
Post-Mortem Estate Planning

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Agenda

- Final 1040 Elections
- Protecting the Fiduciary
- Compressed Income Tax Rates for Estates and Trusts
- Election of Estate's Fiscal Year End
- Section 645 Election
- 65 Day Rule
- Allocation of Estimated Taxes
- Charitable Contributions
- Administration Expense Election
- Section 643(e) Election
- Portability Election
- Alternate Valuation Election
- Special Use Valuation
- Estate Tax Deferral
- QTIP Election
- QDOT
- Gift Splitting
- GST Planning
- Disclaimers
- Death of a Partner
- S Corporation Stock
- QSST
- ESBT

Final 1040 – Filing Status

- D and surviving spouse may file a joint return. §6013(a)(2).
- Surviving spouse includes income and deductions for his/her entire year and the D's income and deductions from January 1 to D/D. Reg. 1.6013-1(d)(1).
- If executor and surviving spouse file a joint return, it is due on the normal due date e.g. April 15. Reg. 1.6072-1(b).
- Remember, a joint return means joint and several liability for tax
 - Executor may want to file separate return for D if spouse's reporting is questionable

Final 1040 – Filing Status

- Conditions precedent to filing a joint return:
 - There is a surviving spouse
 - Tax year of D and surviving spouse is the same
 - Surviving spouse has not re-married before the end of the year. Reg. 1.6013-1(d).

Final 1040 - Planning

- If D has substantial deductions and less income than the surviving spouse, filing a joint return enables the surviving spouse to take advantage of those deductions including the D's NOL, charitable contribution C/O and capital loss C/O. Rev. Rul. 74-175, 1974-1 C.B. 57.
- If estate distributes D's income to surviving spouse, filing a joint return may save income taxes.

Final 1040 – Medical Expenses

- Section 212(c) – executor can deduct medical expenses on the decedent's final 1040 for the year the expense was incurred if paid by the estate within one year of death
- Election filed in duplicate and includes the statement that a deduction not taken on Federal estate tax return and waives the right to claim them on the estate tax return.
- Medical expenses not taken on the decedent's final 1040 can be taken on the Federal estate tax return.
- Medical expense deductible on the 1040 to the extent they exceed 7.5% of AGI (10% of AGI after 2020).

Final 1040 - Series E/EE Bonds

- Cash basis decedent
 - GR: interest on Series E bonds reported when received
 - Election: Taxpayer may elect to include increment of Series E bonds in gross income
 - Once election is made, taxpayer must continue to report increment of Series E bond interest
 - If cash basis decedent made election during life to report increment in value of Series E bonds then his final 1040 must be filed on that basis
 - D's heirs not stuck with D's election. Rev. Rul. 58-435, 1958-2 C.B. 370; Rev. Rul. 64-104, 1964-1 C.B. 223.

Final 1040 - Series E/EE Bonds

- Cash basis decedent
 - Final 1040
 - If no election made during life, executor has two options:
 - Continue to report Series E Series bond interest as it is received
 - Make election to report increment in value of Series E bonds on D's final 1040. Section 454(a).
 - Will increase estate tax deduction for D's final tax liability

Final 1040 - Series E/EE Bonds

- Note:
 - Post death election to report accrued Series E/EE bond interest applies to interest accrued up to date of death.
 - If no election to report accrued Series E/EE bond interest on the final 1040, the interest accrued to date of death is income in respect of a decedent.
 - If election is made to report the accrued Series E/EE bond interest on the decedent's final 1040, that income may offset by losses, deductions or exemptions that may otherwise be lost if the decedent died early in the year with minimal taxable income
 - Remember, the 3.8% surtax on net investment income may apply to whomever reports the interest.

Final 1040 – Losses and Carryovers

- Capital losses – dies with the decedent. Rev. Rul. 74-175, 1974-1 C.B. 52
- Charitable contribution carryover – dies with the decedent. Reg. 1.170A-10(d)(4)(iii).
- Net operating losses – dies with the decedent
- Passive activity losses – excess over any basis step-up is deductible on the final 1040. Section 469(g)(2).

Final 1040 – Election Out of Installment Sale Treatment

- Report sale directly on Schedule D or Form 4797 and recognize entire gain in the year of sale.
- Must be made on a timely filed return, including extensions.
- No special statement is required.
- May be beneficial if decedent will be in a low bracket in final year as opposed to beneficiary or estate.
- Authority: Section 453(d).

Protecting the Fiduciary

- Notice of Fiduciary Relationship - §6903
- Discharge from Personal Liability - §6905, §2204
- Request for Prompt Assessment - §6501(d)

Notice of Fiduciary Relationship - §6903

- Used to notify IRS of fiduciary appointment
- Form 56 – Notice Concerning Fiduciary Relationship
- Prevents IRS notices being sent to wrong address
 - Time period for filing Tax Court petition may expire if statutory notice of deficiency sent to deceased taxpayer's address
- File with Internal Revenue Service Center where decedent is required to file his/her tax return.
- Use Form 56 to notify IRS of commencement and termination of fiduciary relationship

Discharge from Personal Liability - §6905

- Fiduciary personally liable for decedent's unpaid income and gift taxes (§6905) and estate taxes (§2204) if he pays others before paying government the taxes due at death
- Protection available from personal liability by requesting in writing (Form 5495) a discharge from personal liability.
- IRS has 9 months to assess tax due
 - No notice, fiduciary discharged
 - Notice of amount due, fiduciary discharged on payment

Discharge from Personal Liability - §6905

- Discharge only effective to executor in his personal capacity and as to his personal assets
 - Doesn't release fiduciary in his fiduciary capacity
 - Doesn't protect beneficiaries from transferee liability
- File request with Internal Revenue Service Center where estate tax return is required to be filed, or if no 706 due, where decedent's final 1040 filed.
- Send by certified mail/return receipt to prove when 9 month period begins to run

Request for Prompt Assessment - §6501(d)

- Applies to income and gift tax liability and estate's fiduciary income tax return
- Shortens the S/L from 3 years to 18 months after filing the request
- Doesn't apply to returns filed after filing request – a new request is needed
- Use Form 4810
- File with Internal Revenue Service Center where the income or gift tax return was filed
- Send by certified mail/return receipt to prove date when 18 month period begins to run

