Estate Planning

Selected Recent Tax & Related Developments

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Presentation
at
Federal Tax Update Progam

University of Houston Law Center

February 21, 2014

Note: This paper is also posted at http://www.law.uh.edu/faculty/wstreng/current.html

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myf\sp\UHLC Tax Program Feb 2014.1
February 14, 2014

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I. Beginning with the Recent Federal Tax Legislation

A. American Taxpayer Relief Act of 2012

The American Taxpayer Relief Act of 2012, P.L. No. 112-240, 112ndCong. 2nd Sess, as signed by President Obama on January 3, 2013, provides "permanent" estate tax relief. The "sunset" provisions (2001 and 2010) are gone.

This legislation increases the estate, gift and generation-skipping tax rate to 40 percent (from the previous 35%). The graduated transfer tax rates are:

- Over $500,000 but not over $750,000 - $155,800 tax, plus 37% of the excess over $500,000.
- Over $750,000 but not over $1,000,000 - $248,000 tax, plus 39 percent of the excess over $750,000.
- Over $1 million - $345,800 tax, plus 40% of the excess over $1 million.

However, the basic exclusion amount for the (unified) estate and gift taxes is $5 million, as adjusted for inflation.[1] A similar exclusion is available for generation skipping tax purposes. As adjusted for inflation this basic exclusion amount is $5,340,000 for the year 2014.[2]

B. Initial Planning Observations after these Statutory Changes

As a result of this $5,340,000 exclusion ($10,680,000 for a married couple) many estate planners will find that most clients will not be exposed to potential federal estate or gift tax risks. This leads to some preliminary estate planning observations which are applicable:

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[1] With indexing this exclusion can reasonably be anticipated to grow at essentially the same rate as the client's estate grows, unless the client has extraordinary investment success (or failure).

[2] See Rev. Proc. 2013-35, 2013-47 IRB 537, § 3.32.

1. Federal income tax planning may be more important in many estate planning contexts, e.g., encouraging planning to enable the deflection of income to other family members (and trusts) for federal income tax purposes.

2. Multiple methods exist to accomplish assuring the use of the transfer tax exclusion for both spouses, i.e., either (a) the use of a marital deduction trusts (e.g., a QTIP trust), or (b) the subsequent availability at the death of the last spouse to die of the "portability exemption," i.e., the "deceased spousal unused exclusion amount" or "DSUEA."

3. Even assuming a client (including possibly when combined with a spouse's net worth situation) may be close to the maximum exclusion amount(s), various fundamental planning techniques should be considered to "take some value off the top":

a) Maximize the use of the annual donee exclusion ($14,000 per donee for the year 2014).[3] The use of this exclusion does not reduce the amount of the unified exclusion. This gift tax exclusion applies on a per donee basis. Therefore, it can enable significant leveraging, including for children and grandchildren and trusts for these beneficiaries (if exploiting the Crummey power technique to enable "present interest" treatment).

b) Utilize valuation discount opportunities to reduce the putative value of the assets in the client's estate. This can be accomplished, e.g., for closely held stock, for family limited partnership interests, and where "blockage" conditions might exist to reduce the fair market value of assets held at death.

c) Encourage charitable giving to take value "off the top."[4] Of course, this

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[3] See Rev. Proc. 2013-35, 2013-47 IRB 537, § 3.34(1).

[4] Ideal assets for this purpose are the assets held in a trust under a deferred compensation plan, e.g., profit-sharing plan, §401(k) plan, or similar tax deferred arrangements. These assets do not get a tax basis step-up at death (under IRC § 1014), rather being treated as items of "income in respect of a decedent" under IRC § 691. The contribution of these assets to charity avoids the income tax and facilitates an estate tax deduction, thereby causing little real "leakage" from the transferred private wealth.

could be combined with techniques such as charitable lead trusts or charitable remainder trusts.

4. To the extent that the client feels comfortable about making larger gifts (as protected by the unified credit exclusion amount) those transfers should be made promptly to children, grandchildren and, possibly, trusts for these beneficiaries. This will enable the value of this gifted property to begin to immediately appreciate (assuming favorable investment conditions) in the hands of the donee, rather than being on the top of the gross estate of the donor at the time of subsequent death. The "downside," of course, is the loss of the income tax basis step-up (under IRC § 1014) which occurs at death, eradicating the potential 20 percent capital gains tax on that "disappeared appreciation."

C. Recent IRS Statistics of Income Information

1. Estate Tax Return Information

Information recently released by the IRS Statistics of Income Division reveals dramatic changes in federal estate tax return filings. This information is based on returns filed in the year 2012 (and earlier):[5]

- The number of estate tax returns declined 87 percent from about 73,100 in 2003 to about 9,400 in 2012. For 2012 the number of actual taxable estate tax returns was approximately 4,000. This decline was attributable primarily due to the gradual increase in the return filing threshold. The estimate is that less than 0.2% of U.S. estates will be subject to the federal estate tax.
- In 2012 the total net estate tax reported on all estate tax returns filed for the year was $8.5 billion. In 2008 (when the estate tax filing threshold was $2 million) the equivalent net estate tax amount paid was about $25 billion. Historically the annual estate ta collections have been in the $30 billion range.
- California had the highest number of estate tax returns filed in 2012, as

[5] See "Estate Tax Returns Filed for Wealthy Decedents, 2003-2012," as available at www.irs.gov/taxstats.

followed by Florida, New York, Texas, and Illinois.

- Stock and real estate constituted about one-half of all estate tax decedents' asset holdings in 2012, with the proportion of assets held as stocks increasing as wealth became larger.

2. Estate and Trust Income Tax Statistics

The IRS has also recently released estate and trust income tax statistics.[6] This information shows:

- For the filing year 2010 approximately 3.0 million entities filed IRS Form 1041 and reported over $91 billion in income. The number of taxable IRS Forms 1041 was approximately 532,000 in 2010 (presumably the remaining forms reflecting distribution deductions).
- The largest type of income claimed was capital gains, with a total of $32 billion.
- The total tax liability reported on IRS Form 1041 was approximately $10.5 billion.

II. Federal Estate & Gift Tax - Selected Developments

A. Self Canceling Installment Notes

A "self-canceling installment note" or "SCIN" is an installment note that contains a provision where the buyer's obligation to pay in the purchase transaction terminates in the event a specified person (the measuring life) dies before the end of the term of the note. The usual assumption is that the income generated by the asset sold would be sufficient to liquidate the note obligations. This can be an effective mechanism for transferring property to family members without estate or gift tax consequences if the death of the seller-transferor occurs before the last payment has been made under the terms of the installment note, assuming fair value being paid for the note.

[6] See http://www.irs.gov/pub/irs-soi/10estrustsnap.pdf

In CCA 201330033 IRS issued a memo providing guidance regarding the IRS position concerning SCINs. Apparently this concerns the issues in a docketed Tax Court case, Estate of William Davidson, No. 013748-13 (filed June 14, 2013; previously, but no longer, scheduled for trial in 2014). Major issues there concern whether SCINs constituted bona fide consideration equal to the stock transferred in several exchanges for the SCINs. The IRS Notice of Deficiency asserts estate, gift and GST tax deficiencies in excess of $2.6 billion.

These transactions raise many issues, particularly:

- Does any portion of the property transfers in exchange for a SCIN constitute a gift?
- How should the fair market value of SCINs be determined?
- What are the subsequent estate tax consequences of a SCIN at the death of the seller?

