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Third Quarter 2022

In This Issue

- Five years for claiming portability
- Waiver enforced
- The meaning of "unsuccessful"
- The case of the missing stock shares
- Extension for GSTT allocation
- Crypto discount?
- One door closes, another opens

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Five years for claiming portability

For those who die in 2022, the amount exempt from the federal estate tax is generally $12,060,000. Each partner in a marriage has an exemption, so that a married couple could have a total exemption of $24,120,000 should they both die before year-end. The tax benefit is now portable; that is, any part of the exemption not used at the death of a spouse may be inherited by the survivor, to be used in future years.

Example: Married couple John and Mary are worth $20 million. When John dies in 2022, he leaves his entire estate to Mary outright. That transfer is shielded from the estate tax by the marital deduction, so John has used none of federal exemption amount. Mary inherits his Deceased Spousal Unused Exclusion (DSUE) of $12,060,000, which her estate may use in future years to reduce her estate tax liability. Or she could use it to avoid federal gift taxes on large lifetime property transfers.

But there is a catch—one has to ask for the DSUE to receive it; it's not automatic. There's only one way to claim the DSUE, and that is by filing an estate tax return for the first spouse to die, even though no tax will be due.

This point has been frequently overlooked. When the oversight is later discovered, some estates have asked the IRS via a private letter ruling for permission to file a very late estate tax return so as to claim the DSUE. The IRS has taken an unusually taxpayer-friendly posture on this question. For estates smaller than the filing threshold ($12,060,000 in 2022), the Service has granted the extension of time. With larger estates, the tax code does not give the IRS the same flexibility.

So many people were filing these private ruling requests that in 2017 the IRS announced that smaller estates that asked for the extension within two years of death would automatically get a favorable response, and did not need to go to the expense of a private ruling. However, that change did not make a big enough dent in the flood of requests. In July the IRS extended the deadline to five years following the death of the spouse. The estate tax return must say on page 1 "FILED PURSUANT TO REV. PROC. 2022-32 TO ELECT PORTABILITY UNDER §2010(c)(5)(A)."

—Rev. Proc. 2022-32, 2022-30 IRB 101, superseding Rev. Proc. 2017-34

COMMENT: Why have so many estates realized belatedly that they have this issue? The fact that stock prices were, until this year, appreciating very nicely may have grown some estates into taxable territory, triggering the need for a DSUE. Also, the amount exempt from federal estate tax is scheduled to fall roughly in half in 2026 under current law. That change will not affect a DSUE secured in an earlier year.

Waiver enforced

After 21 years of marriage, Richard and Lisa Bicknell divorced. In the property settlement agreement, Richard waived "any and all interest" in Lisa's 401(k) account, worth some $102,000 at that time. However, Richard had been named as the surviving beneficiary of the account during the marriage, as required by ERISA. After the divorce, Lisa never changed the beneficiary designation.

Seven years later, Lisa died intestate. It appears that the 401(k) plan administrator delivered the funds to Richard, as directed by the paperwork. The administrator of Lisa's estate filed a lawsuit to recover the money, arguing that Richard had irrevocably waived his interest in the account in the property settlement agreement, and that the agreement further provided it could not be amended except in writing. Richard countered that he and Lisa had remained friendly and in contact after the divorce, and furthermore Lisa had told him that she would never change her 401(k) beneficiary (the couple had no children).

The court held that the case is a question of contract law, and that the contract—the property settlement agreement—will be enforced by its terms. Richard must send the retirement plan money to the estate for distribution. The appellate court confirmed the judgment.

—Morgan v. Bicknell, 268 A.3d 1180 (2022)

The meaning of "unsuccessful"

Phyllis McDill, resident of Wyoming, created a revocable trust naming her three children—Thomas, Michael, and Teresa—as beneficiaries, as well as her grandchildren. Phyllis named herself as trustee, with Michael and Teresa as successor cotrustees. At her death, her real property was to be sold and the proceeds added to the trust.

The trust was amended four times. In May 2014, she made herself and Michael cotrustees. In June 2016, she added Thomas as a third cotrustee, and further gave Thomas certain real property after her death. That amendment was revoked in September 2016 by a third amendment.

The final amendment, made in December 2016, added a no-contest provision to the trust. Anyone who attacked the trust or any beneficial interest would be disinherited, together with their descendants. However, before the sanction could be enforced, the person contesting the trust would have to be warned about the possibility of disinheritance, and would have 30 days within which to abandon the contest. In that event, the inheritance would be restored.

Two years later, Phyllis died. Michael informed his siblings that they had 120 days to challenge the validity of the trust. Within that time frame, Thomas filed a lawsuit in Texas, alleging that the third and fourth amendments to the trust were invalid, procured by Michael's undue influence. He also sought an order giving him the real property.

Two months later, Michael sent the notice to Thomas that his Texas lawsuit violated the trust's no-contest clause, and that Thomas must abandon the lawsuit within 30 business days or he would be disinherited. When Thomas did not abandon the lawsuit, Michael turned to the Wyoming courts for confirmation that the no-contest provision was triggered.

Next, the Texas court dismissed Thomas' lawsuit for lack of personal jurisdiction over the parties. Thomas then tried to bring his complaint to the Wyoming court, but that court ruled that the Texas lawsuit had indeed been an "unsuccessful contest" of the trust terms sufficient to trigger the no-contest clause. Now Thomas had no standing to sue in Wyoming, because he was not a trust beneficiary.

