DEATHBED INCOME TAX AND TRANSFER TAX PLANNING OPPORTUNITIES

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1. AGENT ACTING UNDER POWER OF ATTORNEY

1.1. When a client is incapacitated and/or near death, using a power of attorney ("POA") can be the most efficient means of accomplishing tax and non-tax planning objectives and goals for the client. Although this outline is not intended to be a comprehensive discussion of POAs, there is a fair amount that is covered here nonetheless because of a POA's vast utility, the wide range of actions an agent can take pursuant to a POA, and the complexity and nuances of the statutory and caselaw (which can trip up not only agents but trusts and estates practitioners as well). To emphasize what we consider to be important points or salient features of the applicable law, we have bolded certain words.

1.2. Thirty-seven (37) states have enacted some form of the Uniform Power of Attorney Act (the "UPOAA"), and so the outline will make references to its sections.

1.3. The UPOAA does not apply however to the following:

1.3.1. "A power to the extent it is coupled with an interest in the subject of the power, including a power given to or for the benefit of a creditor in connection with a credit transaction." UPOAA §103(1).

1.3.2. "A power to make a health-care decision." UPOAA §103(2).

1.3.3. "A proxy or other delegation to exercise voting rights or management rights with respect to an entity." UPOAA §103(3).

1.3.4. "A power created on a form prescribed by a government or governmental subdivision, agency, or instrumentality for a governmental purpose." UPOAA §103(4).

1.4. Key definitions.

1.4.1. "Agent means a person granted authority to act for a principal under a power of attorney, whether denominated an agent, attorney-in-fact, or otherwise. The term includes an original agent, coagent, successor agent, and a person to which an agent's authority is delegated." UPOAA §102.

1.4.2. "Durable, with respect to a power of attorney, means not terminated by the principal's incapacity." Id.

1.4.3. "Incapacity means inability of an individual to manage property or business affairs because the individual: (1) has an impairment in the ability to receive and evaluate information or make or communicate decisions even with the use of technological assistance; or (2) is missing; (ii) detained, including incarcerated in a penal system; or (iii) outside the United States and unable to return." Id.

1.4.4. "Power of Attorney means a writing or other record that grants authority to an agent to act in the place of the principal, whether or not the term power of attorney is used." Id.

1.4.5. "Principal means an individual who grants authority to an agent in a power of attorney." Id.

1.5. Key statutory issues and questions.

1.5.1. Has the POA been executed with the proper formalities, and is it valid? Review UPOAA §§105 and 106 to confirm.

1.5.2. Has the POA been executed with the requisite formalities so that it can be recorded? Review UPOAA §105 and requisite state law to confirm.

1.5.3. Is the POA durable? Under the UPOAA, a POA is durable unless it expressly states otherwise. UPOAA §104.

1.5.4. When is the POA effective? Namely:

A. Is the POA effective immediately? Under the UPOAA, a POA is effective at the time it is executed unless it states that it becomes effective on a future date or upon the occurrence of a future event or contingency. UPOAA §109.

B. Is the POA effective on a future date?

C. Is the POA effective on a future event or contingency?

i. What is the future event or contingency?

ii. Who determines whether the future event or contingency has occurred? Under the UPOAA, the principal may authorize one or more persons to determine whether the future event or contingency has occurred. UPOAA §109.

iii. If, however, the future event or contingency is whether the principal is incapacitated, there is a sequential order of who makes that determination. First, the person who has been authorized to make the determination by the principal in the POA. UPOAA §109(C). Second, if the principal has not authorized any person to make the determination or if such person is unable or unwilling to make the determination, then the determination is made by either:

- the principal's attending physician and a second physician or licensed clinical psychologist after personally examining the principal; or

- an attorney-at-law, a judge or an appropriate governmental official. Id.

iv. A determination of the principal's incapacity by either (1) the principal's attending physician and a second physician or licensed clinical psychologist or (2) an attorney-at-law, a judge, or an appropriate governmental official must meet the subdivision 1 definition of incapacity in UPOAA §102(5)(B). Id.

v. If the principal has authorized a person to determine whether the principal is incapacitated, such person is the principal's personal representative for purposes of HIPAA. UPOAA §109(D).