In the CCA the IRS noted that in the transaction examined the SCINs were valued based on the IRC § 7520 tables. This seems to suggest that the valuation was based on (1) using the IRC § 7520 rate for the discount rate to determine the present value of the future payments, and (2) applying the mortality tables of IRC § 7520 to determine the principal and interest premium amount to determine the value of the self-canceling feature. However, the IRS stated that the IRC § 7520 rates did not apply in this situation. Rather, the IRS states, these notes are to be valued based on a method that takes into account the “willing buyer-willing seller” standard in Reg. § 25.2512-8. The parties are also to take into account the decedent’s medical history on the date of the transfer. A prior assumption has been that the IRC § 7520 rates do apply in these situations unless serious health issues exist for the specific transferor.

If IRS is meaningfully successful in the Davison case this technique will be challenged by IRS in the future in numerous situations. IRS will want to obliterate the prior precedent in Estate of Constanza v. Commissioner, 320 F3d 595 (6th Cir. 2003), where the Sixth Circuit concluded that a SCIN transaction with family members is often presumed to be a gift, and not a bona fide transaction. In that case, however, the Sixth Circuit concluded that the estate rebutted the presumption against

the enforceability of an intrafamily SCIN by affirmatively showing that there existed at the time of the transaction a real expectation of repayment and an intent to enforce the collection of the indebtedness.

IRS will presumably specially examine those situations where the payments are significantly back-loaded. In the situations described in the CCA sales were concluded with grantor trusts and with notes providing for interest-only annual payments, with a balloon payment at the end of a fixed term. In one situation the face amount of the note was almost double the value of the stock that was sold - apparently to compensate for the premium that the note might be cancelled before the expiration of the term. In another situation the premium was represented in the interest payment, rather than as a principal amount premium.

Even if successful in these transaction in the estate tax context the planner should be aware of the income tax consequences of the SCIN. This is an "installment sale" for income tax purposes. If the seller dies before the SCIN matures the deferred gain will be recognized for income tax purposes on the estate's first income tax return. See Estate of Frane v. Commissioner, 998 F.2d 567 (8th Cir. 1993), reversing the Tax Court's holding that the deferred gain was to be recognized, but on the decedent's final income tax return. The Tax Court decision did have a dissenting opinion that no income was recognized in this context.

B. The Deceased Spousal Unused Exclusion Amount

A "portability election" is available to estate of decedents dying in 2011 and after. This allows an election by the executor of a decedent's estate to effectively transfer the unused applicable exclusion amount from the estate of the deceased spouse, up to the applicable exclusion amount, to the decedent's surviving spouse.[7] This avoids the necessity of transferring assets between spouses (these transfers would be

[7] A technical correction to this provision was included in the American Taxpayer Relief Act of 2012. IRC § 2010(c)(4)(B)(i) referenced the decedent's "basic exclusion amount" instead of the "applicable exclusion amount." See ATRA 2012, §101(c)(2). See also Reg. § 20.2010-1T(d)(4) and 20.2010-2T(c)(1)(ii)(A)

protected by a marital deduction) so as to enable both (1) the full use of both spouses' applicable exclusion amounts and (2) the possible avoidance of a "credit shelter trust."

Some fundamental planning observations concerning this provision are provided:

1) If the combined wealth of a married couple will never exceed the estate tax exclusion amount ($5,340,000 in the year 2014) these considerations are not relevant to enable avoiding any federal estate tax.
2) For those couples whose wealth exceeds the basic exclusion amount, but will likely not exceed twice that amount, the credit shelter trust is no longer necessary if this portability election is made on the first spousal death. This consideration could be particularly pertinent where, for example:
a) A competent spouse can manage assets.
b) The clients might desire to avoid the use of trusts, whether because of possible higher income tax costs for trusts or, merely, because they do not understand the trust concept.
c) No children exist from a prior marriage.
d) Clients are interested in the income tax basis step-up at the time of death of the surviving spouse.
e) The transfer of certain assets (e.g., a personal residence) may be cumbersome.
3) The surviving spouse would be required to implement planning to assure full use of this transferred exclusion amount prior to the death of any future spouse (e.g., Husband Two) that this surviving spouse might marry.[8] Any transferred exclusion amount from the first deceased spouse will disappear if the surviving spouse's second spouse dies prior to the surviving spouse's using the transferred exclusion amount obtained at the death of the first spouse.[9] However, this surviving spouse may not

[8] Observe that the surviving spouse can use the DSUE amount at any time after the decedent's death, assuming that the portability election has eventually been made by the executor.

[9] Does this suggest that in this circumstance the older couple might merely cohabitate (i.e., "live in sin" without a common law marraige) rather than having a ceremonial marriage?

wish to transfer sufficient property by gift to absorb all of that transferred exclusion, often premised on the concept that the surviving spouse needs all the assets (no matter how large) to maintain her standard of living.

4) Notwithstanding this flexibility for spousal asset transfer planning, the use of trusts on the first spousal death for the benefit of that spouse's descendants might still be important, thereby reversing the perspective noted in Item 2 just above. The client may wish to ensure provisions for the client's children from a prior marriage, or may be concerned about the surviving spouse entering into a subsequent marriage where his assets will be squandered by the replacement spouse. In this situation the QTIP trust may be preferred. This will enable (1) availability of the marital deduction, (2) providing for the surviving spouse during her survival period, and (3) the first spouse's controlling the identity of the remainder beneficiaries who ultimately receive the first deceased spouse's property.

Note that an estate tax return must be filed for the first deceased spouse's estate to facilitate the portability election.[10] During 2014 IRS has provided relief in some situations where an estate tax return has not been timely filed.[11]

An alternative in this situation is divorce. See Treas. Reg. § 20.2010-3T(a)(3)which specifies that divorcing a new spouse before that new spouse dies will preserve the surviving spouse's ability to use the DSUE amount from the last prior deceased spouse.

[10] An important concern for some may be the cost associated with the filing of an estate tax return when no estate tax is due but the portability election is to be made. To take advantage of the portability election the estate must timely file an estate tax return. The election is made by filing a "complete and properly-prepared" Form 706 Federal Estate Tax Return. See IRC § 2010(c)(5)(A) requiring the filing of an estate tax return. The IRS needs information to confirm that the marital deduction is properly to be allowed for property passing to the surviving spouse and that adequate information is provided to compute the DSUE amount. However, if the decedent dies with assets less that the basic exclusion amount the decedent's estate is not required to file an estate tax return. Therefore, in this situation the cost of preparing and filing the estate tax return is incurred for purposes of making the portability election. Consequently, the identification of the person controlling the making of this election can be important.

[11]Rev. Proc. 2014-18, 2014-7 IRB 513, provides a simplified method for certain taxpayers to obtain an extension of time (under Reg. § 301.9100-3) to make a "portability" election under IRC §2010(c)(5)(A), by which a decedent's unused exclusion amount (deceased spousal unused

C. Net-Net Gifts

In a "net gift" context the amount of the liability for gift tax on a gift transfer will reduce the amount of the gift if the agreement of the donee to pay the gift tax on that transfer is clearly fixed. The gift tax liability for gifts is on the donor under IRC § 2502(c). However, the donee can agree between these parties to assume that responsibility. Of course, that agreement does not eradicate the responsibility for the donor to pay the tax to IRS.