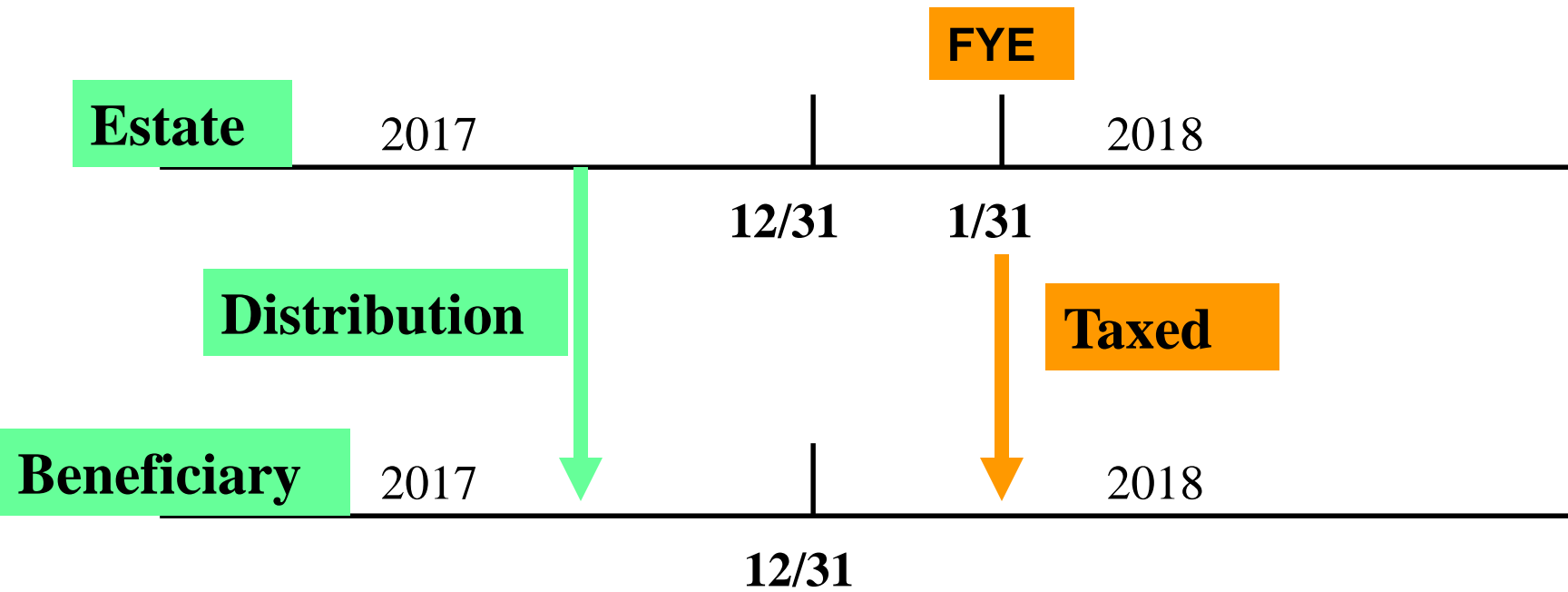
2018 Fiduciary Income Tax Rates

<u>Over</u>	<u>Not Over</u>	
0	2,550	10%
2,550	9,150	24%
9,150	12,500	35%
12,500		37%

Election of Estate's Fiscal Year End

- Fiduciary may select estate's fiscal year end
- May be the last day of any month as long as first FYE doesn't exceed one year
 - Trust MUST use calendar year
 - Trust may get benefit of fiscal year by making a §645 election
- Election made by filing income tax return with the selected year end
- May allow deferral of payment of tax
 - Cut off fiscal year before receipt of substantial income
 - Distributions from estate are deemed made to beneficiary on last day of estate's taxable year regardless of the actual date of distribution

Election of Estate's Fiscal Year End



§645 Election

- Treat “qualified revocable trust” as part of decedent’s estate for Federal fiduciary income tax purposes
- Election made jointly by estate’s personal representative and trustee
 - Election for limited period of time – generally, earlier of (1) when estate terminates or (2) later of 2 years after decedent’s death or 6 months after final determination of estate tax
 - See final regulations for making and terminating the election and tax treatment of trust and estate while election is in effect
 - Election made on Form 8855 by due date of fiduciary income tax return for the first taxable year of the estate, including extensions

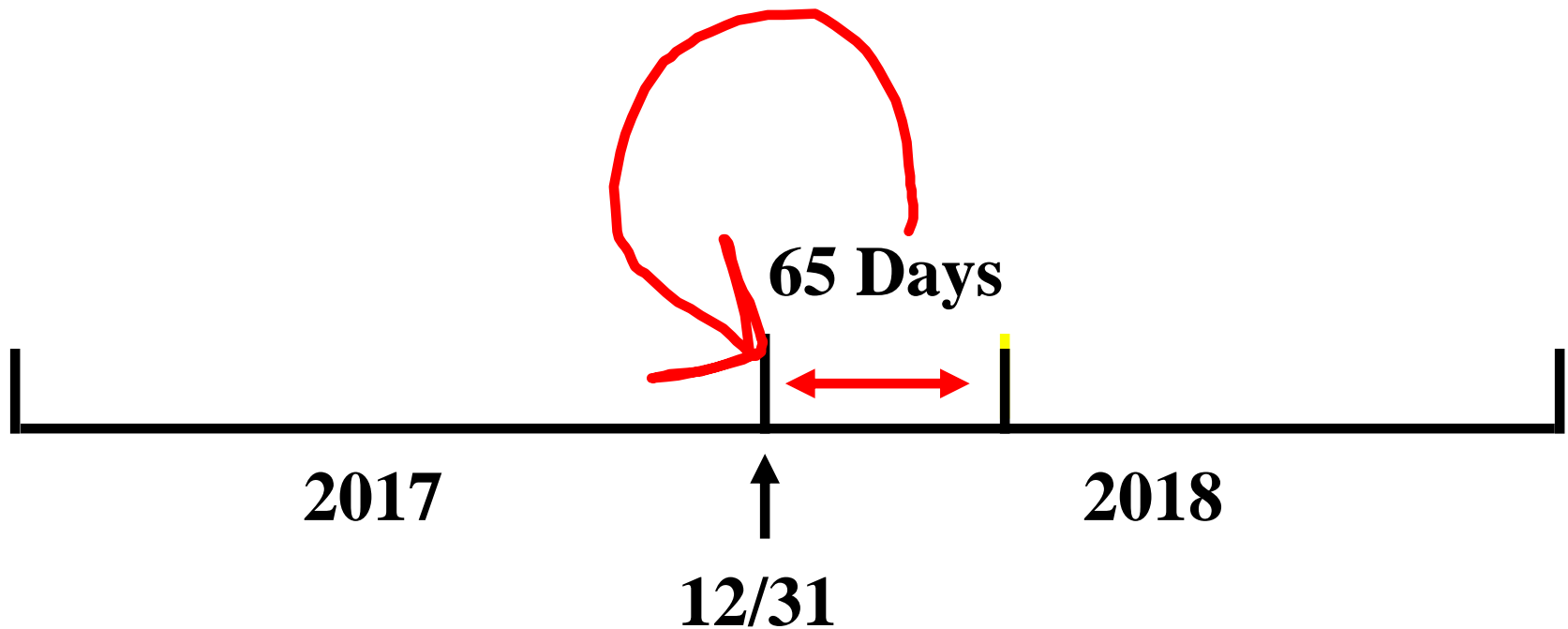
§645 Election - Strategy

- Use fiscal year-end
 - Qualify for estate fiduciary income tax charitable deduction
 - More liberal than trust fiduciary income tax charitable deduction
 - \$25,000 PAL deduction for rental R/E for 2 years of estate. Section 469(h)(4).
 - Eligible to hold S stock for duration of election
 - No estimated tax payments for 2 years after date of death
 - Tax items of estate and trust can offset each other e.g. PALs, NOL, capital loss carryover, investment interest expense
 - \$600 exemption
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65 Day Rule aka Sec. 663(b) Election

- Applies to complex trusts and estates
- Allows fiduciary to treat all or a portion of distributions made within 65 days of Y/E as being made on 12/31 of preceding year
- Election must be made by due date of return, including extensions
- Election is irrevocable
- Year by year election (e.g. good for 1 year only)
- Limited to $>$ DNI less current year distributions or TAI not distributed

