Estate Planning Briefs

Year-End 2022 /Jan 2023

SECURE 2.0

The massive budget bill that passed the Senate just before Christmas may have been a disappointment to those who expected it to be a vehicle for more tax legislation. No tax title was included. The bill did include "Division T—SECURE 2.0 Act of 2022," which enjoyed bipartisan support for its extensive tinkering with the rules for retirement plans. Headline items include:

- Pushing the age for Required Minimum Distributions to 73 in 2023, and 75 in 2033;
- Automatic enrollment in 401(k) plans;
- Emergency savings plans allowed within 401(k) plans;
- Permitting limited rollover of unused 529 plan money into a Roth IRA;
- Allowing employers to make matching 401(k) contributions based upon a plan participant's repayment of student loans;
- Some penalty-free retirement plan withdrawals for the terminally ill or victims of domestic abuse.

The new law will take some time to digest.

—H. R. 2617, Consolidated Appropriations Act, 2023

COMMENT: The Appropriations Committee's press release on the bill may be found at https://www.appropriations.senate.gov/news/majority/chairman-patrick-leahy-d-vt-releases-fiscal-year-2023-omnibus-appropriations-bill. The press release includes links to explanatory statements and summaries of the twelve major sections of the bill.

Priority Guidance

The IRS Priority Guidance Plan for 2023 was released on November 4. It identified 205 guidance projects, including 11 in the estate and gift area. Seven of those already have proposed regulations, so the priority is to finalize the proposals after taking into account the comments received. The most contentious new area is likely "Guidance regarding

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availability of §1014 basis adjustment at the death of the owner of a grantor trust described in §671 when the trust assets are not included in the owner's gross estate for estate tax purposes.".

— *https://www.irs.gov/pub/irs-utl/2022-2023-pgp-initial.pdf*

The IRS is Catching Up

The effect of the Covid-19 pandemic upon the supply chains and prices has been much commented upon. Less well known is that the pandemic caused the development of a major backlog at the IRS. As of the end of August this year, some 8.2 million individual tax returns remained unprocessed.

But according to a November update, major progress has been made. The number of unprocessed returns has been cut to 4.2 million. "These include tax year 2021 returns and late filed prior year returns. Of these, 1.9 million returns require error correction or other special handling, and 2.3 million are paper returns waiting to be reviewed and processed."

There were also an estimated 900,000 unprocessed amended tax returns in November, filed on Form 1040-X. They are processed in the order received, and processing can take up to 20 weeks, the IRS reports. Taxpayers may get status reports on their amended returns by going to "Where's My Amended Return?" at the IRS website [https://www.irs.gov/filing/wheres-my-amended-return].

The Treasury Inspector General for Tax Administration (TIGTA) undertook an audit of the IRS' efforts. Unfortunately, a December TIGTA report projected that the backlog will extend into the 2023 filing season.

— *https://www.tigta.gov/reports/audit/backlogs-tax-returns-and-other-account-work-will-continue-2023-filing-season*

Revocation Incomplete

Mathew and Sara married in 1992. The marriage lasted until 2019, when they divorced. They had no children, and neither remarried. Mathew died in 2021.

Mathew's 1995 will named Sara as the primary beneficiary of his estate. He never amended or revoked the will after the divorce. His will further provided that should Sara die first, his residuary estate would be divided "one half to my heirs at law and one half to my wife's heirs at law." Mathew's brother Michael, as personal representative of the estate, identified to the probate court Mathew's siblings as heirs. Under Minnesota law, any will provision for a spouse is automatically revoked upon divorce, so Sara had no claim to the estate. However, Sara's parents objected, arguing that under a plain reading of the will they should inherit half the estate!

The lower court dismissed the claims of the in-laws, but the Minnesota Court of Appeals reverses. The law negating a surviving spouse's inheritance rights upon divorce could have extended that revocation to the ex-spouse's relatives, but it did not. It is not up to the courts to supply the language that the legislature failed to include.

— *Matter of Estate of Tomczik, 976 N.W.2d 143 (Minn. Ct. App. 2022)*

COMMENT: A vigorous dissent argued that that Sara's "heirs at law" cannot be known because she has not yet died. "The illogic of appellants' argument becomes even more apparent if, for example, Sara had remarried. Under that scenario, if we were to apply appellants' interpretation, Sara's new husband would be a beneficiary of a portion of Mathew's residual estate." The dissenter would have affirmed dismissal of the case.

QDOT Extension Granted

When Decedent died, his heir, Spouse, was not a U.S. citizen. Accordingly, her inheritance passed to a Qualified Domestic Trust, with a U.S. citizen acting as Trustee. The appropriate election was made on Decedent's estate tax return. However, the attorney and the CPA assisting in the estate settlement never told Spouse or Trustee of the necessity of informing the IRS should Spouse ever become a U.S. citizen. As a result, when Spouse did obtain citizenship, the required paperwork was never filed.