That agreement may be extended to cover any estate tax liability that may be due as a result of the possible gross up of the decedent's estate under IRC § 2035(b). The issue then is whether this amount can also be treated as consideration paid for purposes of determining the net gift for gift tax purposes. See Steinberg v. Commissioner, 141 T.C. ___, No. 8 (2013) denying the IRS Motion for a Summary Judgment on this question, i.e., to deny this treatment. The Tax Court will determine factually whether the value of a gift can be reduced under these circumstances both by (1) the gift tax owed because of the gift transfer, and (2) the actuarial value of the donees' assumption of the potential IRC § 2035(b) estate tax "by calculating petitioner's annual mortality rate for the three years after the gift (i.e., the probability that petitioner would pass away within one year, two years, or three years of the gift." The Tax Court effectively rejected the argument by IRS that the value of the assumption of the potential estate tax liability was automatically worthless. The Tax

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exclusion amount, or DSUE amount) becomes available to apply to the surviving spouse's subsequent transfers during life or at death. No user fee is required for submissions filed under this revenue procedure. This treatment is available if the taxpayer is the executor (see Reg. §20.2010-2T(a)(6)) of the estate of a decedent who: (a) has a surviving spouse; (b) died after December 31, 2010, and on or before December 31, 2013; and (c) was a citizen or resident of the United States on the date of death. This applies if the taxpayer (1) was not required to file an estate tax return under IRC §6018 (a) (as determined based on the value of the gross estate and adjusted taxable gifts, without regard to Reg. §20.2010-2T(a)(1)), and (2) the taxpayer did not file an estate tax return within the time prescribed by Reg. §20.2010-2T(a)(1) for filing an estate tax return required to elect portability. A proper return for these taxpayers must be filed prior to December 31, 2014. This Revenue Procedure makes reference to Rev. Proc. 2013-17 (concerning the Windsor case and same-sex marriages, discussed below), contemplating that this delayed estate tax return relief will be available in these situations.

Court determined that the promise to pay the potential estate tax liability could possibly amount to consideration paid in money or money's worth, and that determination must be factually made. This decision is consistent with the Fifth Circuit's decision in Succession of McCord v. Commissioner, 461 F.3d 614 (5th Cir. 2006).

D. Life Insurance

1. Beneficiary Designations

In Hillman v. Maretta, ____ US ____, 133 S. Ct. 1943 (2013), the insured named his wife as the beneficiary of a life insurance policy covered by the Federal Employees' Group Life Insurance Act of 1954 (governed by Federal law). The insured later divorced the beneficiary and remarried but he neglected to change the beneficiary of the policy. After his death, both his current wife and his former wife claimed the proceeds. His current wife claimed that the divorce acted to revoke the insured's designation of his ex-wife as a beneficiary, as required under applicable Virginia law. However, the former wife asserted that local law was preempted by federal law and, therefore, her designation as the beneficiary remained effective. In addition, the former wife also claimed that the Virginia statute holding her liable for the proceeds even if preemption occurred was likewise preempted. The Supreme Court of the United States agreed that the Virginia statute was pre-empted and that the ex-wife was entitled to the proceeds of the life insurance policy.

Consequently, policies governed by federal law will not get the benefit of state law which automatically voids a beneficiary designation in favor of an ex-spouse. Obviously, upon divorce (or even while the divorce is pending), life insurance beneficiary designations need to updated to reflect the insured's intent (even though a state statute might often provide relief in this situation. The Hillman v. Maretta decision is just the latest of several U.S. Supreme Court decisions confronting the issue of benefits contractually still payable to the former spouse.

2. IRC § 2042 and Gross Estate Inclusion

IRS Private Letter Ruling 201327010 reminds us of the risks of an insured acting as the trustee of a trust holding a life insurance policy on the life of the insured. Insured's spouse purchased life insurance on insured and at spouse's death named the family trust created under her testamentary documents as the beneficiary under the policy. The family trust designated the insured surviving spouse as the trustee of the family trust. The family trust was to be used for the insured surviving spouse and descendants. Insured surviving spouse inquired whether insurance proceeds would be includible in his estate at the time of his subsequent death. Previously, in Rev. Rul. 84-179, the IRS had ruled that a decedent did not hold "incidents of ownership" where the decedent's powers were held in a fiduciary capacity, were not exercisable for the decedent's personal benefit, where the decedent did not transfer the policy or any of the consideration for purchasing or maintaining the policy from personal assets and the devolution of the powers on the decedent was not part of a prearranged plan involving the participation of the decedent. The IRS distinguished this revenue ruling and concluded in the facts presented in this PLR request that the insured did hold incidents of ownership over the policy. However, IRS did recognize that the family trust could be divided into two trusts, one to hold the life insurance policies and the other to hold all the other trust assets. If the insured resigned from being trustee of the trust with the life insurance policies and then lives for three years from the date of that resignation, IRC § 2035 would not apply to include the proceeds of the life insurance policies in taxpayer's gross estate. This suggests that post-mortem planning in this type of situation is important to enable avoidance of gross estate inclusion - but the insured must survive for three years from the time that this post-mortem planning is implemented.

3. IRC § 2042 and Receipt of Policy Dividends

IRS has ruled that the right to receive insurance policy dividends (or apply them under any policy options) does not constitute an "incident of ownership" within the meaning of IRC § 2042(2). Rather, these dividends are treated as a return of excess premiums paid and not an economic return on the investment in the policy. Since the decedent-insured possessed no other rights over the policy the IRS concluded that the

proceeds were not includible in the decedent's gross estate under IRC § 2042(2). See ILM 201328030.

E. Exploiting the "GRAT" Opportunity

Much notoriety is occurring about the use of the "Grantor Retained Annuity Trust" or "GRAT" because it seems to be an important technique being exploited by very rich people. The GRAT is a technique by which an individual puts wealth into a trust and retains the lead interest for a specified limited period, e.g. two year or ten years. The gift transfer is only as to the value of the remainder which is ordinarily for beneficiaries such as children and grandchildren. That value is sought to be depressed for gift tax valuation purposes The objective is to assure that the return on the investments in the trust is greater than the mandatory payout to the trust grantor so that, at the end of the trust, much greater value will be in the hands of the remaindermen, but without any gift tax effect at that time. Further, assuming that the donor survives the term of the trust, the assets will be treated as having been completely previously transferred away to enable avoidance of any estate tax inclusion.

This technique is asserted (in a Daily Tax Report article) to have enabled avoidance of more than $100 billion of estate tax since the year 2000.[12] A variant in this planning context is the zeroed-out GRAT, made famous when used by Audrey Walton, the former wife of brother of WalMart Stores, Inc. founder Sam Walton. She created several $100 million "zeroed-out" GRATs. Although Treasury Regulations had banned the use of this technique the U.S. Tax Court determined that a "zeroed-out" GRAT was not prohibited under the authorizing legislation.

In the Daily Tax Report article these notations are made (with facts reported as being sourced from SEC filings):
1) Sheldon Adelson, owner of the Las Vegas Sands Corporation (and major contributor to the presidential political campaigns of Newt Gingrich and, then Mitt Romney), apparently created as least 25 GRATs, 14 of which were "zeroed'out."

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[12] See BNA Daily Tax Report, December 18, 2013, p. G-2.

These trusts transferred at least $7.9 billion to family members, an amount which could have incurred $2.8 billion in federal gift tax.
2) A Goldman Sachs filing disclosed that 84 of the firm's current and former partners used GRATs and that the CEO of Goldman Sachs has transferred more than $50 million to family members with little or no gift tax liability being incurred.
3) Ralph Lauren used a GRAT to transfer gift-tax free an amount of more that $300 million.
4) JP Morgan Chase has so many clients using GRATs that the bank has a special unit dedicated to processing GRAT documents. A JP Morgan private-wealth banker is quoted: "I have a client who's done 89 GRATs."
5) One technique used by former Aetna, Inc. CEO John W. Rowe to generate even more savings is to put corporate stock options into a GRAT.
6) Charles Dolan, whose family controls the New York Knicks basketball team and who is chairman of Cablevision Systems Corp, has swapped his shares out of his GRATs and replaced them with IOUs.
7) Quoting Professor Edward McCaffery of the University of Southern California Gould School of Law, this is one of the estate planning techniques which "make[s] the estate tax system essentially voluntary."