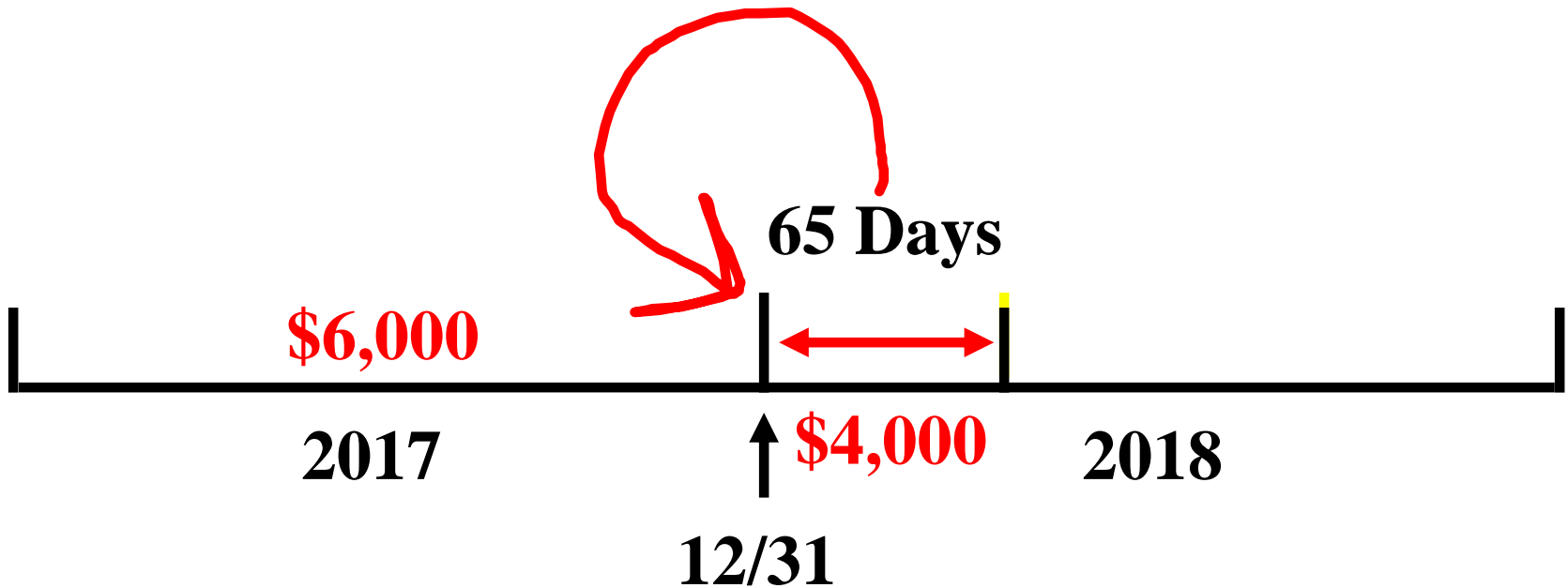
65 Day Rule aka Sec. 663(b) Election



65 Day Rule aka Sec. 663(b) Election

Facts: \$10,000 DNI for 2017

Distributes \$6,000 in 2017, \$4,000 in 2018



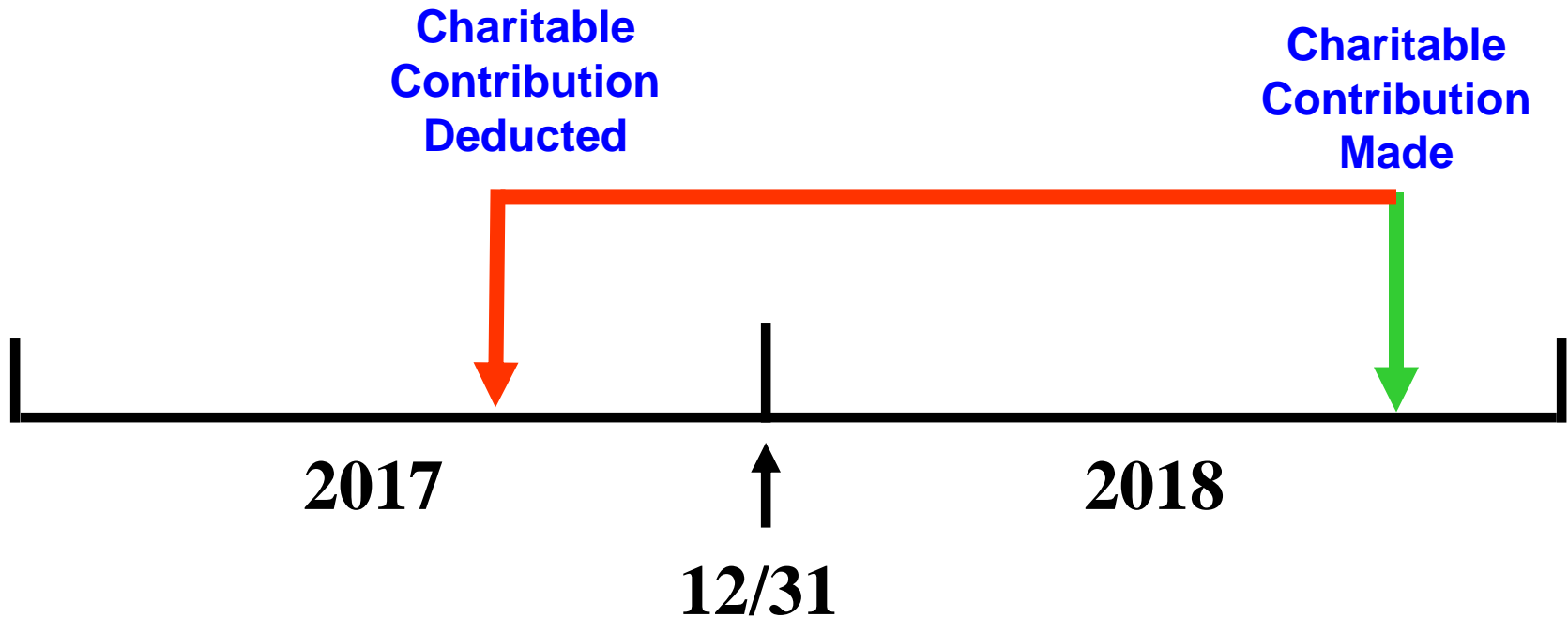
Allocation of Estimated Taxes to Beneficiaries

- Executor or trustee may elect to treat any portion of an estimated tax made by the estate/trust as a payment made by a beneficiary of the estate/trust
- Treated as an estimated payment made by the beneficiary on January 15 of the following year (after the last day of the taxable year of the beneficiary)
- Election must be made on or before the 65th day after the close of the taxable year of the estate/trust
- Only available to estate in its final year
- Authority: Section 643(g)

Election to Treat Charitable Contribution as Made in Preceding Year

- Estate or trust can treat charitable contribution made in a succeeding taxable year as if made in the immediate preceding taxable year.
- Election made by filing a statement with tax return for which deduction is being claimed. See Reg. 1.642(c)-1(b)(3) for details of what statement must contain.
- Need amended return.
- Election can be made up until the due date, including extensions, of the succeeding year's tax return.
- Can be made on an amended return if within above time frame after which the election is irrevocable unless consent from IRS obtained.
- Authority: Section 642(c)(1); Reg. 1.642(c)-1(b).

Election to Treat Charitable Contribution as Made in Preceding Year



Administration Expenses – Summary #1

- Deduct on either 706 or 1041
 - Waiver required if taken on 1041
 - Administration expenses can be split between 706 and 1041

 - Compare estate tax rate with income tax rate
 - No 706 due, or 706 due but no tax, deduct on 1041
 - Exception: if applicable credit amount used, take administration expenses on 706
 - If estate tax due, deduct on 706

 - Timing
 - If taken on 706, pay anytime
 - If taken on 1041, pay in year deduction desired
 - Caution: in year prior to termination, deductions in excess of income are wasted
 - If expenses exceed income, pay in year of termination and pay out “excess deductions” to beneficiaries – However, no excess deductions for years 2018-2025 under TCJA of 2017
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Administration Expenses – Summary #2

- Adjustment between income and principal
 - If expenses taken on 1041 when estate tax is payable, should income beneficiaries reimburse the remainder beneficiaries for the increase in the estate tax?

- Optimal marital deduction
 - Use of administration expenses on 706 reduces size of marital bequest
 - Use of administration expenses on 1041 decreases size of bypass trust and increases size of marital bequest

- No bypass trust
 - If administration expenses taken on 1041, estate tax generated via a circular calculation
 - If administration expenses taken on 706, no circular computation

Administration Expenses – Summary #3

- Subject to 2% floor
 - Per Knight, only if expenses (e.g. investment advisory fees) uncommon (or unusual or unlikely) for an individual to incur
 - Can have substantial AMT consequences
- True double deductions
 - §691(b) deductions deductible on both 706 and 1041
 - Distinguish between §691(b) (incurred before death but payable after death) and §642(g) (post-death expenses)

Section 643(e) Election – Residuary Bequest

- Estate/Trust may *elect*, but is not required, to recognize G/L
- Distribution carries out DNI, but amount of DNI depends on whether the Section 643(e) election was made
 - No Election: DNI carried out is *lesser* of basis or FMV of distributed property
 - Election: DNI carried out is FMV of distributed property
- Basis of property to beneficiary is basis of property to estate/trust plus or minus any gain or loss the estate/trust elects to recognize on the distribution
- Holding period tacks if basis is same “in whole or in part” as transferor’s basis, otherwise, holding period starts anew

Portability

- \$11.18 million exemption (2018) per person, \$22.36 million exemption per couple
- Permanent
- Grows with inflation
- If exemption not used, it is portable
- Must file a complete and timely estate tax return to be entitled to portability
- Executor makes the election, not the surviving spouse - can create conflict
- Takes most estates out of a taxable situation
- Want to address portability election in estate planning documents
 - Whether the election will be made
 - Who will have authority to make the election
 - Who will bear cost associated with filing the portability election
 - Providing for portability in prenuptial agreement

