First Bankers Trust Services

estate planning briefs®

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Prospects dim for technical corrections

The Retirement, Savings and Other Tax Relief Act (H.R. 88) was introduced in the House by Ways and Means Chair Kevin Brady (R-Texas) in late November. The bill includes technical corrections to the Tax Cuts and Jobs Act, extensions of many of the "tax extenders" that otherwise have expired in 2018, changes for tax-qualified retirement plans, and provisions affecting IRS reforms. The House Rules Committee voted 6-1 to send an amended version of the bill to the floor on November 28.The Congressional Budget Office estimated that the bill would add $54.7 billion to the deficit over ten years.

Technical corrections usually are not controversial, and the tax extensions likely were added to attract greater support from Democrats. The retirement savings provisions enjoyed bipartisan support earlier this year. Nevertheless, there was much uncertainty over whether this bill could be passed during the lame duck session.

—H.R. 88

No clawbacks

Next year the amount exempt from the federal estate and gift tax will be $11.4 million per taxpayer. The exemption is scheduled to fall roughly in half in 2026, unless Congress acts before then to make it permanent.

Reductions in the federal estate tax exemption have been scheduled before, but one never has happened in the history of our estate tax. If a reduction does take place, there is some concern about how that will work. The confusion arises because the federal estate tax is imposed based upon the sum of the lifetime gifts and the assets that the decedent still owns at death. Specifically, could a gift that was protected from the federal gift tax by the enlarged exemption amount be hit by an estate tax that would "claw back" the tax benefit?

To take an extreme and simplified example, Jonathan is worth $11.4 million. He makes a taxable gift of all of his assets in 2019, but owes no federal gift tax because the exemption amount covers it. Jonathan then survives until 2026, when he dies. Theoretically, his federally taxable estate that year is $11.4 million (his lifetime taxable gifts), while the exemption will have fallen to roughly $5.5 million. Theoretically, that suggests a federal estate tax of some $2 million could be due, even though the estate will have no assets.

The IRS recently has proposed new regulations to head off this possibility. Gifts that were free of transfer tax during the period of an enlarged exemption will stay tax free forever; they won't be hit by a later estate tax.

— https://federalregister.gov/d/2018-25538

COMMENT: The practical import of this development for those who have larger estates is that they should consider making substantial gifts before 2026 so as to "lock in" the benefit of the larger exemption. The gift also locks in the taxable value of the transfer. However, the last time that this advice was given, it proved to be unnecessary.

December rush on divorce negotiations

The Tax Cuts and Jobs Act included a fundamental change in the taxation of divorced couples. Today the alimony payment is deductible to the payor and taxable to the recipient. The deduction is typically worth more to the payor spouse than the taxes paid by payee, so the family overall has more money to work with. On January 1, 2019, that tax treatment ends for new divorce agreements. Alimony from future divorce decrees will be tax free, and not deductible by the payor spouse.

"Tax Watch" columnist David McKay Wilson reports that as a consequence of the change, there is a rush to get divorce agreements buttoned up before the end of this year. He provides a simplified example of the math involved. Assume that Husband earns $300,000 per year and is taxed at a 35% rate on income over $200,000. If he pays alimony of $100,000, he will get a deduction worth $35,000 in tax savings, so his net cost is only $65,000. Assume that Wife has no other income, so the income tax on her alimony comes to $17,000. On balance, the family unit is $18,000 ahead with this tax treatment.

For agreements reached next year and later, Wife's alimony is tax free, saving her $17,000, but Husband's loss of the deduction means that he'll be paying $35,000 in taxes on money he no longer has. The bottom line is that Husband will no longer be able to be as generous in making alimony agreements, according to Wilson's sources.

— https://www.lohud.com/story/money/personal-finance/taxes/david-mckay-wilson/2018/12/06/alimony-deduction-divorce-2019/2196394002/

Spousal bequest determined to be a life estate

James Feeney's will provided that "I devise and bequeath all of such rest and residue of my Estate to MARJORIE [the surviving spouse], should she survive me." The will went on to state an intention that the funds be used for Marjorie's health and support, and for the health, support, and education of James' minor son from a prior marriage. Four persons were identified as excluded from inheriting any portion of the estate.