F. Some Interesting Federal Estate Tax Valuation Controversies

1. Estate Tax Valuation Controversies

The greatest source for revenue to IRS which is derived from estate tax audits is valuation controversies. This necessitates posturing (if possible) the client's assets to facilitate careful valuation analysis by IRS. These valuation controversies can occur with respect to numerous illiquid assets, including closely-held stock holdings, interests in family limited partnerships, real property, and art. Some examples of several high profile valuations controversies are also noted below.

2. Estate of Elkins v. Commissioner

In Estate of Elkins v. Commissioner, 140 T.C. ___, No.5 (2013), the U.S. Tax Court addressed in the estate tax context the value of artwork in which (1) the decedent held

a fractional interest, and (2) his children held the remaining fractional interests. The decedent's estate had already paid estate tax in excess of $102 million. The case focused on the appropriate manner in which to value fractional interests in 64 pieces of art which were subject to an agreement restricting their sale. IRS took the position that the art should be included in the gross estate of the parent based on a pro rata position of its value without any discount being applied. IRS asserted that a restriction on sale should be disregarded pursuant to IRC § 2703. IRS further argued that, since no market actually exists for fractional interests in works of art, no fractional interest discount can be available.

The Tax Court concluded that any restrictions on the right to use or sell the property contained in their agreements should be disregarded, and that they did not meet any exceptions under IRC §2703. However, applying a "hypothetical buyer and hypothetical seller" approach the court determined that a fractional interest discount was appropriate. That discount was determined to be 10 percent, but this was much less than the 44 percent discount suggested by the taxpayer.

3. Estate of Jean-Michel Basquiat

This tax valuation dispute involves the saga of valuing the art held by Jean-Michel Basquiat at his death when dying intestate, with his mother dying intestate thereafter when being entitled to a 50 percent stake in her son's estate, with the estranged husband then receiving a split of his wife's interest in the son's estate, and the father subsequently dying, with his one-half of the son's estate being distributed to two daughters, as well as his interest in the deceased wife's estate. The valuation case for the mother's estate (Estate of Mathilda Basquiat) is scheduled to be tried in the U.S. Tax Court in April 2014.

At the son's death (of a drug overdose at age 27 in 1988) he held 1,351 of his own paintings and drawings, as well as 36 works by other well-known artists, including Andy Warhol. IRS has determined that Jean-Michel's estate is currently worth $138 million, with his own artwork valued at $131 million. Before his death the father had asserted that the art collection was worth $127 million. The further claim is that a blockage discount of $58.4 million should be available, with the entire estate's value

being only $72 million.

Obviously the estate tax valuation complexities are immense, with the paintings going through three decedents' estates and the values of these paintings ever increasing. One of these paintings ("Dustheads," 1982) sold at Christie's in May 2013 for the amount of $48.84 million!

4. Estate of Michael Jackson

When Michael Jackson died in 2009 his executors valued his estate at $7.2 million, including his likeness being valued at $2,105, and his sizeable interest in the trust that owns his and The Beatles' music catalogue treated as being worth zero. Apparently in the current U.S. Tax Court proceeding involving the federal estate taxes for the Michael Jackson estate IRS has asserted that the value of his estate at the time of his death was $1.25 billion. The $1,178 billion difference equates to $505 million in estate taxes, with an additional $197 million in penalties (imposed at a 40 percent rate, as based on the gross valuation misstatement penalty). The Michael Jackson likeness is valued by IRS at $434,264 million (rather than the $2,105 as reported).

The legal ownership of a deceased celebrity's estate to name and likeness rights are governed by state law, not federal law. Under California law the rights of celebrities in their names, voices, signatures, photographs, and likenesses are protected for 70 years after death.[13] These property rights are licensable, and are transferrable under a last will (or in intestacy). Obviously, the name and likeness rights in this situation are being immensely exploited. Consequently, the resolution of the value of those rights for federal estate tax will be interesting to watch. This controversy also reminds one of the immense importance in some situations of appropriately defining

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[13] Apparently after Marilyn Monroe died she was determined to have been a New York resident, and not a California resident, which meant that her rights of publicity failed to survive her (since New York has no law protecting posthumous rights of publicity).

property interests under applicable state/local law.[14]

G. Planning for Same Sex Marriages

In United States v. Windsor, 133 S. Ct. 2675 (2013), the U.S. Supreme Court held Section 3 of the Defense of Marriage Act (DOMA) to be unconstitutional. This provision defines marriage for federal purposes (including, therefore, for federal tax purposes) as "only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife." This decision by the U.S. Supreme Court in the Windsor case has dramatically enabled expanded federal income tax and federal estate tax planning for same sex couples. Remember, of course, that notwithstanding Texas law precluding same sex marriages, this prohibition does not limit federal tax benefits available to same sex couples in Texas. For example, these same sex couples may have been ceremonially married in another jurisdiction which enables such marriages, and those "married" same-sex individuals may thereafter reside in Texas.[15]

This decision has immense ripple effects concerning many federal tax planning issues. IRS began to address some of these issues when issuing Rev. Rul. 2013-17, 2013-38 I.R.B. 11. This ruling specifies that if a couple enters into a valid marriage this couple will be treated as married for federal tax purposes without regard to the location of their residence (i.e., a "place of celebration" standard is to be applied). However, the term "marriage" does not include registered domestic partnerships, civil unions, or other similar formal relationships recognized under state law that are not denominated as a marriage under that state's laws. Some of the many impacts of this treatments are as follows:

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[14] See Commissioner of Internal Revenue v. Estate of Bosch; Second National Bank of New Haven, Executor v. United States, 387 U.S. 456 (1967), concerning how local law is to be identified.

[15] Note, e.g., the situation of the marriage of the Mayor of Houston, recently occurring in the State of California. In the Windsor case the decedent's Canadian same-sex marriage was recognized as valid by New York law.

● Availability of joint return filing for federal income tax purposes, producing both joint return benefits (i.e., a "marriage bonus" when income levels are significant different) and a possible "marriage penalty" (when income levels of the two individuals are essentially equivalent.
● Questions about whether federal income tax returns for prior years should be amended, or must be amended, when same-sex marriages were legalized several years ago.
● Availability of the marital deduction for federal estate tax purposes (the Windsor situation).
● Availability for federal gift tax purposes of gift splitting by "spouses," as permitted by IRC § 2513.
● Applicability of constructive ownership rules of IRC § 318 in the corporate tax context (e.g., determining whether a corporate stock redemption occurring in the estate planning context is a dividend distribution and not a sale or exchange transaction).
● Applicability of the constructive ownership rules of IRC § 267 in determining, e.g., whether parties are related for purposes of recognizing (or postponing) tax losses when transactions occur between those parties.
● Nonrecognition of gain for inter-spousal transfers (under IRC § 1041).
● More rigorous treatment of the grantor trust rules when a "spouse" has certain powers. See IRC § 671-677.
● Different contribution rules for estate tax purposes for jointly owned property. See IRC § 2040(b).
● Availability of the total income tax basis adjustment for community property at the death of the first same-sex couple to die. See IRC § 1014(b)(6). Consider the impact of this provision for same-sex married couples in California.

Outside the federal tax context (but relevant to personal wealth planning considerations) a variety of other policy changes have been implemented, e.g.:

● The Department of Health and Human Services (HHS) ruled (on August 29, 2013) that legally married same-sex couples, regardless of where they live, are eligible for Medicare benefits that are available to married heterosexual couples.
● The Department of Labor provided guidance (on September 18, 2013) which

affords legally married same-sex couples the right to participate in employee benefit plans even if they do not live in states that recognize their marriage.