Portability – Making the Election

- Not an affirmative election. A deemed election is made if a timely and complete and properly prepared 706 is filed with DSUE and there is a surviving spouse.
- Election is made by the executor (Form 706, Part 6)
- Not available to a non-resident surviving spouse who is not a U.S. citizen, unless allowable by treaty
- Assets transferred to a QDOT – calculation is preliminary (Form 706, Part 6, Section B)
- Portability does not apply to decedent's unused GST exemption

Portability – Making the Election

- Election is effective as of the date of death
- Election is irrevocable as of the due date of the Form 706
- Statute of limitations on decedent's return is extended with regard to the determination of the DSUE amount until the expiration of the statute of limitations of the surviving spouse's estate tax return.
 - See Estate of Vose, 390 P3d 238 (Okla. 2017)

Portability – Applicable Exclusion Amount

Form 706, Line 9a	Basic Exclusion Amount*
Form 706, Line 9b	<u>DSUE**</u>
Form 706, Line 9c	Applicable Exclusion Amount

* \$11,180,000 in 2018. Indexed for inflation. In 2026 reverts to \$5,000,000 indexed for inflation from 2011 base year

** Not indexed for inflation – frozen at date of death

Portability – DSUE = Lesser Of:

- The basic exclusion amount, or
- The excess of:
 - The applicable exclusion amount of the last deceased spouse, over
 - The amount with respect to which the tentative tax is determined under Section 2001(b)(1) on the estate of the deceased spouse
- Authority: Section 2010(c)(4)

Portability – Reporting Requirements

- Special rule for reporting values on Form 706 which is not otherwise required to be filed:
 - For property subject to marital or charitable deduction, need only report:
 - Description
 - Ownership
 - Beneficiary
 - Information to establish right of estate to the deduction

Portability – Reporting Requirements

- Special rule for reporting values on Form 706 does not apply if:
 - ❑ Value needed to determine value passing to another recipient
 - ❑ Value needed to determine eligibility under Section 2032 (alternate valuation), Section 2032A (special use valuation) or Section 6166 (deferral of time to pay estate tax related to a closely held business)
 - ❑ Less than the entire interest in the property is marital or charitable deduction property
 - ❑ A partial disclaimer or partial QTIP election is made with respect to property which is marital or charitable deduction property

Portability – Who Makes or Opts Out of Election?

- Duly appointed executor or administrator of the estate
- If no duly appointed executor, a person in actual or constructive possession of any property of the decedent
- What if executor and surviving spouse do not agree?
 - Consider including provisions in wills and trusts with specific instructions for electing portability and who will pay to prepare the Form 706

Portability – Late Election

- If estate is over the Section 6018 filing threshold – no relief
- If estate is below the Section 6018 filing threshold - See Rev. Proc. 2017-34

Portability – Opting Out

- Check the box on Form 706, Part 6, Section A
- Estates below the Section 6018 filing threshold, simply do nothing i.e. don't file a return
- Hazards of not electing portability:
 - To family: Assets grow, surviving spouse's estate subject to Federal estate tax
 - To advisor: potential lawsuit – have writing which memorializes whether to make or not make the portability election. Best if acknowledged and signed by the executor.

Portability – Last Deceased Spouse

- Last spouse of decedent who predeceased decedent
- DSUE applied to surviving spouse's lifetime gifts before surviving spouse's applicable exclusion amount

Portability – Advantages

- Get a double step-up in basis
- Income subject to individual tax brackets, not compressed estate and trust brackets
- May minimize the 3.8% surtax on net investment income

Credit Shelter Trust – Advantages

- Asset protection
- Appreciation out of surviving spouse's estate
- Ability to use GST exemption

Portability – Recent Developments – Estate of Vose, 390 P3d 238 (Okla. 2017)

- Decedent and spouse entered into a prenuptial agreement waiving all rights in the other's estate
- Administrator of decedent's estate was his son by a prior marriage
 - Son/administrator's name was Robert E. Lee III
- Spouse wanted step-son, as administrator of the estate to make a portability election. Son refused. Spouse sought court order compelling son to make the portability election.
- Trial court ordered administrator to make the portability election and the Oklahoma Supreme Court upheld the decision.
- Court held the prenuptial agreement was executed before portability was enacted and the parties couldn't waive rights they didn't know would accrue in the future. Court also held that portability didn't trump state fiduciary law so state fiduciary law could restrict the administrator's refusal.

Portability – Recent Developments - Rev. Proc. 2017-34 - Late Portability Election

- Effective June 9, 2017, executors can file “portability only 706s” by the later of :
 - Second anniversary of the decedent’s death, or
 - January 2, 2018
- Applies to estate under the §6018 filing threshold
- Executors seeking to make the portability election after the applicable deadline date can do so only through 9100 relief
- Top of the Form 706 must state: “FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER §2010(c)(5)(A).”

Alternate Valuation

- Value as of D/D or 6 months after D/D
 - Or as of the date property sold, distributed or disposed of during the 6 month period
- Must both decrease the value of the gross estate and the amount of estate tax and GSTT
- Election, which is made by the executor, made by checking box on 706
- Once made is irrevocable
- Applies to all property included in gross estate
 - Can't be made on an asset by asset basis
- Affects basis of property
- Proposed regs (11/17/2011) indicate that alternate valuation election can be made only for post death reduction in value due to market conditions and not due to other post-death events such as a change in ownership structure.

Alternate Valuation

- Election can be made on last estate tax return filed by executor on or before the due date of the return including extensions
- Late election – final regs. issued January 3, 2005
 - No election if estate tax return is filed more than one year after the 706 due date plus extensions
 - Thus, A/V election can be made up to 27 months after death: 9 months after D/D plus 6 month maximum extension plus 12 months
 - If 706 filed within one year after due date plus extensions but no election is made, §9100 relief available even if more than one year has passed at time relief is sought
 - See, for example, PLR 201118030 where the IRS granted §9100 relief to make a late alternate valuation election more than 1 year after the due date of the return where a timely filed estate tax return omitted making the election due to reasonable reliance on the accountant who prepared the return.
 - Permit protective election

Alternate Valuation

- Unlimited marital deduction – no estate tax, no A/V election available
- Solution – 2 alternatives:
 - Spouse could disclaim sufficient amount so a small estate tax is owed
 - Must disclaim within 9 months
 - Executor could make partial QTIP election
 - If 706 is extended, have 15 months (9 months after D/D plus 6 month extension) to decide
 - Spouse can retain a STPOA with the partial QTIP but not with a disclaimer
- Caution: watch the effect a disclaimer or partial QTIP election may have on state estate taxes, especially since most state exemptions are lower than the federal estate tax exemption
- Allows less to be funded into the marital trust which means less is taxable on surviving spouse's subsequent death

Alternate Valuation

- Sales and distributions within the 6 month A/V period
 - Fixes the A/V of that particular asset as of the date of sale or distribution
 - Funding sub-trusts within the 6 month A/V period will fix A/V
 - If assets have reached a low during the 6 month A/V period and the executor thinks those assets will appreciate before the end of the 6 month A/V period, sell or distribute those assets during the 6 month period to lock in the low A/V
 - Sell or distribute assets in the 6 month A/V period to avoid having assets that appreciate during the 6 month A/V period from “cannibalizing” the reduction in value of other estate assets

Alternate Valuation

- A/V election may affect ability to qualify under §303 and/or §6166
 - §303 allows redemption of closely held stock to be treated as a sale or exchange for amount of state and federal death (including GST) taxes and funeral and administration expenses
 - §6166 allows deferral of estate tax attributable to the interest in a closely held business for up to 15 years.
- Both provisions require, among other things, that the value of the included business interest exceed 35% of the value of the adjusted gross estate (gross estate less expenses under §2053 and §2054)
- A/V election may help or hurt the ability to qualify under §303 and/or §6166