1.5.5. Is the POA being held in escrow?

A. The principal might have instructed a third-party to hold onto the POA until either the principal directed the third-party to release the POA to the agent or the occurrence of a future event or contingency, at which time the third-party was to release the POA to the agent.

1.5.6. What authorities have been granted by the principal to the agent under the POA, and what is the scope of those authorities?

A. The following authorities are known as "hot powers" because they must be expressly granted by the principal in order for the agent to exercise them:

i. "Create, amend, revoke, or terminate an inter vivos trust";

ii. "Make a gift";

iii. "Create or change rights of survivorship";

iv. "Create or change a beneficiary designation";

v. "Delegate authority granted under the power of attorney";

vi. "Waive the principal's right to be a beneficiary of a joint and survivor annuity, including a survivor benefit under a retirement plan";

vii. "Exercise fiduciary powers that the principal has authority to delegate"; and

viii. "Exercise authority over the content of electronic communications, as defined in 18 U.S.C. Section 2510(12)[, as amended,] sent or received by the principal;" and

ix. "Disclaim property, including a power of appointment." UPOAA §201.

B. A "do all acts that the principal could do" grant of authority by the principal to the agent grants to the agent all of the authorities under UPOAA §§204 through 216. UPOAA §201(c).

Note: Language saying that the agent can do all acts that the principal could do does also grant to the agent the authority to make gifts, but only gifts that conform with the requirements of UPOAA § 217.

C. Even if the agent has been granted hot powers under UPOAA §201 or has the authority to make gifts under UPOAA §217, the exercise of those hot powers or the exercise of that authority may be nonetheless circumscribed due to how the agent is related to the principal. "Notwithstanding a grant of authority to do an act described in subsection (a), unless the power of attorney otherwise provides, an agent that is not an ancestor, spouse, or descendant of the principal, may not exercise authority under a power of attorney to create in the agent, or in an individual to whom the agent owes a legal obligation of support, an interest in the principal's property, whether by gift, right of survivorship, beneficiary designation, disclaimer, or otherwise." UPOAA §201(b).

D. The UPOAA groups authorities under rubrics, to wit: real property (§204); tangible personal property (§205); stocks and bonds (§206); commodities and options (§207); banks and other financial institutions (§208); operation of entity or business (§209); insurance and annuities (§210); estates, trusts, and other beneficial interests (§211); claims and litigation (§212); personal and family maintenance (§213); benefits from governmental programs or civil or military service (§214); retirement plans (§215); taxes (§216); and gifts (§217).

E. A principal can incorporate authorities by reference. Namely, if the POA refers to the descriptive term identifying the particular rubric or cites to the applicable statute for the particular rubric, the entirety of the rubric and all of the authorities granted thereunder are incorporated into the POA. A principal may modify however any authorities incorporated by reference. UPOAA §202(c).

F. The UPOAA has a layered approach when the authority to make gifts is granted. **Remember:** An agent has the authority to make gifts when the principal does one or more of the following: makes an express grant of the same, says that the agent can do all acts that the principal could do, refers to the rubric titled "gifts" under the UPOAA, and/or cites to UPOAA §217 (which is the statute for the "gifts" rubric).

i. The principal can customize the gifting authority.

ii. Any grant of authority to make gifts is subject to UPOAA §217 unless the POA states otherwise. UPOAA §201(d).

iii. Because UPOAA §217 can have a critical bearing on the scope of the agent's gifting authority, it is fully reproduced here:

"A. In this section, a gift 'for the benefit of' a person includes a gift to a trust, an account under the Uniform Transfers to Minors Act (1983/1986), and a tuition savings account or prepaid tuition plan as defined under Internal Revenue Code Section 529, 26 U.S.C. Section 529 [, as amended].