III. Trusts/Estates and Federal Income Tax Developments

A. Grantor Trusts as Disregarded Entities

In CCA 201343021 the IRS reminded us that grantor trusts are disregarded as entities separate from their owners for all federal income tax purposes, including for IRC § 267 regarding transactions between related taxpayers and IRC § 707(b)(1)(A) regarding partner-partnership transactions. If, however, interests of an owner are varied in this type of transaction these conduit rules may not be applicable.

B. Applicability of the Medicare Tax

The 3.8 percent Medicare surtax is imposed under IRC § 1411(a)(2) on the undistributed investment income of a trust or estate. Prop. Reg. § 1.1411-3 specifies that the starting point for the calculation of this tax is the entity's adjusted gross income, as determined under IRC § 67(e). Income that is not treated as distributed by the trust or estate to the beneficiaries is subject to the 3.8 percent tax. Investment income realized by the trust and distributed is carried out to the beneficiaries under the normal character pass-through rules.[16] The 3.8 percent tax applies to the undistributed net investment income of trusts in excess of the income level at which the highest trust rate applies ($12,150 for the year 2014).[17]

Grantor trusts are exempt from this 3.8 percent tax since the normal grantor trust rules

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[16] This suggests possible use of the 65 day rule which permits making a distribution decision after the tax year when financial information for the prior year has become finally available. See IRC § 663(b).

[17] In contrast, this 3.8 percent Medicare tax for individuals only applies above a threshold amount of $200,000 for individuals and $250,000 for couples, the amount subject to this tax being limited to the lesser of the modified gross income in excess of this threshold or the individual's net investment income for the year.

apply to this income. Therefore, in this situation the investment income realized by the trust will be treated as owned by the grantor.

IV. Local Trust & Estate Law Developments

A. The 2014 Texas Estates Code

1. The Estates Code Becomes Effective

Commencing on January 1, 2014 the Texas Estates Code has finally become effective, replacing the Texas Probate Code (which was not really a "Code").[18] The objective of the Estates Code (which has been in transition for several years) is stated to be a reorganization and codification of the old Probate Code. The stated objective is that this is merely to coherently state in an organized form the various probate code and related provisions. However, as noted at locations below, in some instances substantive or mechanical changes have occurred.

For a considerable period many documents will no doubt continue to be drafted with references to the Texas Probate Code, although now legally it has disappeared. But, good practice obviously suggests preparing documents in 2014 that refer to the Texas Estates Code, and not to the Texas Probate Code!

2. Changes to the Durable Power of Attorney Form

Notwithstanding various statements that the Texas Estates Code is merely a codification of existing law numerous small changes can be identified. Consider, for example, the changes to the form for implementing a Durable Power of Attorney. See Texas Estates Code § 752.051 (derived from the prior Texas Probate Code § 490(a)) which provides the form of Statutory Durable Power of Attorney. Previously to withhold a power the person granting the power need to cross out each power withheld. The revised form includes a list of powers which the principal may grant

[18] See Pargaman, "The Story of the Texas Estate Code," REPTL Reporter (Real Property, Probate and Trust Law Section, State Bar of Texas), Vol. 52, No. 2, Feb. 14, 2014.

by initialing a line in front of the specific power being granted. Alternatively, the principal may grant all the powers by initialing a particular designated line.

B. "Decanting" Possibilities

1. Authorization to "Decant" a Trust

In its 2013 session the Texas Legislature enacted a trust "decanting" bill, effective September 1, 2013, which specifies (in Texas Trusts Code § 112.072):

"(a) An authorized trustee who has the full discretion to distribute the principal of a trust may distribute all or part of the principal of that trust in favor of a trustee of a second trust for the benefit of one or more current beneficiaries of the first trust who are eligible to receive income or principal from the trust and for the benefit of one or more successor or presumptive remainder beneficiaries of the first trust who are eligible to receive income or principal from the trust.
"(b) The authorized trustee may, in connection with the exercise of a power of distribution under this section, grant a power of appointment, including a currently exercisable power of appointment, in the second trust to one or more of the current beneficiaries of the first trust who, at the time the power of appointment is granted, is eligible to receive the principal outright under the terms of the first trust.
"(c) If the authorized trustee grants a power of appointment to a beneficiary under Subsection (b), the class of permissible appointees in whose favor the beneficiary may appoint under that power may be broader or different than the current, successor, and presumptive remainder beneficiaries of the first trust.
"(d) If the beneficiaries of the first trust are described as a class of persons, the beneficiaries of the second trust may include one or more persons who become members of that class after the distribution to the second trust.
"(e) The authorized trustee shall exercise a power to distribute under this section in good faith, in accordance with the terms and purposes of the trust, and in the interests of the beneficiaries."

See, generally, Acts 2013, 83rd Leg. - Regular Session, ch. 699 , Sec. 3 , eff. 9/1/2013 (enacting Texas Trust Code §§ 112.071-112.087). What is the objective of this

provision?

These new statutory "decanting" provisions are to supplement any similar provisions in a trust unless the trust settlor expressly prohibits decanting. A standard "spendthrift clause" can not be treated as sufficient to prohibit the decanting of a trust.

2. Scope of the Trust "Decanting" Power

The following guidelines might be noted in describing the scope of this power:

1) A trustee with "full discretion" (i.e., a power that is not limited in any manner) may distribute principal to another trust for the benefit of one or more of the current beneficiaries of the first trust.
2) A trustee having only "limited discretion" may distribute principal to another trust, but the current, successor, and remainder beneficiaries, and the distribution standards, must be the same.
3) In implementing one of these changes the trustee must act "in good faith, in accordance with the terms and purpose of the trust, and in the interests of the beneficiaries."
4) A trustee may not exercise a decanting power if it would (a) reduce a beneficiary's current right to a mandatory distribution or to withdraw a portion of the trust; (b) materially impair the rights of any beneficiaries, (c) materially lessen a trustee's fiduciary duty; (d) decease the trustee's liability or indemnify or exonerate a trustee for failure to exercise reasonable care, diligence, and prudence; (e) eliminate another person's power to remove or replace the trustee; or (f) modify the perpetuities period (unless the first trust expressly permits this modification).
5) A trustee may not exercise a decanting power without court approval solely to change the trustee compensation provisions, but those provisions may be modified without court approval if made in conjunction with other valid reasons for decanting and the change raises the trustee's compensation to reasonable limits in accord with Texas law.
6) No "duty to decant" is created.
7) A trustee may ask a court to order the distribution. If a beneficiary timely objects to a proposed decanting transaction, either the trustee or the beneficiary may petition

the court to approve, modify or deny the power.

As specified in Texas Trust Code §§ 112.085, an authorized trustee may not exercise a power to distribute the principal of a trust (under Trust Code §§ 112.072 or 112.073) to:

1) reduce, limit, or modify a beneficiary's current, vested right to: (a) receive a mandatory distribution of income or principal; (b) receive a mandatory annuity or unitrust interest; (c) withdraw a percentage of the value of the trust; or (d) withdraw a specified dollar amount from the trust;
2) materially impair the rights of any beneficiary of the trust;
3) materially limit a trustee's fiduciary duty under the trust;
4) decrease or indemnify against a trustee's liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence, and prudence;
5) eliminate a provision granting another person the right to remove or replace the authorized trustee exercising the distribution power under §§ 112.072 or 112.073; or
6) reduce, limit, or modify in the second trust a perpetuities provision included in the first trust, unless expressly permitted by the terms of the first trust.