Now Spouse has died, and Trustee has learned of the overlooked duty. An extension of time to file the change of citizenship papers on Form 706-QDT was requested, and the IRS granted an additional 120 days for the filing.

—Private Letter Ruling 202244005

Checks Must Clear for Gift to be Complete

William DeMuth executed a power of attorney appointing his son Donald as agent in 2007. From that year through 2014 Donald gave annual gifts to his brothers and other family members relying upon the annual gift tax exclusion to avoid transfer taxes. In the summer of 2015, as William's health began to fail, Donald wrote an additional 11 checks for an aggregate of $464,000 from his father's brokerage account. (Some checks were for more than one person, so all came within the annual gift tax exclusion.). Four of the donees deposited their gift checks before William died in September, but only one check had been paid by the drawee bank by the date of death.

The estate tax return for William did not include the value of the gift checks, which the IRS spotted upon audit. The Service argued that the ten checks that had not cleared before death were estate includible. However, in its opening brief the IRS conceded that all four checks had been "credited by drawee banks."

The Tax Court holds that under state law (here, Pennsylvania) a gift of a check is not complete until it is no longer possible to issue a stop payment order. The Court noted that both the IRS and the taxpayer seemed to confuse the idea of a "depository bank" which accepts the check deposit and the "drawee bank" which pays the funds. Under these facts, only the check that cleared should be excluded from the taxable estate.

However, that early concession made by the IRS, even though it was erroneous, may not now be withdrawn. All four of those checks avoid the estate tax, while the other seven will be taxed.

—Estate of DeMuth v. Comm'r, T.C. Memo. 2022-72

Trust Amended Via Email?

Mark Douglas created the Omega Trust in December 2005. He amended the trust in June 2015 and again in September 2015. The Omega Trust had a trust protector. In July 2016 Mark informed the trust protector that he would be making a third amendment to the trust, that his health was deteriorating, and that he would contact his attorney with the changes. Mark sent an email to his attorney in August outlining the changes, including the addition of four beneficiaries. On August 12, the attorney responded to the email with some questions, and on August 16 the attorney sent a summary of the actions the firm would take to implement the amendment. Mark replied to that summary: "Very nice job, there are just a few suggested changes as noted below." Unfortunately, Mark died on August 18 without having signed the third trust amendment.

The appellate court reversed, holding that Mark had the right to amend the trust at any time, and that the terms of the trust did not expressly forbid the use of email correspondence to effectuate an amendment. "Thus, the petitioner has sufficiently pled his case to survive a motion to dismiss."

—In re the Omega Trust, 2022 WL 1498499 (N.H. May 12, 2022)

COMMENT: However, that may not be the last word, as the matter must return to the lower court for additional fact finding. The executor has only won the right to have his day in court.

Prosperity for Donor-Advised Funds

Taxpayers generally welcomed the rough doubling of the standard deduction in the 2017 tax reform legislation. One group that was worried about unintended side effects of the change was the nonprofit sector. The larger standard deduction coupled with the cap on the deduction for state and local taxes meant that most taxpayers would no longer get any tax benefit for their charitable gifts.

The worries turned out to be unfounded, as total charitable giving has not declined. Most people give to charity for philanthropic reasons, not to get tax benefits. However, there was a related side effect, and that has been a boom in donor-advised funds.

The idea behind a donor-advised fund is that money is permanently set aside for charity in the fund, but the charity may not yet be specified. A full tax deduction may be allowed in the year of the contribution to the fund, while the disbursements to charity take place over the subsequent years. Note that the advice that the donor makes to the fund about the charitable beneficiary in subsequent years is not binding, but the fund will typically follow the wishes of the donor.

The tax strategy that this suggests is to bunch charitable deductions. One year the taxpayer doubles up on charitable gifts and itemizes deductions, while the next year no such gifts are made and the standard deduction is taken instead. When the large gift is made to a donor-advised fund, the receipt of the money by the charity is deferred.

A recent report from the National Philanthropic Trust documents the success of donor-advised funds. Key metrics:

- The number of accounts in donor-advised funds rose from 1,007,745 in 2020 to 1,285,801 in 2021, an increase of 27.6%
- Assets held in these funds grew 39.5% from 2020 to 2021, from $167 billion to $234 billion.Total transfers to charities by the funds in 2021 were $45.74 billion, a 27.3% payout rate. This was a 12.7% increase over the 2020 payout rate.
- Private foundations hold some $1.3 trillion in assets, about five times larger than the donor-advised funds. Yet the total grants by private foundations came to only $96.27 billion, about double the total grants from the donor-advised funds. (Private foundations are only required to distribute 5% of their assets annually to charity).

The report concluded with a prediction of slower growth for donor-advised funds, in part as a response to financial market volatility in 2022.

— https://www.nptrust.org/reports/daf-report/