B. Unless the power of attorney otherwise provides, language in a power of attorney granting general authority with respect to gifts authorizes the agent only to:

1. Make outright to, or for the benefit of, a person a gift of any of the principal's property, including by the exercise of a presently exercisable general power of appointment held by the principal, in an amount per donee not to exceed the annual dollar limits of the federal gift tax exclusion under I.R.C. §2503(b), as amended, without regard to whether the federal gift tax exclusion applies to the gift, or if the principal's spouse agrees to consent to a split gift pursuant to I.R.C. §2513, as amended, in an amount per donee not to exceed twice the annual gift tax exclusion limit; and

2. Consent, pursuant to I.R.C. §2513, as amended, to the splitting of a gift made by the principal's spouse in an amount per donee not to exceed the aggregate annual gift tax exclusion for both spouses.

C. An agent may make a gift of the principal's property only as the agent determines is consistent with the principal's objectives if actually known by the agent and, if

unknown, as the agent determines is consistent with the principal's best interest based on all relevant factors, including:

1. The value and nature of the principal's property;

2. The principal's foreseeable obligations and need for maintenance;

3. Minimization of taxes, including income, estate, inheritance, generation-skipping transfer, and gift taxes;

4. Eligibility for a benefit, a program, or assistance under a statute or regulation; and

5. The principal's personal history of making or giving in making gifts."

Note: Virginia's modifications to the UPOAA have slightly different consequences than the UPOAA when it comes to gifting because the authority to make gifts pursuant to the "do all acts that the principal could do" language is not subject to Va. Code §64.2-1638 (UPOAA §217) unless the POA states that it is. Va. Code §§64.2-1622(C) & (H).

G. The rubric titled "estates, trusts, and beneficial interests", which appears at UPOAA §211, enables and authorizes the agent, in relevant part, to "exercise for the benefit of the principal a presently exercisable general power of appointment" and to "transfer an interest of the principal in real property, stocks and bonds, accounts with financial institutions or securities intermediaries, insurance, annuities, and other property to the trustee of a revocable trust created by the principal as settlor". UPOAA §211(b).

H. The rubric titled "personal and family maintenance", which appears at UPOAA §213, allows and authorizes the agent, in relevant part, to:

i. "perform the acts necessary to maintain the customary standard of living of the principal, the principal's spouse, and the following individuals, whether living when the power of attorney is executed or later born: (a) the principal's children; (b) the individuals legally entitled to be supported by the principal; and (c) the individuals whom the principal has customarily supported or indicated the intent to support;" UPOAA §213(a)(1).

ii. *"provide living quarters for the individuals described in [UPOAA §213(a)(1)] by: (a) purchase, lease, or other contract; or (b) paying the operating costs, including interest, amortization payments, repairs, improvements, and taxes, for premises owned by the principal or occupied by those individuals;"* UPOAA §213(a)(3).

iii. *"provide normal domestic help, usual vacations and travel expenses, and funds for shelter, clothing, food, appropriate education, including postsecondary and vocational education, and other current living costs for the individuals described in [§UPOAA §213(a)(1)];"* UPOAA §213(a)(4).

iv. *"pay expenses for necessary health care and custodial care on behalf of the individuals described in [§UPOAA §213(a)(1)];"* UPOAA §213(a)(5).

v. *"act as the principal's personal representative pursuant to the Health Insurance Portability and Accountability Act, §§1171 through 1179 of the Social Security Act, 42 U.S.C. §1320d, as amended, and applicable regulations, in making decisions related to the past, present, or future payment for the provision of health care consented to by the principal or anyone authorized under the law of this state to consent to health care on behalf of the principal;"* UPOAA §213(a)(6).

vi. *"continue any provision made by the principal for automobiles or other means of transportation, including registering, licensing, insuring, and replacing them, for the individuals described in [§UPOAA §213(a)(1)]*;" UPOAA §213(a)(7).

vii. *"maintain credit and debit accounts for the convenience of the individuals described in [§UPOAA §213(a)(1)] and open new accounts;"* UPOAA §213(a)(8); *and*

viii. *"continue payments incidental to the membership or affiliation of the principal in a religious institution, club, society, order, or other organization or to continue contributions to those organizations."* UPOAA §213(a)(9).