3. Impact of Certain Tax-Relevant Powers

Under Texas Trust Code §§ 112.086 (entitled "Tax-Related Limitations") does provide certain limitations when federal tax considerations may be relevant:

(a) The authorized trustee may not distribute the principal of a trust (under Section 112.072 or 112.073) in a manner that would prevent a contribution to that trust from qualifying for or that would reduce the exclusion, deduction, or other federal tax benefit that was originally claimed for that contribution, including:
1) the annual exclusion under IRC § 2503(b);
2) a marital deduction under IRC §§ 2056(a) or 2523(a);
3) the charitable deduction under IRC §§ 170(a), 642(c), 2055(a), or 2522(a)
4) direct skip treatment under IRC § 2642(c); or
5) any other tax benefit for income, gift, estate, or generation-skipping transfer tax purposes under the Internal Revenue Code of 1986.
(b) Notwithstanding Subsection (a), an authorized trustee may distribute the principal

of a first trust to a second trust regardless of whether the settlor is treated as the owner of either or both trusts under IRC §§ 671-679.
(c) If S corporation stock is held in trust, an authorized trustee may not distribute all or part of that stock under Section 112.072 or 112.073 to a second trust that is not a permitted shareholder under IRC §§1361(c)(2).
(d) If an interest in property that is subject to the minimum distribution rules of IRC § 401(a)(9) is held in trust, an authorized trustee may not distribute the trust's interest in the property to a second trust under Section 112.072 or 112.073 if the distribution would shorten the minimum distribution period applicable to the property.

4. Federal Gift Tax Implications

The question must be examined concerning whether a decanting of assets from one irrevocable trust to another can constitute a taxable gift by a beneficiary, particularly if that beneficiary's interest in the trust is being reduced or eliminated. Ordinarily in a decanting an act of property transfer occurs, as implemented by the trustee. The trustee is implementing the transfer, as permitted under state law. But, state law may mandate that the beneficiary whose rights and trust benefits are being reduced may be required to agree to this transaction. If so, does this constitute a gift for federal gift tax purposes by the acquiescing beneficiary?

5. Federal Income Tax Implications

If the entire assets of one trust are moved to another trust through a decanting process it would seem that this should be a "nonevent" for federal income tax purposes. If, however, the decanting process produces distributions to several new trusts, or the decanting trust retains certain assets, these transactions might be treated as trust distributions within the meaning of IRC § 641. If appreciated property is distributed by the decanting trust a further question might arise concerning whether these distributions produce gain recognition events. Ordinarily, this latter event should be encompassed within Rev. Rul. 85-13 which disregards transactions between two grantor trusts that are deemed to have the same grantor as being gain recognition events.

C. An Interesting Texas Law Court Decision

1. Arbitration of a Trust Dispute Can Be Required

The Texas Supreme Court has determined that an arbitration clause in an intervivos trust agreement must be recognized for dispute resolution purposes. A beneficiary sued the successor trustee, who was the attorney who prepared the trust agreement. The beneficiary had asserted that the trustee had misappropriated trust assets and refused to provide an accounting. The Texas Supreme Court held that the arbitration clause was binding for several reasons: (1) to enforce the intent of the settlor, and (2) the Texas Arbitration Act applied because the trust agreement effectively constituted a written agreement to arbitrate. The beneficiary's acceptance of trust benefits and the suit to enforce the trust constituted assent by the beneficiary to arbitrate. Rachal v. Reitz, 403 S.W.3d 840 (Tex. 2013).[19]

D. Other Interesting Trust/Estate Inquiries

1. The Will Execution Ceremony

The proper protocol of the will execution process should not be overlooked. This is the time when the client needs to be impressed that the asset transfer process at death is a serious matter and the will signing should ordinarily not merely be handed over to the legal assistant to properly complete in the attorney's absence. Although from a foreign jurisdiction, a January 2013 decision from the Supreme Court in England provides a vignette of how not to conclude the representation of clients in the will

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[19] See Delaney, Byer & Schwartz, "Rachal v. Reitz and the Evolution of the Enforceability of Arbitration Clauses in Estate Planning Documents," Probate & Property, Vol. 27, No. 6 (November/December 2013). The authors indicate that this court decision is the latest step in the evolving national acceptance and enforcement of arbitration clauses in estate planning documents. This article discusses the reasoning in Rachal and explores the potential effect of the decision on the national debate about arbitration in estate planning matters. This article seeks to provide some practical drafting approached for crafting arbitration clauses in trusts and wills so as to maximize the prospect of their enforceability.

preparation process.[20] The story is as follows: In 1989 Mr. and Mrs. Rawlings instructed a solicitor to prepare mirror wills. Each spouse left his or her estate to the other and upon the death of the surviving spouse to their informally adopted son, Mr. Marley. Their two biological sons were disinherited. Due to an oversight by the solicitor, Mr. and Mrs. Rawlings each signed the will means for the other. Mrs. Rawlings died in 2003 but the error in signing the wills was only noticed after Mr. Rawlings had died in 2006. Mr. and Mrs. Rawlings' sons challenged Mr. Rawling's will on the basis that it was invalid as it was not signed by him. If the will was invalid Mr. Rawlings would have died intestate and the two sons would inherit the estate. If the will was valid Mr. Marley would inherit the estate.

Mr. Marley commenced probate proceedings. The solicitor who drafted the wills admitted that he had accidentally given the wrong will to each spouse to sign. In the trial court the claim for probating was dismissed on the grounds that the will did not satisfy the wills act since not signed by the testator.[21] Further, the court determined that it was unable to rectify the will as the mistake was not a clerical error.[22] The Court of Appeal upheld the decision on the basis that the requirement of the Wills Act had not been satisfied.

The Supreme Court of England allowed the appeal by Mr. Marley and held that the will should be rectified so that it contained the typed parts of the will signed by Mrs. Rawlings. The Court considered the approach in commercial contracts, where the court is concerned about identifying the intention of the contracting parties, and considered that the approach to wills should be the same. Further, the Court considered that extrinsic evidence should be used to assist with the interpretation of the will. Therefore, the will should be interpreted in the same way as any other document, including reference to the testator's intentions. The Court referred to circumstances where a solicitor inserts the wrong word, figure or name into a clause

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[20] Marley (Appellant) v. Rawlings and another (Respondents), 1024 UKSC 2, Hilary Term, Supreme Court of England (January 22, 2014).

[21] Section 9 of the Wills Act 1837.

[22] Section 20 of the Administration of Justice Act 1982.

in a will. The Court considered that the outcome should be no different where the mistake is the insertion of a wrong clause, provided that the testator's intentions were clear. The Court held that while the expression "clerical error" can have a narrow meaning it could carry a wider meaning to include a mistake arising from office work such as preparing, filing, sending and organizing the execution of a document. A mistake in connection with these activities could be "a clerical error" and, therefore, the will could be rectified.

In England this certainly broadens the scope of those situations where significant mistakes in the will preparation and execution process might be remedied. Here the Supreme Court of England adopted a commercial and common sense approach, emphasizing the importance of the testator's intentions. The concept of "clerical mistake" is obviously significantly broadened. Query as to whether this type of approach towards will interpretation will be imported to the United States.

2. Reciprocal Last Wills in Texas

This saga of the Rawlings will does remind us that Texas law specifies that the contemporaneous signing by a husband and wife of reciprocal wills by itself does not constitute sufficient evidence of the existence of a contract.[23] The Rawlings situation was really not a situation of reciprocal wills but merely at attempt to find the actual last will. In the joint will context we are reminded to ordinarily include in the documents that the contemporaneous nature of the wills does not represent a contractual arrangement.

3. Risks of Intestacy of a Decedent's Estate

Of course, this also reminds us that many individuals do die without an effective last will, whether having no document or where the document was actually invalid (and the intestacy rules then became applicable). Some individuals believe they have limited assets and that the laws of intestacy are sufficient under these circumstances to accomplish the distribution of one's assets. But, post-death facts may demonstrate

[23] Texas Estates Code, § 255.004(b).

that the estate valuation situation was dramatically different.[24] In these circumstances the simple will may be better than none!

