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November 2021

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Progress toward tax reform

The logjam in the House of Representatives finally broke, with the passage of the bipartisan infrastructure plan and the promise of a vote on the Build Back Better Act the week of November 15. That is the week when the Congressional Budget Office will provide an analysis of the fiscal impact of the bill. Democratic moderates insisted upon seeing that report before taking a vote.

The tax elements of the Build Back Better legislation have been changed significantly from the earliest draft. The President proposed a new framework in October, which was followed by the release of a massive rewrite of the bill on November 3. Some 782 pages of the original bill were cut, and 530 of the axed pages were from the Ways and Means section. Nothing is final as of this writing, but of special interest to estate planners in the current draft:

- the acceleration of the reduction in the unified transfer tax credit is dropped;
- rewrite of the grantor trust tax treatment is omitted;
- still no sign of the repeal of basis step-up at death;
- the $14 billion revenue raiser from changes to the carried interest rule has gone missing;
- the idea for a tax on the unrealized capital gains of billionaires came and went; and
- the cap on the SALT deduction would be lifted from the current $10,000 to $72,500.

There is considerable resistance from some Democrats over the lifting of the SALT cap, as most of the tax benefits would go to the highest-income Americans. Senator Bernie Sanders said, “At a time of massive income and wealth inequality, the last thing we should be doing is giving more tax breaks to the very rich.” Repealing the SALT cap would lose $85 billion annually in federal tax revenue. According to CFRB.org, the top 1% of taxpayers would get an average $35,660 tax break, while those in the 90% to 99% group would get an average of $2,480. Those not in the top 10% of taxpayers would get less than $400 on average—many of them do not itemize, so the cap really has no effect on them.

Abandoning the proposed 39.6% top individual tax rate had very little revenue effect, because that is already scheduled to happen in 2026. Preserving the 21% corporate tax rate, on the other hand, sacrifices an expected $540 billion that raising the rate to 26.5% would have collected. That loss is offset by the creation, beginning in 2023, of a corporate minimum tax on financial statement income for companies with more than $1 billion of such income, expected to raise $325 billion over ten years.

The current draft includes a 5% surtax on income over $5 million and 8% above $25 million for individuals. Those new brackets kick in at markedly lower levels for estates and trusts, $200,000 for the 5% surtax and $500,000 for the 8% surtax. The tax applies after allowing for distribution deductions, so that trusts that do not accumulate income would generally not be affected.

COMMENT: When the budget resolution was passed, leaders hoped to "pre-Conference" the bill, so that the Senate would be able to simply accept whatever passed in the House. That hasn't happened, and the current tax provisions are very different from earlier iterations. The House may include immigration provisions that the Senate Parliamentarian has already ruled cannot be included in a reconciliation bill. Should the Senate decide against "rubber-stamping" the House bill, there are not many legislative days left in 2021 for rewrites, hearings, and votes.

Acceptance of benefits bars later will contest

Dempsey's will made several specific bequests and divided his residuary estate among his three daughters, Lisa, Tia, and Carla. Tia also was specifically left a mutual fund worth $143,229 and half of a bank account. Lisa was named executor of the estate.

Dempsey died in August 2017. Lisa began the probate of Dempsey's will in October that year, and she distributed the mutual fund to Tia in December. In February 2018 Tia brought a lawsuit alleging that Dempsey's will was tainted by undue influence or a lack of testamentary capacity. She argued that the will should be set aside, which would result in an intestacy. In that case, she would inherit 1/3 of the $1.4 million estate (the value of the other specific bequests is not provided in the opinion).

Lisa moved to dismiss on the grounds that Tia had no standing to attack the will, as she had already accepted benefits under it. The trial court agreed. Tia appealed, on the basis that she would receive a far larger inheritance should her suit be successful. Because Lisa did not offer evidence to rebut that assertion, the appellate court reversed.

The Supreme Court of Texas now reverses the appellate court decision, holding that her acceptance of benefits barred Tia's attempt to overturn the will. Tia did not return the mutual fund to the estate. "Equity does not permit the beneficiary of a will to grasp benefits under the will with one hand while attempting to nullify it with the other."

—Estate of Johnson, 64 Tex. Sup. Ct. J. 1160 (Tex. 2021)

COMMENT: Tia accepted the mutual fund voluntarily. The court recognized that the beneficiary's acceptance of benefits must be voluntary so that "an opportunistic executor [cannot] offensively deny a would-be will contestant's claim by partially distributing the estate to an unwitting beneficiary to avoid a will contest."

Charitable deduction for nonitemizers

In September the IRS reminded the 90% of taxpayers who do not itemize their deductions that they still have access to an above-the-line deduction for charitable gifts in 2021. The extra deduction was created by the CARES Act in 2020 and extended to the 2021 tax year by the Taxpayer Certainty and Disaster Relief Act of 2020 enacted last December.

Single taxpayers are permitted a deduction of up to $300, marrieds filing jointly up to $600, for cash gifts to qualified charities.

—IR-2021-190

COMMENT: When the standard deduction was doubled with TCJA 2017, making itemizing unnecessary for the large majority of taxpayers, there was a fear that the loss of the tax benefit might reduce American generosity. That does not appear to have happened. According to Giving USA, charitable giving by individuals rose by 2.2% in 2020, reaching $324.1 billion. That was the year of the economic hardships of the pandemic, but those who could still opened their wallets wide.

Closing letter fees now active

Despite the fact that fewer and fewer estates are subject to the federal estate tax as the exemption equivalent has grown, the number of Forms 706 filed every year has exploded. Most are nontaxable returns; they have been filed solely to claim the Decease Spouse's Unused Exemption Amount, which will be lost if the Form is not filed.

Faced with this administrative burden that generated no revenue, the IRS announced in June 2015 that it would no longer routinely provide estate tax closing letters. That did not stop estate administrators from needing the letters, however, and they continued to request them.

In December 2020, the IRS proposed new regulations in this area to speed the process of getting an estate tax closing letter. The regulations included a $67 fee to obtain a closing letter. Final regulations were issued on September 27, 2021, and the fee went live on October 28, 2021. To obtain a closing letter now, one goes to pay.gov and searches for "estate tax" or "closing letter," then selects "Estate Tax Closing Letter User Fee" from the results.

— T.D. 9957; 86 F.R. 53539-53542; 2021-41 IRB 452

Whistleblower dies, claim survives

In 2007, when he was an employee of the Dutch bank Rabobank Group, Joseph Insinga filed a report with the IRS Whistleblower Office. He alleged that billions of dollars from U.S. companies were being inappropriately sheltered from taxation at the bank. Insinga provided the IRS with internal audit reports to demonstrate the claims. Five years went by with no word on what reward he might receive for blowing the whistle. In 2012, Insinga filed a Tax Court petition to get the IRS to give him an answer.

In 2013 the answer finally came, and it was a denial that Insinga was due any reward at all for the information he provided. There were no collected proceeds on which to base the reward, according to the Service. A new lawsuit was filed challenging that determination, and years of discovery followed.

Insinga died in March 2021. His estate moved to substitute itself as the petitioner, and the IRS did not oppose the motion. However, an agreement by the parties does not confer jurisdiction, and the Tax Court took up the question, which was one of first impression.

The Court held that based on the common law rule that rights of action under federal statutes survive a plaintiff's death if the statute is remedial, not penal, Insinga's case can go forward. The fact that the reward is proportional to the recovery supports that conclusion, the Court ruled.

—Joseph Insinga v. Commissioner, 157 T.C. No. 8

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