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In This Issue

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Progress for the Prince estate

The IRS and the executors of the Prince estate have compromised on the taxable value of the late singer's real estate. They seemed to have split the difference—where the estate reported a value of $15.7 million for nine real estate parcels and the IRS countered with $21.4 million, both sides settled for $17.7 million.

The more difficult valuation questions still lie ahead, concerning the value of music royalties and Prince's likeness. Where the executor reported a total estate value of $82 million, the IRS tally came to $163 million, and a valuation understatement penalty of $6.4 million was added for good measure.

Three of the six heirs to the Prince estate have sold their interests to New York music company Primary Wave for an undisclosed amount.

Resistance to step-up repeal

All 50 Republican Senators signed a July 21 letter to the White House in opposition to President Biden's proposal to eliminate basis step-up at death, except for an exemption for the smallest estates. Such a change would be "a new backdoor death tax" that would cripple the economic viability of family farms and small businesses, according to the letter. The end result would be further consolidation of major agribusinesses.

Democrats remain supportive of the President's ideas, however, and reportedly are looking for ways to protect family farms and family-owned businesses from the more severe effects of the new rule.

No tax on gift for services

Businessman Ronald Pratte hired Jeffrey Bardwell in 2001 to manage a Phoenix lumberyard. During the next four years the two became close friends. Ronald sold his construction business. He then met with Jeffrey and four other men at the Las Vegas airport. At that meeting he gave each man a check for $2 million and expressed the wish that each would start a home construction business. Ronald reported the transfers as taxable gifts and paid the gift taxes on them. No, it's not the setup for a Hollywood movie. This really happened.

Ronald claims that, in exchange for the check, Jeffrey had promised to work for him for the rest of Ronald's life. Jeffrey counters that he made no such promise and that he understood the transfer to be an unrestricted gift. Ronald filed a lawsuit for breach of contract, and among the damages he claimed was his payment of gift taxes. Both sides moved for summary judgment.

The trial court held that the pleadings were sufficient to allow a jury to conclude that there had been an enforceable contract. However, if there was a contract, then there was no gift and no need to pay the gift tax. Ronald apparently thought he had paid the gift tax for Jeffrey, but the obligation to pay the tax falls on the donor, not the donee. The court dismissed any damage claim based upon the erroneous gift tax payment.

—Ronald H. Pratte v. Jeffrey Bardwell et al.; No. 2:19-cv-00239

COMMENT: Ronald might look to the IRS for a refund of the gift tax, but the statute of limitations has likely expired.

The durable penalty

Jagmail Gill became a green card holder and immigrated to the U.S. in 1984. Jagmail became a U.S. citizen in 2008. He was financially successful and accumulated foreign accounts with balances from $7.6 million to $18.1 million. Unfortunately, from 2005 to 2010, he did not comply with the FBAR (Foreign Bank Account Report) reporting requirements. The IRS assessed an FBAR penalty of $740,848 on Jagmail. The penalty was stipulated to be non-willful, perhaps because all income taxes had been paid and only the reporting was deficient. The Service later assessed another $55,304 penalty on Jagmail's wife, Amarjit.

Unfortunately, Jagmail died from complications of COVID-19 in April 2020. Settlement of his estate was delayed by the pandemic. After Amarjit was named personal representative, the estate argued that the FBAR penalty was extinguished by Jagmail's death.

Whether the penalty survives the penalized party depends upon whether the penalty is primarily remedial or penal. Remedial penalties survive but penal punishments do not. In what the District Court conceded was a "close case," the non-willful penalty was determined to be remedial, and so did not die with Jagmail.

— U.S. v. Amarjit Gill; No. 4:18-cv-04020

SECURE 2.0

H.R. 2954, Securing a Strong Retirement Act of 2021, passed the House on a voice vote in May. The legislation follows up on the SECURE Act, providing more changes for qualified retirement plans and retirees. Two bills in the Senate on the same subject are S. 1770 and S.1703. Key items included in one or more of the proposal include:

- automatic enrollment;
- automatic increases in contribution rates;
- phasing in an increase in the age for Required Minimum Distributions from the current 72 to 75;
- enhanced saver's credit; and
- increased catch-up contributions for older workers.

In the House bill the larger catch-up contributions are required to be Roth contributions; that is, there is no immediate tax benefit, but future withdrawals will be tax free. That bill also would allow employers to designate matching contributions as Roth contributions. These changes were scored as raising government revenue by $26.1 billion over ten years, helping to make the House bill revenue neutral. This scoring is possible because most of the revenue shortfalls of the Roth contributions fall outside the 10-year budget window, while the taxes paid on the contributions are within the window.

COMMENT: The essential elements of these bills appear to enjoy bipartisan support, but it is not clear that Congress will get to them this year.

Ignorance may be an excuse after all

David Leighton's sons, Frank and David Jr., were nominated as co-executors after David Sr.'s death in 2017. David Jr. refused the nomination to serve, leaving Frank as the sole executor. Frank diligently sought out professional advice for administering the estate, which he expected to be worth $1 million to $2 million. He properly filed the decedent's final income tax return and was advised that no estate tax return would be needed if the estate did not exceed $5.49 million. Accordingly, he let the time for filing an estate tax return expire without filing a return.

About two years after David Sr.'s death, David Jr. revealed that a substantial trust had been created and funded with more than $5 million in assets, and a gift tax return had been filed reporting the transfer in 2012. Frank promptly arranged for the preparation of an estate tax return and paid estimated taxes, penalties, and interest on the overdue filing. He paid too much, and the IRS refunded an overpayment of roughly $50,000.

The IRS calculation included a late-filing penalty of $85,000. Frank objected that the penalty was improper, as he had acted reasonably with all the information that he had been given about his father's assets and giving history. When the IRS failed to respond to his request for abatement, he took the matter to the Court of Federal Claims.

The IRS moved to dismiss, arguing essentially that executors have no defense against failing to file a return. The Court rejected the motion, holding that the key question to be settled by a trial is "should the Executor or his tax advisors have known about the Decedent's funded trusts prior to their unveiling in 2019?"

—Frank T. Leighton et al. v. United States; No. 1:21-cv-00840

COMMENT: Had David Sr. simply survived to 2018, his estate would have been free of estate tax. Given that Frank took the initiative to call the failure to timely file to the attention of the IRS, it would seem to be a better tax policy to not impose a penalty so as to encourage forthrightness in taxpayers.

Can an IRA be too large?

Some members of Congress are concerned that rich people are getting too much benefit from the IRA rules. Finance Committee Chair Ron Wyden of Oregon reported at a meeting in July that nearly 29,000 Americans have IRAs worth more than $5 million. Some 497 people have $25 million or more in their retirement account, totaling $77 billion.

How is that possible? Venture capitalists are able to contribute start-up company stock to an IRA, and they do so when the stock has very little value and is not available to the public. They may do this with many different companies, hoping that some will explode in value—and evidently, some have. If the stock was placed in a Roth IRA, those gains will never be taxed.

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