2. A Decedent's Digital Property

When an individual dies (or becomes incapacitated) the representative (executor or guardian) can encounter significant challenges when dealing with that person's smartphones, computers, electronically stored information, online account, internet domain names, and other digital property. The first challenge will be identifying the property and seeking to determine whether it is valuable or otherwise significant. Numerous obstacles must often be confronted in this context:
1) identifying passwords,
2) encryption,
3) dealing with federal and state (criminal?) laws which penalize unauthorized access to computers and data (including the Computer Fraud and Abuse Act), and
4) federal and state privacy laws (including the "Stored Communications Act").

Some states (but not Texas) have enacted laws to help fiduciaries deal with fiduciary access to online accounts. The Uniform Law Commission has appointed a "Drafting Committee on Fiduciary Access to Digital Assets" to prepare a model act concerning this subject.

A significant possibility exists that some of this property could have significant value for federal estate tax and federal income tax purposes. Consequently, the estate planning advisor must in this context consider both (1) the conveyancing and (2) the tax elements.

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[24] Consider that Martin Luther King, Jr., died long ago (1969) without a will. His children have been fighting over the reputational rights and similar items for decades. Supposedly their disputes had been resolved in a settlement, but during February 2014 two sons sued their sister for the possession of Martin Luther King, Jr.'s "traveling bible" and his Nobel Prize medal, presumably to be sold for the benefit of the children.

V. The Federal Estate Tax and Future Legislation?

A. Obama Administration's Fiscal Year 2014 Budget Proposals

1. The Fiscal Year 2014 Treasury Department Greenbook

During April 2013 the Obama Administration's Treasury Department issued its "Greenbook" including the Administration's tax proposals for the U.S. Government's fiscal year to end September 30, 2014.[25] Similar proposals can be anticipated in the near future to be included in a 2014 "Greenbook" for the fiscal year to commence October 1, 2014 and to end September 30, 2015. The proposals concerning estate tax, gift tax, generation skipping transfer tax and related income tax considerations are described below.

2. Restoring the 2009 Estate, Gift and GSTT Rates

The Greenbook states that "ATRA retained a substantial portion of the tax cut provided to the most affluent taxpayers under TRUIRJCA that we cannot afford to continue. We need an estate tax law that is fair and raises an appropriate amount of revenue." Accordingly, beginning in 2018, the proposal would make permanent the estate, GST, and gift tax parameters as they applied during 2009. The top tax rate would be 45 percent and the exclusion amount would be $3.5 million for estate and GST taxes, and $1 million for gift taxes. There would be no indexing for inflation. The proposal would confirm that, in computing gift and estate tax liabilities, no estate or gift tax would be incurred by reason of decreases in the applicable exclusion amount with respect to a prior gift that was excluded from tax at the time of the transfer. Finally, portability of unused estate and gift tax exclusions between spouses

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[25] See Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals*, April 2013; Joint Committee on Taxation, *Description of Certain Revenue Provisions Contained in the President's Fiscal Year 2014 Budget Proposal* (JCS-4-13), December 2013. Because many of the provisions in the 2014 budget proposal are substantially similar or identical to the fiscal year 2013 budget proposal, the Joint Committee Staff has described only those provisions that did not appear in the fiscal year 2013 budget proposal or that are substantially modified.

would be continued.

3. Requiring Consistency in Valuations for Transfer and Income Tax Purposes

The Greenbook specifies that "[t]axpayers should be required to take consistent positions in dealing with the Internal Revenue Service. The basis of property acquired from a decedent generally is the fair market value of the property on the decedent's date of death. Consistency requires that the same value be used by the recipient (unless that value is in excess of the accurate value). In the case of property transferred on death or by gift during life, often the executor of the estate or the donor, respectively, will be in the best position to ensure that the recipient receives the information that will be necessary to accurately determine the recipient's basis in the transferred property."

The proposal would impose both a consistency and a reporting requirement. The basis of property received by reason of death under IRC § 1014 would be required to equal the value of that property for estate tax purposes.[26] The basis of property received by gift during the life of the donor must equal the donor's basis determined under IRC § 1015. The basis of property acquired from a decedent to whose estate IRC §1022 was applicable would be the basis of that property, including any additional basis allocated by the executor, as reported on the IRS Form 8939 that the executor filed. The proposal would require that the basis of the property in the hands of the recipient be no greater than the value of that property as determined for estate or gift tax purposes (subject to subsequent adjustments). A reporting requirement would be imposed on the executor of the decedent's estate and on the donor of a lifetime gift to provide the necessary valuation and basis information to both the recipient and the Internal Revenue Service. A grant of regulatory authority would be included to provide details about the implementation and administration of these requirements, including rules for situations in which no estate tax return is required to be filed or

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[26] Presumably this would be after any estate tax audit adjustments. When different beneficiaries receive different assets any compromise adjustments in the audit context could favor some beneficiaries to the detriment of other beneficiaries.

gifts are excluded from gift tax under Section 2503, for situations in which the surviving joint tenant or other recipient may have better information than the executor, and for the timing of the required reporting in the event of adjustments to the reported value subsequent to the filing of an estate or gift tax return. The proposal would be effective for transfers on or after the date of enactment.

4. Required Minimum Term for GRATs

The Greenbook notes that "GRATs have proven to be a popular and efficient technique for transferring wealth while minimizing the gift tax cost of transfers, providing that the grantor survives the GRAT term and the trust assets do not depreciate in value. The greater the appreciation, the greater the transfer tax benefit achieved. Taxpayers have become adept at maximizing the benefit of this technique, often by minimizing the term of the GRAT (thus reducing the risk of the grantor's death during the term), in many cases to two years, and by retaining annuity interests significant enough to reduce the gift tax value of the remainder interest to zero or to a number small enough to generate only a minimal gift tax liability."

The proposal specifies that it would require, in effect, some downside risk in the use of this technique by imposing the requirement that a GRAT have a minimum term of ten years and a maximum term of the life expectancy of the annuitant plus ten years. The proposal also would include a requirement that the remainder interest have a value greater than zero at the time the interest is created and would prohibit any decrease in the annuity during the GRAT term. Although a minimum term would not prevent "zeroing-out" the gift tax value of the remainder interest, it would increase the risk that the grantor fails to outlive the GRAT term and the resulting loss of any anticipated transfer tax benefit. The proposal would apply to trusts created after the date of enactment.

5. Limit Duration of GSTT Exemption

The Greenbook proposal notes that "[a]t the time of the enactment of the GST provisions, the law of most (all but about three) states included the common law Rule Against Perpetuities (RAP) or some statutory version of it. The RAP generally

requires that every trust terminate no later than 21 years after the death of a person who was alive (a life in being) at the time of the creation of the trust. Many states now either have repealed or limited the application of their RAP statutes, with the effect that trusts created subject to the law of those jurisdictions may continue in perpetuity." The proposal observes that a trust may be sitused anywhere. A grantor is not limited to the jurisdiction of the grantor's domicile for this purpose. As a result, the transfer tax shield provided by the GST exemption effectively has been expanded from trusts funded with $1 million (the exemption at the time of enactment of the GST tax) and a maximum duration limited by the RAP, to trusts funded with $5 plus million and continuing (and growing) in perpetuity.