The will then contained this further explanation: "Marjorie and I have agreed to keep our personal assets separate. We may use each other's estate assets for our personal support and well-being as is normal and expected for a husband and wife to care for one another after their spouse has deceased. But the accounts are to be kept separate so that, at the time of our respective deaths, any assets remaining from my estate will be used for the care and welfare of my children and their descendants, and any assets of her remaining estate will be used for the care and welfare of her children and grandchildren."

Marjorie was the executor of James' estate. After the will was probated, the sons of James from an earlier marriage asked the circuit court to interpret the bequest to Marjorie as a life estate, but the court refused. The language used in the will did not include the phrase "life estate."

The appellate court now reverses, holding that a reading of the will as a whole makes clear that the testator intended a life estate for his surviving spouse, not fee simple ownership. However, the sons' request that their legal costs be paid by the estate was denied.

—Feeney v. Feeney, 811 S.E. 2d 830 (Va. 2018)

In terrorem clause does its work

Spencer Willey grew up on a ranch in Wyoming with his father and grandparents. He expected to take over the family ranching operation eventually. In 2001 Spencer's father, Allen, created a revocable trust to manage his property, including the ranch. Allen was the trustee, Spencer the successor trustee, and Spencer's wife another successor trustee should Spencer be unavailable. Spencer's children were to become co-trustees when they reached age 21, and they were the ultimate beneficiaries of the trust. At that time Allen was living with Bertha, and the trust also provided her with a life estate in the home that they shared. Allen later married Bertha.

In 2006 Allen amended the trust. He granted a life estate in another home on the ranch to Bertha's daughter and granddaughter from her earlier marriage, and he removed Spencer's wife as a possible successor trustee. In a 2009 amendment, Bertha's daughter was named a successor trustee.

A major revision of the trust occurred in 2010, when Spencer and his wife were removed as beneficiaries and successor trustees, and the grandchildren would no longer become co-trustees. In fact, the trust then stipulated that none of Allen's descendants could ever serve as trustee. The beneficial interests of Bertha and her children were expanded, and they were expanded again in a 2011 amendment. The record does not indicate the reasons for these changes, whether Allen had a falling out with Spencer, or even if Spencer was kept informed of the amendments when they were made.

In 2012 Allen began suffering from memory and speech problems. He was diagnosed as having "frontal temporal dementia."

In October 2013 Allen put the ranch up for sale. In March 2014 more trust amendments were executed, further enlarging Bertha's interests. A confidentially clause was added forbidding the trustee from telling Spencer's children about the terms of the trust. Finally, an *in terrorem* clause was added to disinherit anyone and their descendants who challenged the trust terms.

Spencer filed a lawsuit in May 2014 to stop the sale of the ranch, to remove his father as trustee of the trust due to incapacity, and alleging that Bertha had exercised undue influence over Allen in persuading him to sell the ranch instead of leaving it in trust for his grandchildren. Allen resigned as trustee in October 2014, First Interstate Bank declined the position, and First Federal Savings Bank of Sheridan took the responsibility. In May 2015 Spencer amended the complaint to allege Bertha's undue influence in persuading Allen to remove Spencer and his wife as trust beneficiaries. Allen died a month later.

A trial was held on the issue of undue influence and whether there was an oral contract for the inheritance, and Spencer lost. An appeal concerning the jury instructions and the burden of proof was similarly unsuccessful [*Willey v. Willey*, 385 P.3d 290 (2016)].

When the grandchildren went to court to stop the sale of the ranch, the lower court held that they were no longer trust beneficiaries as a result of their father's lawsuit in defiance of the *in terrorem* clause. The Supreme Court of Wyoming now affirms that ruling, holding that the forfeiture of the interests of minors resulting from the actions of their parents does not violate public policy.

—EGW v. First Federal Savings Bank of Sheridan, 413 P.3d 106 (Wyo. 2016)

COMMENT: Curiously, the comprehensive factual summary in *Willey* does not mention the *in terrorem* clause. It is possible that Spencer and his children never knew of its existence.

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