Special Use Valuation

- Real estate used in a farm or trade or business can be valued based on its actual use rather than its highest and best use
- Reduction in FMV can't exceed \$750,000 indexed for inflation – for 2018 the reduction can't exceed \$1,140,000
- Detailed qualification requirements
 - Qualifications are complex
 - Must carefully follow requirements
 - For summary of requirements, see the instructions for Schedule A, Form 706

Estate Tax Deferral - §6166

- Allows estate tax deferral for up to 15 years on estate tax attributable to a closely-held business
 - Interest only for first 5 years
 - Interest and principal payable in equal installment over next 10 years

 - Requirements:
 - Must be active trade or business
 - Sole Proprietorship
 - Partnership with 45 or fewer partners or decedent with at least 20% capital interest
 - Corporation with 45 or fewer shareholders or decedent with at least 20% of voting stock
 - Value of business interest exceeds 35% of adjusted gross estate
 - If decedent owns two or more businesses, the value of each business in which the decedent owns at least a 20% interest may be aggregated to satisfy the 35% rule
 - Decedent must be a U.S. citizen
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Estate Tax Deferral - §6166

- Interest rate on deferred tax
 - 2% interest payable on estate tax attributable to the first \$1 million (indexed for inflation - \$1,520,000 for 2018) of the closely held business interest over the estate tax exclusion amount
 - Amount subject to 2% interest rate for 2018 is \$608,000
 - Interest rate on balance is 45% of the regular IRS underpayment rate
 - Trade-off for favorable interest rate – no interest deduction

Estate Tax Deferral - §6166

- Acceleration of deferred estate tax
 - If payments are not made when due – subject to a 6 month grace period
 - If there is a sale, disposition or withdrawal of money or other assets of 50% or more of the value of the closely held business
 - If the estate has undistributed net income

Estate Tax Deferral - §6166

- Presents the opportunity for a closely-held business to use the cash flow of the business over the deferral period to pay the estate tax
- Allows estate to, in effect, borrow 40% of the value of the collateral for 14 years

QTIP Election - Qualifications

- Surviving spouse is a U.S. citizen
- Surviving spouse is entitled for life to all income from the property payable at least annually
- No person, including the surviving spouse, has power exercisable during spouse's life to appoint any part of property to any person other than spouse during spouse's lifetime
- Executor elects QTIP treatment – automatically made unless executor elects out

QTIP Election – How and When to Make

- Made on last estate tax return filed on or before due date of return, including extensions
- If estate tax return not timely filed, election made on first estate tax return filed after the due date
- Election on late-filed return is invalid where no election made on previously filed timely return
- Election made by listing QTIP property on Schedule M and deducting the value
- Election should be made by formula since QTIP election is irrevocable and value of the estate may change on audit
- Assets in QTIP receive step-up in basis at the death of both spouses

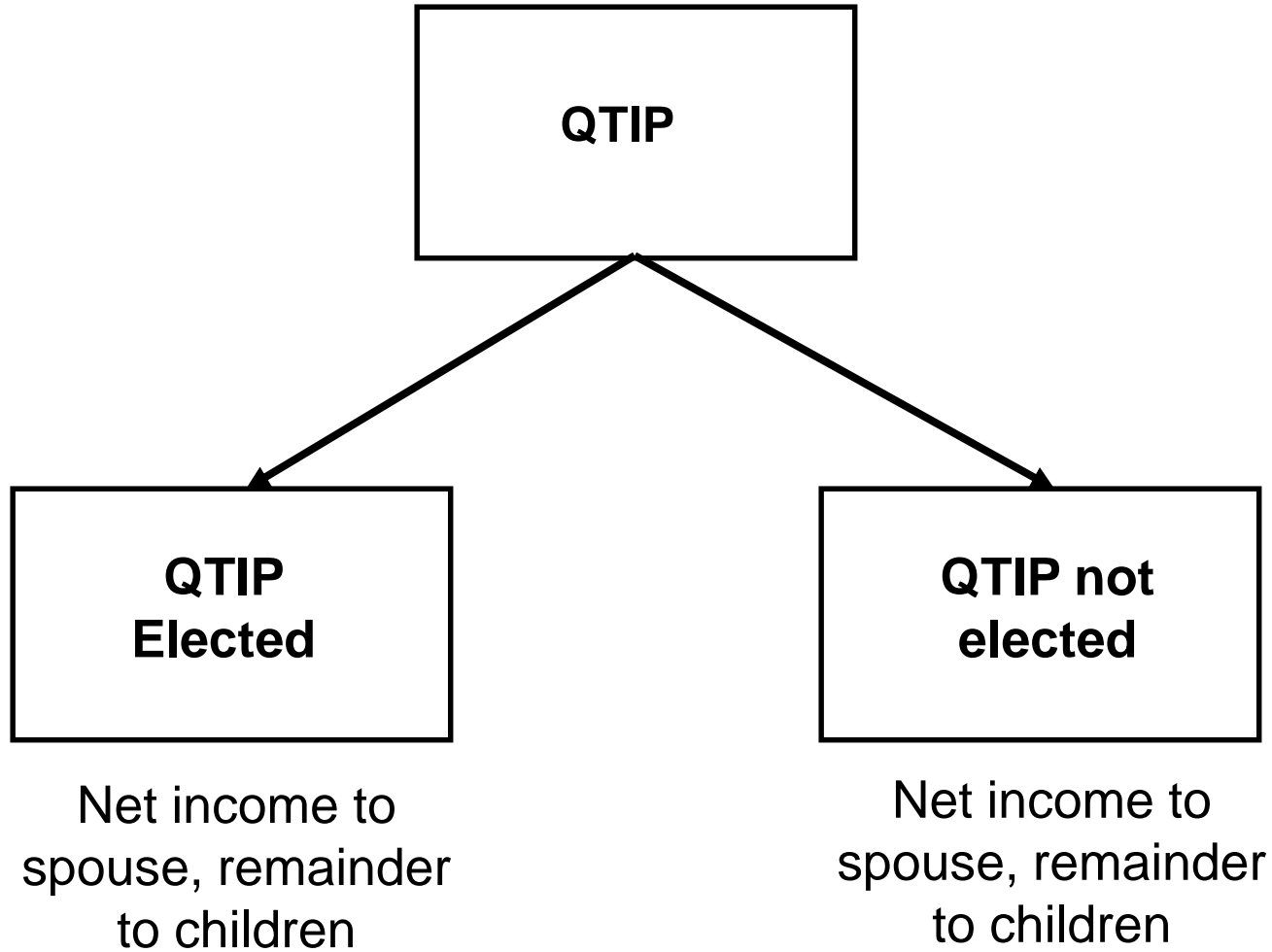
QTIP Election

- Partial QTIP election
- Segregation of elected portion of QTIP
- Clayton QTIP
- Qualifying an IRA payable to a trust for the QTIP election

Partial QTIP Election

- Must be specific portion i.e. fractional or percentage share
- Use formula partial election so the marital deduction is self-adjusting as election is irrevocable and values can change on audit
 - Numerator is amount needed to reduce the estate taxes to the lowest possible amount and the denominator is the value of the fund against which the fraction is applied
- If partial QTIP election made and the elected share is not segregated, the amount included in the estate of the surviving spouse is the FMV at the D/D or A/V date of the entire interest times the fractional or percentage share