Under the proposal, on the 90th anniversary of the creation of a trust, the GST exclusion allocated to the trust would terminate. Specifically, this would be achieved by increasing the inclusion ratio of the trust (as defined in Section 2642) to one, thereby rendering no part of the trust exempt from GST tax. Because contributions to a trust from different grantors are deemed to be held in separate trusts under Section 2654(b), each such separate trust would be subject to the same 90-year rule, measured from the date of the first contribution by the grantor of that separate trust. The special rule for pour-over trusts under Section 2653(b)(2) would continue to apply to pour-over trusts and to trusts created under a decanting authority, and for purposes of this rule, such trusts will be deemed to have the same date of creation as the initial trust, with one exception, as follows. If, prior to the 90th anniversary of the trust, trust property is distributed to a trust for a beneficiary of the initial trust, and the distributee trust is as described in Section 2642(c)(2), the inclusion ratio of the distributee trust will not be changed to one (with regard to the distribution from the initial trust) by reason of this rule. This exception is intended to permit an incapacitated beneficiary's share to continue to be held in trust without incurring GST tax on distributions to that beneficiary as long as that trust is to be used for the sole benefit of that beneficiary and any trust balance remaining on that beneficiary's death will be included in that beneficiary's gross estate for Federal estate tax purposes. The other rules of Section 2653 also would continue to apply, and would be relevant in determining when a taxable distribution or taxable termination occurs after the 90th anniversary of the trust. An express grant of regulatory authority would be included to facilitate the implementation and administration of this provision. The proposal

would apply to trusts created after enactment, and to the portion of a pre-existing trust attributable to additions to such a trust made after that date (subject to rules substantially similar to the grandfather rules currently in effect for additions to trusts created prior to the effective date of the GST tax).

6. Coordinate Income and Transfer Tax Rules for Grantor Trusts

This proposal observes that under current law a grantor trust is a trust, whether revocable or irrevocable, of which an individual is treated as the owner for income tax purposes. For income tax purposes, a grantor trust is taxed as if the grantor or another person owns the trust assets directly, and the deemed owner and the trust are treated as the same person. Thus, transactions between the trust and the deemed owner are ignored. For transfer tax purposes, however, the trust and the deemed owner are separate persons, and under certain circumstances, the trust is not included in the deemed owner's gross estate for estate tax purposes at the death of the deemed owner. The Greenbook notes that the lack of coordination between the income and transfer tax rules applicable to a grantor trust creates opportunities to structure transactions between the deemed owner and the trust that can result in the transfer of significant wealth by the deemed owner without transfer tax consequences.

This proposal specifies that, if a person who is a deemed owner under the grantor trust rules of all or a portion of a trust engages in a transaction with that trust that constitutes a sale, exchange, or comparable transaction that is disregarded for income tax purposes by reason of the person's treatment as a deemed owner of the trust, then the portion of the trust attributable to the property received by the trust in that transaction (including all retained income therefrom, appreciation thereon, and reinvestments thereof, net of the amount of the consideration received by the person in that transaction) (1) will be subject to estate tax as part of the gross estate of the deemed owner, (2) will be subject to gift tax at any time during the deemed owner's life when his or her treatment as a deemed owner of the trust is terminated, and (3) will be treated as a gift by the deemed owner to the extent any distribution is made to another person (except in discharge of the deemed owner's obligation to the distributee) during the life of the deemed owner. The proposal would reduce the amount subject to transfer tax by any portion of that amount that was treated as a prior

taxable gift by the deemed owner. The transfer tax imposed by this proposal would be payable from the trust.

The proposal would not change the treatment of any trust that is already includable in the grantor's gross estate under existing provisions of the Internal Revenue Code, including without limitation the following: grantor retained income trusts; grantor retained annuity trusts; personal residence trusts; and qualified personal residence trusts. Similarly, it would not apply to any trust having the exclusive purpose of paying deferred compensation under a nonqualified deferred compensation plan if the assets of such trust are available to satisfy claims of general creditors of the grantor. It also would not apply to any trust that is a grantor trust solely by reason of Section 677(a)(3). The proposal would be effective with regard to trusts that engage in a described transaction on or after the date of enactment. Regulatory authority would be granted, including the ability to create exceptions to this provision.

This proposal has been narrowed from an earlier year proposal so that the current proposal only applies to sales to grantor trusts. These rules would also apply to Section 678 trusts if the deemed owner sells assets to the trust. The transfer taxes would be payable from the trust.

7. Lien for Estate Tax Deferrals

This proposal notes that Section 6166 allows the deferral of estate tax on certain closely held business interests for up to fourteen years from the (unextended) due date of the estate tax payment (up to fifteen years and three months from date of death). This provision was enacted to reduce the possibility that the payment of the estate tax liability could force the sale or failure of the business. Section 6324(a)(1) imposes a lien on estate assets generally for the ten-year period immediately following the decedent's death to secure the full payment of the estate tax. Thus, the estate tax lien under Section 6324(a)(1) expires approximately five years before the due date of the final payment of the deferred estate tax under Section 6166. The Greenbook states that in many cases, the Internal Revenue Service (IRS) has had difficulty collecting the deferred estate tax, often because of business failures during that tax deferral period. The IRS sometimes requires either an additional lien or some form of security,

but these security interests generally are prohibitively expensive and damaging to the day-to-day conduct and financing of the business. In addition, unless these other security measures are put in place toward the beginning of the deferral period, there is a risk that other creditors could have a higher priority interest than the Government. This proposal is expected to substantially eliminate the need for IRS to determine whether and when additional security is needed, and the significant burdens on the closely held business from having to provide such additional security.

This proposal is to extend the estate tax lien under Section 6324(a)(1) throughout the Section 6166 deferral period. The proposal would be effective for the estates of all decedents dying on or after the date of enactment, as well as for all estates of decedents dying before the date of enactment as to which the Section 6324(a)(1) lien has not then expired.

8. GSTT Treatment of HEETS

This proposal states that some taxpayers have interpreted the language of Section 2611(b)(1) as permitting the avoidance of GST tax through the use of a trust known as a HEET. A HEET provides for the medical expenses and tuition of multiple generations of descendants. Taxpayers using this technique take the position that Section 2611(b)(1) exempts these trust distributions from GST tax (generally, in perpetuity) because the distributions are used for the payment of medical care expenses and tuition. The substantial amounts contributed to HEETs will appreciate in these trusts, and taxpayers claim that no estate, gift, or GST tax will ever be incurred after the initial funding of these trusts. The Greenbook states that the intent of Section 2611(b)(1) is to exempt from GST tax only those payments that are not subject to gift tax, that is, payments made by a living donor directly to the provider of medical care for another person or directly to a school for another person's tuition.

The proposal would clarify that the exclusion from the definition of a GST under Section 2611(b)(1) applies only to a payment by a donor directly to the provider of medical care or to the school in payment of tuition and not to trust distributions, even if for those same purposes. The proposal would apply to trusts created after the introduction of the bill proposing this change, and to transfers after that date made to

pre-existing trusts.

B. The Republican Efforts to Repeal the Estate Tax

Some Republicans continue to insist that the federal transfer taxes should be totally repealed. Some argue that the total collections from the estate, gift and generation skipping taxes have become so small that the tax is merely a nuisance. The response to this position will be dependent, of course, on forthcoming federal elections. But, at present, both for the Republican proposal and the Obama proposal little appetite seems to exist on Capitol Hill to address this fundamental question.

IX. Concluding Notes

The framework of "estate planning" has radically changed after the 2012 (or 2013?) tax legislation which made "permanent" an exclusion for $5 million (as indexed), or $10 million (plus) per couple. Many clients will not be in the situation of having taxable estates. However, they will want to plan to reduce potential income tax risks. Further, they will want to achieve even more fundamental estate planning objectives: to transfer their assets to their intended beneficiaries with limited administrative encumbrances, to have their beneficiaries enjoy that property in the future free of the claims of creditors (including, possibly) ex-spouses, and, to manage that property responsibly for the future.