

***49th Annual
Heckerling Institute
on Estate Planning Update***

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Basis

§ 1014(e) – no step-up in basis for property acquired by decedent within one year of death and such property passes to the donor of the property as a result of decedent's death.

Consider:

- Bifurcating marital share
- Sell such assets
- Give such assets to a credit trust and give trust protector the power to add the donor as a beneficiary of the credit trust

Basis (cont'd)

Reconsider use of Credit Trust due to loss of step-up in basis upon death of surviving spouse

- Portability
- Consider non-tax reasons for using Credit Trust
- Contingent general power of appointment to surviving spouse

Basis (cont'd)

Step-up in basis for existing Credit Trusts

- Distribute low basis assets to surviving spouse
- Trust Protector power to grant general power of appointment to surviving spouse
- Trigger Delaware Trap

Basis (cont'd)

Tax Basis Revocable Trust / Joint Estate Step-up Trust ("JEST")

- Joint revocable trust
- Deceased spouse has general power of appointment over all trust assets
- Full step-up in basis
- Expect IRS to challenge this

EVERGREEN



Powers of Appointment

Using powers of appointment to keep a trust up to date at every generation.

- Settlor's children may be in a better position than settlor to decide how the assets should be used for the respective children.

Powers of Appointment (cont'd)

Other Uses

- Basis adjustment
- Stop meddling – give power holder the right by lifetime power of appointment to exclude certain individuals as beneficiaries
- Prevent completed gifts – donor's retained general power of appointment

IRS Audit and Litigation Issues

1) Installment Sales

Woelbing case – IRS attempt to value note at zero under § 2702

2) Promissory Notes

Bona fide loan or gift?

Key: reasonable expectation of repayment

IRS Audit and Litigation Issues (cont'd)

2) Promissory Notes (cont'd)

Factors:

- note
- interest
- schedule of repayment
- security or collateral
- demand for repayment made
- records reflecting loan
- actual repayment
- borrower solvency

No one factor is determinative.

IRS Audit and Litigation Issues (cont'd)

3) Formula Transfers

- Defined value clause based on value “as finally determined for estate/gift tax purposes” (*Christiansen, Petters, Wandry*)
- Defined value clause (*McCord, Hendrix*)
- Reversion clause (*Procter*)

IRS Audit and Litigation Issues (cont'd)

Recommend using *Petters*-type formula with public charity/donor-advised fund on back end. (Private foundation is not recommended due to self-dealing and excess business holding rules.)

OR

- Lifetime QTIP
- GRAT (IRS has argued this is a reversionary interest like *Procter*)
- None (*Wandry*)

IRS Audit and Litigation Issues (cont'd)

4) § 2036

IRS pursuing § 2036 argument for transfers of FLP interests and sale transactions

- Significant and legitimate non-tax reasons for creating entity
- IRS focused on actual operations of entity

IRS Audit and Litigation Issues (cont'd)

4) § 2036 (cont'd)

- Maintain proper records
- For sale transactions put time between gift and sale
- Paper trail for payments on note
- Beware of timing distributions from entity to coincide with timing of note payments – make them different

IRS Audit and Litigation Issues (cont'd)

5) GRATs

- Terms comply with § 2702 Regs.
- GRATs operated in accordance with terms
 - Substantiation of annuity payments
 - Atkinson analysis
- Valuation

IRS Audit and Litigation Issues (cont'd)

6) Transferee Liability

- *U.S. v. Marshall*
Split in circuits on whether donee liability for gift tax is limited to value of gift received (3rd/8th circuits) or includes unlimited liability for interest (5th/11th circuits)
- Donee statute of limitations does not expire until 1 year after donor's statute of limitations expires

Final Regulations on 2% Floor on Miscellaneous Deductions for Trusts and Estates (§ 1.67-4)

Subject to 2%

- Tax prep. fees:
 - Gift tax return
 - Other tax returns
- Ownership costs (e.g. association dues, insurance, maintenance, etc.)
- Investment fees

Not subject to 2%

- Tax prep. fees:
 - Estate tax return
 - Fiduciary tax returns
 - Decedent's final income tax return
- Appraisal fees for estate tax return or distribution purposes
- Court fees, publication, certified copies, bond premiums, etc.
- Investment fees that exceed the amount charged to individuals

Administration's Fiscal Year 2015 Revenue Proposals

- Reinstate 2009 rates and exemptions
- Require consistency in basis and transfer tax value
- Require a minimum 10-year term for GRATs
- Limit the GST exemption to 90 years
- Coordinate income and transfer tax treatment of grantor trusts
- Extend the lien on estate tax deferrals to 15 years

Administration's Fiscal Year 2015 Revenue Proposals (cont'd)

New for 2015:

- Simplify annual gift tax exclusion by eliminating the present interest requirement and creating a new category of transfers with an annual limit of \$50,000
- Expand the applicability of the definition of Executor
- Eliminate stretch IRAs by requiring non-spouse beneficiaries to take distributions over no more than 5 years
- Limit total accrual of tax-favored retirement benefits

Administration's Fiscal Year

2016 Revenue Proposals

- Elimination of basis step-up at death
- Increase capital gains rate to 28% for couples with income over \$500,000 (includes 3.8% tax)
- Remainder interest in GRAT at time interest is created has a minimum value = greater of 25% of assets or \$500,000
- No "tax-free" exchanges of assets held in GRAT
- Portion of assets in trust attributable to sale to grantor trust would be includible in grantor's estate (excludes insurance trusts)