Partial QTIP Election



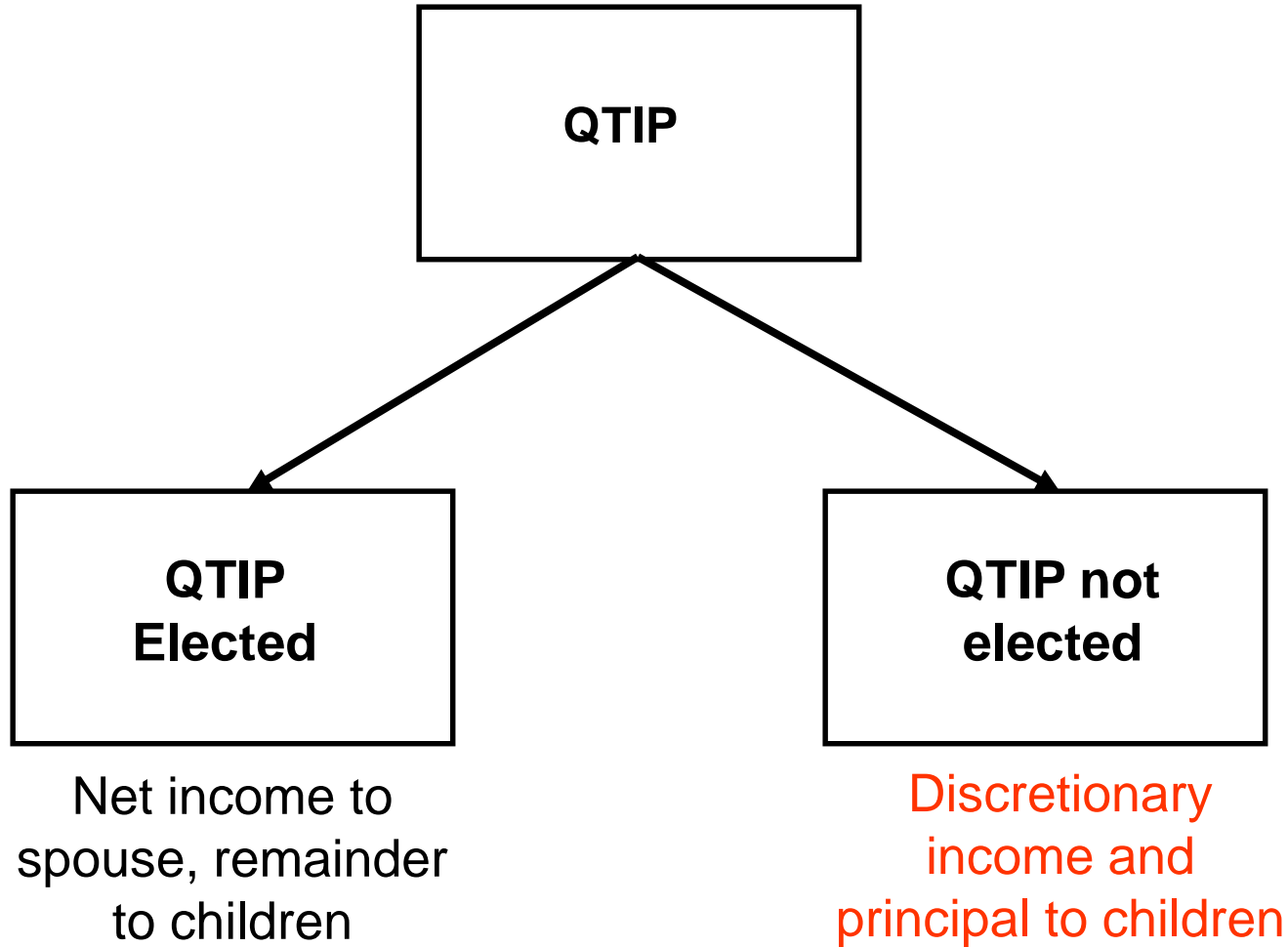
QTIP – Partial Election

- Divide QTIP trust for which partial election has been made into separate trusts if authorized by the governing instrument or state law
 - If QTIP trust is severed, principal distributions to spouse can be made from QTIP portion. If trust not severed, principal distributions may have to be made pro-rata from both QTIP and non-QTIP portion.
 - Reg. 20.2044-1(d)(3) allows principal distributions to be made from QTIP portion before being made from non-QTIP portion if allowed by the trust document. The severed portion for which the QTIP election is made will be included in the surviving spouse's estate
 - Severance must be accomplished no later than the end of the period of administration
 - Notice that the portion of the QTIP trust for which the QTIP election is not made remains subject to the provisions of the QTIP trust
 - Solution: Clayton QTIP which allows portion for which QTIP not elected to benefit non-spouse beneficiaries

QTIP – Clayton QTIP

- Portion of trust for which QTIP is not made passes to another trust with potential different provisions, different beneficiaries

Clayton QTIP



Qualifying an IRA for the QTIP Election

- Rev. Rul. 2006-26 – deals with qualification for marital deduction where IRA payable to trust where state law has:
 - UPIA statute
 - Unitrust statute
 - Traditional definition of trust accounting income
- Note: trust instrument states that spouse can require the trust and IRA to invest in productive assets and spouse has the right to compel the trustee to withdraw the IRA income each year and pay it to the spouse

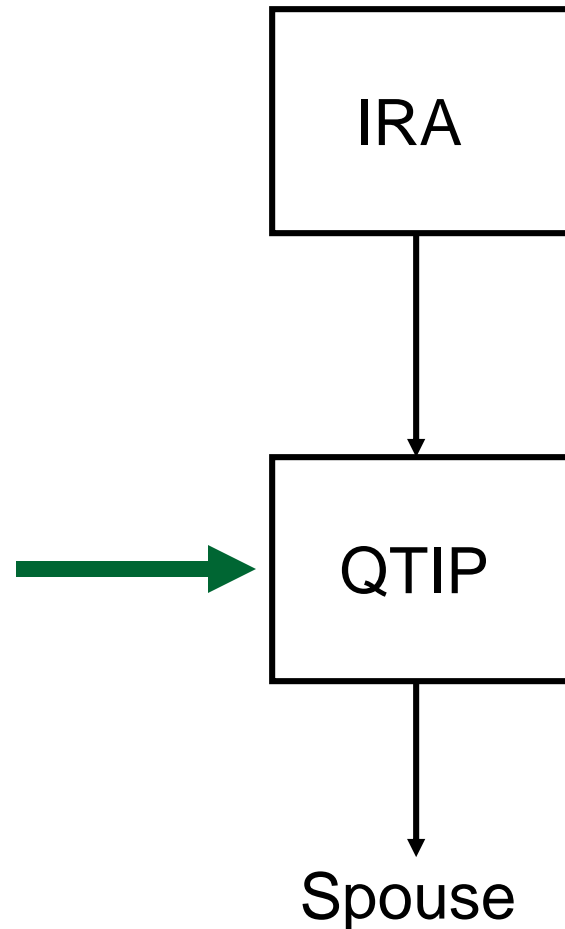
Qualifying an IRA for the QTIP Election

- Must make QTIP election for both the trust and the IRA
- Rev. Rul. 2006-26 sets forth how to qualify an IRA payable to a QTIP trust for the marital deduction regardless of whether the state has adopted the UPIA, a unitrust statute or uses the traditional definition of TAI

QTIPing An IRA – Rev. Rul. 2006-26

4 step process:

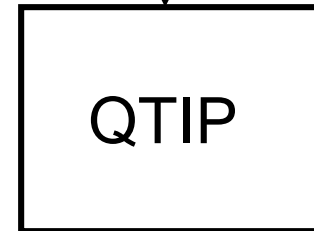
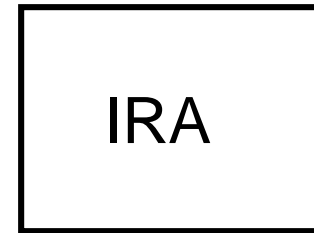
1. Trust instrument states that spouse can require the trust and IRA to invest in productive assets and spouse has the right to compel the trustee to withdraw the IRA income each year and pay it to the spouse
2. Determine total return of trust (exclusive of IRA) and allocate that amount between income and principal. Annually distribute the amount allocated to income to spouse



QTIPing An IRA – Rev. Rul. 2006-26

4 step process:

3. Determine total return of IRA (exclusive of trust) and allocate that amount between income and principal. If spouse exercises his/her withdrawal power, the trustee must pay the income to the spouse
4. Make QTIP election for BOTH the IRA and the QTIP trust



Spouse

Rev. Rul. 2006-26 – Alternative Method

- Marital deduction is allowed if the trust directs trustee annually to withdraw all IRA income and distribute it to the spouse

Post Mortem Planning with QTIP Election

- Planning in an uncertain tax environment – what will the exemption amount be in the future?
- To take full advantage of the applicable exclusion amount e.g. entire estate in trust, income to surviving spouse, remainder to children – make partial QTIP election
- To maximize use of generation skipping tax exemption e.g. reverse QTIP election
- Clayton QTIP – non-elected portion held for benefit of non-spousal beneficiaries
- To equalize the estate tax brackets of both spouses
- State tax savings – inconsistent QTIP elections at state and Federal level (if permitted by state)
- QTIP election must be made within 15 months of date of death (filing date of 706 plus a 6 month extension) whereas a disclaimer must be made within 9 months of date of death.

