

The rest of the family opposed Greg's inheritance, arguing that the adoption was a subterfuge. The probate court upheld his claim, and the Iowa Supreme Court agrees. "We find the record fails to demonstrate Greg's adoption occurred solely for the purpose of taking under the trusts."

—In re Est. of Weidner v. Peifer, 68 N.E. 3d 1011 (2016)

Opposition remains strong to IRS valuation proposals

The Family Business Estate Tax Coalition is already on record in opposition to the IRS proposals for limiting discounts on the valuation of family business interests for estate and gift tax purposes. In June they renewed that plea in a letter to Treasury Secretary Mnuchin. They argued that the objectives of two of President Trump's executive orders would be furthered by scrapping the IRS Regs. Executive Order 13789 on Identifying and Reducing Tax Regulatory Burdens (April 21, 2017) and Executive Order 13790, Promoting Agriculture and Rural Prosperity in America (April 25, 2017), would seem to be on point.

"The proposed regulations will discourage families from continuing to operate and build their family businesses and passing them on to future generations, undermining economic growth and job creation." The negative response to the IRS proposals at the public hearing last December was unprecedented.

Procedure changed for late portability elections

After an avalanche of requests for letter rulings extending the time to make a portability election, the IRS has created a simplified process for some estates. It seems that a great many executors overlooked the importance of making the election that is required to preserve a Deceased Spousal Unused Exclusion amount (DSUE amount), which must be made on a timely filed Form 706. In many cases, evidently, the executor of an estate that was smaller than the filing threshold never realized the value that could be preserved by going ahead with filing the return. No excuses for the oversight have been required for the IRS to grant relief in the private rulings.

With the new procedure, in essence, the executor now simply files Form 706 late with this printed at the top of the Form: FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER §2010(c)(5)(A). Such a filing must be made by the later of January 2, 2018 (for past decedents) or two years after the date of decedent's death (for more recent and future decedents). This process is only available to the small estates, those not required otherwise to file a federal estate tax return. If it later turns out that an estate tax return was required, the grant of extension will be void *ab initio.*

The Procedure includes three examples of its application. In Example 1, Spouse 1 dies on January 1, 2014, with a $2 million estate, and Spouse 2 dies on January 30, 2014, with an $8 million estate. No estate tax return is filed for Spouse 1. The return for Spouse 2 claims only the applicable exclusion for that year, $5.34 million, and pays an estate tax.

Pursuant to this Rev. Proc., in December 2017 Spouse 1's executor files an estate tax return to claim the DSUE amount of $5.34 million, which the IRS accepts. That leaves the question of how the estate of Spouse 2 can get its taxes refunded. The period for filing that claim expires on October 30, 2017. The Rev. Proc. states that a Form 843 should be filed early (no later than October 30, 2017), in anticipation of the later filing of the estate tax return to make the portability election. It then will be considered a protective claim, and it will be held by the IRS and processed once the portability election has been filed.

In Example 2, we have the same facts, except that instead of dying, Spouse 2 makes a $6 million taxable gift in December 2014, paying some gift tax. The same process applies, and Spouse 2 must file for a protective claim within the time prescribed by IRC §6511(a) to get a refund of gift taxes after Spouse 1's executor makes the portability election.

Finally, assume that in Example 2 Spouse 2 simply claimed the DSUE amount on the gift tax return and did not pay any gift tax. The IRS will not accept that, even though the DSUE amount, once elected, is available retroactively to the date of Spouse 1's death. A gift tax will be assessed, and Spouse 2 will have to wait for the executor of Spouse 1's estate to act to obtain relief.

—Rev. Proc. 2017-34; 2017-24 IRB 1282

COMMENT: The Rev. Proc. took effect on June 9, 2017. Any estates that had letter rulings pending on this subject on that date will get a refund of their filing fees, and they must refile for relief using this simplified procedure.

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