Note: The authorities the agent has under this rubric are not affected by whether the principal has granted to the agent the authority to make gifts. UPOAA §213(b). **In other words, the agent can make the payments authorized under the "personal and family maintenance" rubric even though the agent has not been otherwise authorized by the**

principal to make gifts, and such payments are not subject to, and therefore not constrained by, the limitations or conditions contained in UPOAA §217.

I. The rubric titled "benefits from governmental programs or civil or military service", which appears at UPOAA §214, enables and authorizes the agent, in relevant part, to "prepare, file, and maintain a claim of the principal for a benefit or assistance, financial or otherwise, to which the principal may be entitled under a statute or regulation", and "receive the financial proceeds of [such a] claim and conserve, invest, disburse, or use for a lawful purpose anything so received." UPOAA §214.

J. The rubric titled "retirement plans", which appears at UPOAA §215, enables and authorizes the agent, in relevant part, to "select the form and timing of payments under a retirement plan and withdraw benefits from a plan." UPOAA §215.

Note: The rubric does not expressly authorize the agent to make a Roth conversion.

K. The rubric titled "taxes", which appears at UPOAA §216, enables and authorizes the agent to:

i. *"prepare, sign, and file federal, state, local, and foreign income, gift, payroll, property, Federal Insurance Contributions Act, and other tax returns, claims for refunds, requests for extension of time, petitions regarding tax matters, and any other tax-related documents, including receipts, offers, waivers, consents, including consents and agreements under I.R.C. §2032A, as amended, closing agreements, and any power of attorney required by the Internal Revenue Service or other taxing authority with respect to a tax year upon which the statute of limitations has not run and the following 25 tax years;"*

ii. *"pay taxes due, collect refunds, post bonds, receive confidential information, and contest deficiencies determined by the Internal Revenue Service or other taxing authority;"*

iii. *"exercise any election available to the principal under federal, state, local, or foreign tax law;" and*

iv. *"act for the principal in all tax matters for all periods before the Internal Revenue Service or other taxing authority."* UPOAA §216.

Note:

- This rubric arguably allows the agent to make a Roth conversion.
- Review Treas. Reg. §601.503, paragraphs (a), (b), and (c) in particular, to understand the interaction between a POA and Form 2848 and the IRS's procedural requirements when an agent is attempting to handle tax matters on behalf of a principal.
- For example, the IRS will accept a POA if (1) the principal has granted the authority under the "taxes" rubric to the agent and/or authorized the agent to do all acts that the principal could do, (2) a completed Form 2848 with the principal's information as the taxpayer is attached to the POA, and (3) a statement executed by the agent under penalty of perjury is attached to the Form 2848 confirming the POA is valid under Virginia law.

L. A POA that says that the agent can do all acts that the principal could do and/or incorporates authorities by reference also grants to the agent the incidental authorities under UPOAA §203. These incidental authorities are presumably necessary for the agent to exercise effectively the authorities granted to the agent.

M. In the event any authorities granted to the agent are similar to or overlap with one another, the authority that is the broadest controls. UPOAA §201(E).

1.5.7. What duties does the agent owe to the principal?

A. The following are non-waivable under the UPOAA:

i. To "act in accordance with the principal's reasonable expectations to the extent actually known by the agent and, otherwise, in the principal's best interest;"

ii. To "act in good faith;" and

iii. To "act only within the scope of authority granted in the power of attorney." UPOAA §114(a).