QDOT - Theory

- Unlimited marital deduction allowed before 1988
- Congress concerned non-U.S. citizen surviving spouse would relocate outside U.S. taxing jurisdiction
- After 1988, marital deduction denied for property passing to non-U.S. citizen surviving spouse unless property passes to or is placed in a QDOT
- To ensure the U.S. can collect estate tax on non-U.S. citizen spouse's assets passed from decedent spouse
- Effect of QDOT is merely to postpone the decedent spouse's federal estate tax on property included in the QDOT
- Governed by Sections 2056(d) and 2056A

QDOT – Alternative Structures

PROPERTY PASSES TO:

- QDOT
- Non-qualifying trust reformed post-decedent's death into a QDOT
 - Judicial reformation must be commenced before due date (plus extensions) of estate tax return
- Surviving spouse not in trust (outright, joint tenancy, etc.)
 - Surviving spouse actually transfers assets or irrevocably assigns property to QDOT
 - Surviving spouse can create QDOT after decedent's death and transfer property to QDOT
 - Surviving spouse's transfer of property to QDOT is treated as a gift of the remainder interest for gift tax purposes unless spouse retains power to make transfer incomplete

QDOT – Alternative Structures

QDOT NOT NEEDED

- ❑ Surviving spouse becomes a U. S. citizen prior to date decedent's estate tax return is filed
 - Surviving spouse must be a U.S. resident at all times after the decedent's death and before becoming a U.S. citizen
 - Surviving spouse must actually become a U.S. citizen before the date on which the decedent's estate tax return is filed
 - A citizenship application in process is not sufficient

- ❑ Treaty provisions elected

QDOT Requirements

MUST QUALIFY FOR THE MARITAL DEDUCTION

- ❑ Section 2056(b)(5) – life estate/general power of appointment trust
- ❑ Section 2056(b)(7) – QTIP trust
- ❑ Section 2056(b)(8) – Life estate to spouse/charitable remainder
- ❑ Estate trust
- ❑ Passes outright to spouse

QDOT – Who Can Create

QDOT CAN BE CREATED BY:

- ❑ Citizen spouse
- ❑ Personal Representative of deceased citizen spouse
- ❑ Surviving non-citizen spouse

QDOT – The Tax

DISTRIBUTIONS EXEMPT FROM TAX

- ❑ Distributions of “income” i.e. trust accounting income
- ❑ Hardship distribution of corpus
 - No definition of hardship in statute
 - Relies on Section 401(k) definition of hardship – made to spouse or person spouse is obligated to support in response to an immediate and substantial financial need relating to health, education, maintenance and support. Need to take liquid assets into consideration.
- ❑ Reimbursement for federal income tax paid by surviving spouse on QDOT income surviving spouse is not entitled to receive
- ❑ Certain administrative distributions
 - Income tax
 - Premiums for bond or letter of credit
- ❑ Distribution for full and adequate consideration

QDOT – Tax – Form 706-QDT

HOW TAX IS COMPUTED

- ❑ Based on the estate of the estate tax return of the decedent who established the QDOT
- ❑ Based on tax rates in effect at time of death of first decedent
- ❑ Result: non-citizen spouse unable to reduce Federal estate tax on assets left to him or her in a QDOT
- ❑ Applicable exclusion amount is not available to the non-citizen spouse for QDOT taxable (lifetime or death) events
 - Reason: QDOT assets not considered part of non-citizen spouse's tax base

Consent to Split Pre-Death Gifts

- Reg. 25.2518-2(c) allows the executor or administrator of a deceased spouse to consent to gift-splitting with the surviving spouse with respect to pre-death gifts
- Note: surviving spouse may not elect to split gifts with deceased spouse if he/she remarries before the end to the calendar year. Section 2513(a).

Generation Skipping Tax Planning

- Reverse QTIP election
 - Treats decedent as transferor for GST purposes, allowing use of decedent's GST exemption
 - Partial reverse QTIP election not available
 - Trust instrument should allow severance of trust – qualified severance allowed at any time
 - Court petition to sever trust required if trust or state law silent on severance

- Allocation of GST exemption
 - May be allocated at any time on or before estate tax return is due, including extensions

Generation Skipping Tax Planning

- Automatic allocation rules
 - Allocated first to direct skips made during life unless transferor elects out on a timely filed gift tax return
 - Allocated next to indirect skips made during life unless transferor elects out on a gift tax return
 - Allocated next to testamentary direct skips
 - Allocated next to trusts from which a taxable distribution or taxable termination might be made at or after the death of the decedent

- Allocation of exemption can be made by formula

- An allocation of GST exemption greater than the amount needed to have an exclusion ratio of zero is void

Disclaimers

- Requirements:
 - Irrevocable and unqualified refusal to accept property
 - In writing, identifies property being disclaimed and signed by disclaimant or his legal representative
 - Delivered to transferor within 9 months of transfer
 - Exception: if disclaimant under 21, disclaimer must be made within 9 months of attaining age 21
 - Disclaimant may not accept property or any of its benefits
 - Disclaimed property passes without direction by disclaimant
 - Exception: spouse can disclaim property which, as a result of the disclaimer, passes to a trust fbo the spouse so long as the spouse doesn't have a power of appointment over the trust assets.

Disclaimer - Result

- Assets pass as if the disclaimant predeceased the donor
- Results in no taxable transfer

Disclaimer

- Can do a partial disclaimer
- Can disclaim specific assets from a trust
 - If specific trust asset is disclaimed, it must “leave” the trust i.e. be segregated
- Can do a formula disclaimer – fraction or percentage

Disclaimer

- Disclaimant who is also a fiduciary.
 - A person who is also a fiduciary can disclaim with the fiduciary retaining the fiduciary power to designate beneficiaries as long as the power is subject to an ascertainable standard.
- Disclaimant cannot retain a power of appointment

Reason for Disclaimers

- To avoid overfunding a marital deduction bequest
- To qualify for the marital or charitable deduction by causing the property to pass to the surviving spouse or a qualified charity
- To fully fund a bypass trust
- To avoid inclusion of assets in a beneficiary's estate

Death of a Partner - General

- P/ship year terminates for partner whose interest terminates by death
 - P/ship tax year as to the deceased partner ends on the date of the partner's death
 - Deceased partner's share included in his final 1040
 - Post-death share of partnership income taxed to successor in interest

- Cash flow issues
 - Partner makes no w/drawal before death but income to date of death included on 1040
 - Partner makes withdrawal before death leaving insufficient cash for successor to pay tax

Death of a Partner – Post-Death Planning

- Have p/ship income for year of death taxed on final 1040
 - If estate is successor in interest and estate's FYE ends on or before 12/31, executor can distribute entire p/ship interest before year-end to spouse and all of that year's p/ship income will end up on the decedent's final joint return
 - If estate is successor in interest and estate's FYE ends on or before 12/31, executor can make distributions of cash or property from estate to the spouse that carry out DNI which will be taxed on the decedent's final joint return.

Death of a Partner – Basis

- Partner's basis in p/ship interest is separate and distinct from p/ship's own basis in the underlying assets of the p/ship
- Basis of deceased partner's partnership interest is its FMV as of the D/D or the A/V date
- Partnership does not receive new basis for partnership assets upon death of a partner
- Consider the §754 election

Death of a Partner – Basis

- Ginger and Mary Ann, form a 50/50 partnership
- Buy a apartment building for \$100,000, each contributing \$50,000
- Building appreciates to \$1,000,000
- Ginger dies
- \$500,000 partnership interest gets included in Ginger's estate for FET purposes
- Ginger's basis in her partnership interest is \$500,000
- The partnership's basis in the bldg is \$100,000

Death of a Partner – Basis (cont.)

- Ginger's successor-in-interest sells her partnership interest for \$500,000
 - No gain or loss
 - \$500,000 proceeds less \$500,000 basis stepped-up to FMV as of D/D

Death of a Partner – Basis (cont.)