On appeal, Thomas argued that an "unsuccessful contest" had to be one that failed on the merits, not one dismissed on jurisdictional grounds. The Supreme Court of Wyoming was not impressed by his logic. "The plain meaning of 'unsuccessful' is 'not successful: not meeting with or producing success,'" the Court observed. Whether the contest failed on procedural grounds or on the merits is not relevant.

—Matter of Phyllis V. McDill Revocable Trust, 506 P.3d 753 (2022), 2022 WY 40

The case of the missing stock shares

Cone Solvents, Inc., was a family-owned chemical distribution company. Tom Cone owned 12.5% of the shares; his father and sister, Susan, owned the balance. In his will, Tom left his sister a bequest of “any interest I may own at the time of my death in Cone Solvents, Inc.”

In 2006, Tom started a new business venture, a trucking business, Frontier Logistical Services, LLC. Tom had an 85% membership interest and a 100% governance interest in the new company. Four years later, the new company agreed to buy all the tangible and intangible assets of Cone Solvents, Inc. Frontier assumed the most of Cone’s liabilities, including a $475,000 debt to Cone Sr.; it hired Cone Sr. as a consultant; and it kept Cone Solvents’ employees on staff. Thereafter, Frontier added chemical distribution to its trucking business under the Cone Solvents, Inc. name and logo.

Cone Solvents, Inc. was liquidated, and Tom gave Susan a 12.5% interest in Frontier. However, he never amended his will.

When Tom died in 2015, still owning 72.5% of Frontier, his widow asked the probate court to rule that the bequest to Susan had been adeemed by extinction. There were no shares of Cone Solvents, Inc., in Tom’s estate, the court held. The sale of the firm’s assets had been to an existing company, so there was no argument that it was a mere change in form. The Court of Appeals in Tennessee affirmed. “Cone Solvents, Inc. did not merely change name or form. Its assets were sold to another—already existing—business. Frontier had been a viable trucking business for almost four years before the asset purchase. More importantly, Frontier was the buyer, not the decedent.”

— In re Estate of Cone, 2022 WL 587448 (Tenn. Ct. App. Feb. 28, 2022)

COMMENT: Susan also argued that Frontier kept separate books for the chemical distribution business. The will provision refers to an “interest” in Cone Solvents, not shares of stock, but the Court rejected that distinction.

Extension for GSTT allocation

At Donor’s death, her revocable trust was divided into three charitable remainder annuity trusts (CRATs)—one each for Son, Daughter, and Grandson. The CRATs are not skip persons, but they have potential exposure to the generation-skipping transfer tax (GSTT) because there are contingent annuitants who are skip persons.

The executor of Donor’s estate relied on an attorney to file a timely estate tax return and claim a charitable deduction for the remainder interests of the trusts. However, the attorney did not affirmatively allocate Donor’s GSTT exemption, which means that there is a deemed allocation equally among the three trusts.

This is not optimal, and now that the oversight has been discovered, the estate would like an extension of time for allocating the exemption. Specifically, the exemption will be allocated to cause Grandson’s CRAT to have an inclusion ratio of zero, and any remaining exemption to be divided equally between the remaining two trusts.

In private advice, the IRS concludes that everyone acted in good faith, and grants an additional 120 days to allocate the exemption.

—Private Letter Ruling 202233002

Crypto discount?

Matthew Mellon II became a brand ambassador for Ripple XRP, a cryptocurrency token. He purchased $1 million worth of the tokens in 2015, and another $1 million in 2016. The tokens exploded in value. Mellon terminated his relationship with the company, but in doing so accepted substantial limitations on his ability to transfer his tokens. Specifically, his sales could not exceed 0.5% of the average daily trading volume of the prior week. In accordance with the agreement, he sold 5.7% of his holdings for some $13 million over a period of many months.

Mellon died unexpectedly at age 53 in 2018. At his death, his remaining tokens had a nominal value of $242 million. An appraisal was conducted, taking into account the restrictions on sale and the volatility of the cryptocurrency markets. The appraiser concluded a 40% discount was appropriate, and so the tokens were valued at $151 million and reported on a timely filed federal estate tax return.

The IRS rejected the discount entirely, and called for an increase in the estate’s taxable value of some $90 million,

triggering an estate tax deficiency of $36 million. The estate is resisting the demand, and has filed a petition in the Tax Court.

—Estate of Matthew T. Mellon II et al. v. Commissioner; No. 18446-22

COMMENT: The fact that there was a thorough appraisal, plus the Mellon's family connection to a professional estate administration entity, could help establish a recognized procedure for future cryptocurrency estate valuations.

One door closes, another opens

Pop star Prince died without having made a will or taken any other estate planning steps. What's more, there were tricky questions about who his heirs would be, as he died without children or a surviving spouse. The estate's executor had to attend to those matters at the same time that an inventory of Prince's assets needed to be compiled and valued. Eventually six heirs were identified. Three of them sold substantially all of their expected inheritance to music company Primary Wave.

The executor reported a total value for Prince's estate of some $82 million. The IRS believed that his fortune was worth nearly double that, $163 million, which would have meant additional estate taxes of $32 million and a penalty of $6 million for the substantial understatement of the tax liability on the estate tax return.

After a series of negotiations, the estate and the IRS reached a compromise, valuing Prince's estate at $156 million, some six years after his death. Now that the tax issues are taken care of, the heirs can begin promotions of Prince's music and likeness. Reportedly there are plans for music exhibitions, films, even Broadway shows. Primary Wave's statement: "When we announced our acquisition of the additional expectancy interests in the estate last year, bringing our ownership interest to 50%, our goal was to protect and grow Prince's incomparable legacy. With the distribution of estate assets, we look forward to a strong and productive working relationship."

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