- Partnership sells the apartment building for \$1,000,000
 - Partnership's gain is \$900,000 (\$1,000,000 proceeds less p/ship \$100,000 basis in the bldg)
 - Ginger's successor-in-interest distributive share of the gain on the sale is \$450,000 (\$900,000 gain divided between the two partners)
 - Note that if Ginger had owned her one-half interest in the property outright rather than in partnership, her estate would have a basis in the apartment building of \$500,000 and would not have had to recognize a gain on the sale

Death of a Partner – Basis (cont.)

- Note the problem
 - Sale of partnership interest – no gain to Ginger’s successor-in-interest
 - Sale of underlying asset of partnership (apartment building) - \$450,000 gain to Ginger’s successor-in-interest
- The amount of gain is determined by whether the partnership interest is sold or the partnership’s underlying asset is sold
- Inequitable result depending on the structure of the transaction

Death of a Partner – Basis (cont.)

- §754 election allows p/ship to elect to adjust the basis of the underlying assets of the p/ship to eliminate the disparity
- Election may be made on the death of a partner
- Election is made by the partnership
- Must be made by due date for p/ship return for the year in which the partner dies
- Requires separate accounting for deceased partner and all other partners

Death of a Partner – Basis (cont.)

- Election is made
- Sale of underlying partnership asset
- Proceeds \$1,000,000 less \$50,000 surviving partner's basis less \$500,000 deceased partner's basis as a result of the §754 election equals \$450,000 gain
 - Surviving partner reports entire \$450,000 gain
 - Deceased partner's successor in interest reports no gain
- Result: same tax treatment regardless of whether p/ship interest or p/ship's underlying assets sold

Death of a Partner – Basis (cont.)

- Alternative option if p/ship won't make §754 election
- §732(d) – any property distributed from the p/ship to the estate within 2 years of the partner's death gets a basis equal to the FET value

S Corporation - Taxation

- Beneficiary's income determined on a pro-rata basis (per share, per day)
- Decedent's 1040 reports income from beginning of year to D/D
 - No IRD
- Successor in interest reports income from day after D/D to end of year

S Corporation - Taxation

- Special allocation rule under §1377(a)(2) for “termination of interest”
- Share of income computed as if taxable year consisted of 2 taxable years, the first of which ends on the D/D
 - Special allocation valuable if income, deductions did not accrue ratably during the year

S Corporation – Special Allocation

S Corporation earns \$365 for the year

Regular Method:	6/30	
	D/D	
\$181		\$184
<hr/>		

Special Allocation:	6/30	
	D/D	
(\$100)		\$465
<hr/>		

S Corporation

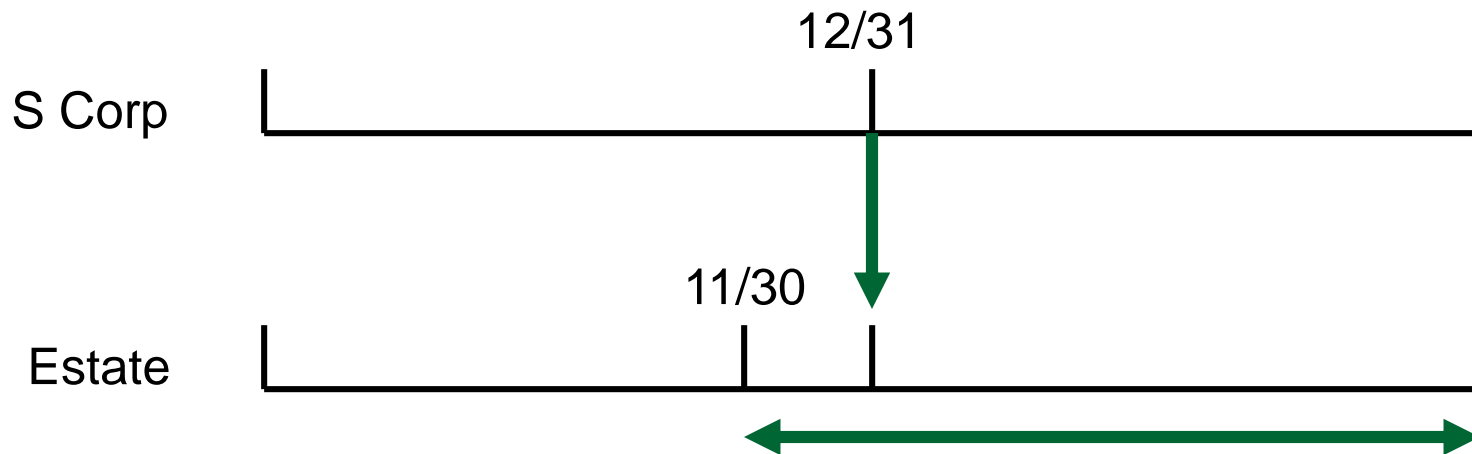
- An estate may hold S stock indefinitely, subject only to prolonged administration rules
- Estates may elect S status for corporations that were not operated as a S corporation by the decedent prior to the decedent's death. Rev. Rul. 92-83, 1992-2 C.B. 36.
 - If decedent died within 2 ½ months of the beginning of the C corporation's taxable year, a retroactive S election can be made and have the pre-death income taxed on the decedent's final 1040

S Corporation

- The estate, not its beneficiaries, is the S corporation shareholder
 - Thus, the following disqualified beneficiaries that could not own S corporation stock could receive the benefit of S corporation status during the administration of the estate:
 - Non-resident aliens
 - Complex and sprinkle trusts with multiple beneficiaries (absent a QSST or ESBT election)
 - Charitable split interest trusts

S Corporation

- Estate as a S corporation shareholder allows for a deferral of recognition of S corporation income
 - Example: Estate with November 30 FYE doesn't have to recognize December 31 FYE S corporation income until the following November 30 FYE



S Corporation

- In addition to estates, only certain trusts are eligible S corporation shareholders
 - Grantor Trust
 - Grantor Trust after owner's death* – 2 years beginning with D/D
 - Testamentary Trust* – 2 years after transfer of assets to trust
 - Voting Trust
 - QSST
 - ESBT

*May continue as eligible S corporation shareholder by electing QSST or ESBT status

S Corporation - Trusts

- LE/GTPOA marital trust under §2056(b)(5) is eligible S corporation S/H due to grantor trust status
- QTIP trust under §2056(b)(7) is not an eligible S corporation S/H unless a QSST or ESBT election is made
- QDOT under §2056A cannot qualify as a QSST unless the spouse/beneficiary becomes a U.S. citizen
- §2503(c) trust qualifies as a QSST as long as the trustee distributes or is required to distribute the income at least annually to the beneficiary
- CRAT or CRUT cannot qualify as a QSST

S Corporation - Trusts

- Termination of grantor trust at owner's death
 - If trust distributes outright, determine if distributees are qualified to hold S stock
 - If distributees are corporation, p/ship, ineligible trust or foreign individual or the number of S/H exceeds 100, S election automatically terminated
 - If trust continues after owner's death, trust is eligible S/H for 2 years
 - Trust would also be eligible S/H if it qualified as a QSST or ESBT

S Corporation - QSST

- Requirements – see §1361(d)(3)
 - Generally, the benefits of the S corporation are dedicated to one individual beneficiary and the beneficiary agrees to be treated as the deemed owner of the trust
- Election by beneficiary needed
 - Income beneficiary treated as owner of portion of trust consisting of S stock
 - Separate election for each S corporation whose stock owned by trust

S Corporation – ESBT §1361(e)

- Election needed by trustee

- Portion of ESBT that consists of S corporation stock is separate trust for income tax purposes
 - ESBT share taxable on S corporation income at highest trust income tax rate
 - Normal Subchapter J rules do not apply to S corporation portion
 - ESBT allows trust to have 2 or more beneficiaries, accumulate income, make discretionary distributions of both income and principal among the beneficiaries
 - Cost for distribution flexibility is higher income tax on S corporation's income

Conclusion

- Estate planning doesn't end when the client walks out the door
- There are a number of valuable post-mortem elections available
- Fiduciaries must be aware of the possible elections
- Realize that the most important estate planning is probably that which occurs AFTER DEATH

Thank You!