B. The following are waivable under the UPOAA:

i. To "act loyally for the principal's benefit;"

ii. To "act so as not to create a conflict of interest that impairs the agent's ability to act impartially in the principal's best interest;"

iii. To "act with the care, competence, and diligence ordinarily exercised by agents in similar circumstances;"

iv. To "keep a record of all receipts, disbursements, and transactions made on behalf of the principal;"

v. To "cooperate with a person that has authority to make health care decisions for the principal to carry out the principal's reasonable expectations to the extent actually known by the agent and otherwise act in the principal's best interest;" and

vi. To "attempt to preserve the principal's estate plan, to the extent **actually** known by the agent, **if preserving the plan is consistent with the principal's best interest based on all the relevant factors**, including: (a) the value and nature of the principal's property; (b) the principal's foreseeable obligations and need for maintenance; (c) minimization of taxes, including income, estate, inheritance, generation-skipping transfer, and gift taxes; and (d) eligibility for a benefit, a program, or assistance under a statute or regulation." UPOAA §114(b).

C. Review the POA to confirm which of the agent's duties the principal has waived.

D. **Note:** "An agent that acts with care, competence, and diligence for the best interest of the principal is **not** liable solely because the agent also benefits from the act or has an individual or conflicting interest in relation to the property or affairs of the principal." UPOAA §114(d).

1.5.8. What is the relationship between the agent and a court-appointed fiduciary for the principal? "If, after a principal executes a power of attorney, a court appoints a conservator or guardian of the principal's estate or other fiduciary charged with the management of some or all of the principal's property, the agent is accountable to the fiduciary as well as to the principal. The power of attorney is **not** terminated and the agent's authority continues unless limited, suspended, or terminated by the court." UPOAA §108.

1.5.9. What if the POA is not accepted by an institution? Review and consider the remedies available under the various alternatives of UPOAA §120.

1.6. Caselaw: Federal and Virginia.

1.6.1. Although a POA is primarily a statutory creature, the common law continues to have relevance to the extent the UPOAA does not speak to or address a particular issue or matter. UPOAA §121. The following cases are some of the more significant ones that have dealt with the authorities granted to an agent under a POA.

1.6.2. Estate of Casey v. Comm'r, T.C. Memo. 1989-511, rev'd, 948 F.2d 895 (4th Cir. 1991).

A. **Note:** Casey was decided before the enactment of the UPOAA and is a federal judicial decision.

B. The power of attorney did not expressly grant to the agent the authority to make gifts or to convey or transfer property without consideration or value in return.

C. The power of attorney did authorize, though, the agent "to transact all of my business and to do and perform all things and acts relating to my property, real, personal or mixed, which I might do," and "to do, execute and perform all and every other act or acts, thing or things as fully and to all intents and purposes as I myself might or could do if acting personally, it being my intention by this instrument to give my attorney hereby appointed, full and complete power to handle any of my business or to deal with any and all of my property of every kind and description, real, personal, or mixed, wheresoever located and howsoever held, in his full and absolute discretion."

D. The agent made gifts of the principal's property to various individuals and entities, including the agent, and released the principal's dower interest when joining in gifts made by the principal's husband.

E. After the principal's death, a federal estate tax return was filed, and the gifts were not included in the gross estate.

F. The Tax Court held that transfers made by the agent were completed gifts "based on the broad grant of authority in the power of attorney itself and on the particular circumstances under which it was granted, as well as [the principal's] established pattern of giving . . . ."

G. The Fourth Circuit reversed on appeal, refusing to infer that the principal had granted to the agent an implied power to make gifts. Because the agent accordingly did not have the authority to make gifts of the principal's property under Virginia law, the transfers were void and therefore includible in the principal's gross estate pursuant to I.R.C. §2038.

1.6.3. Estate of Ridenour v. Comm'r, T.C. Memo. 1993-41, aff'd, 36 F.3d 332 (4th Cir. 1994).

A. **Note:** Ridenour was likewise decided before the enactment of the UPOAA and is a federal judicial decision.

B. Under the power of the attorney, the principal granted to the agent the authority "to do, execute and perform all and every act, matter and thing, in law or in the judgment of [the agent] needful or desirable to be done in relation to all or any part of [the principal's] property, estate, affairs, and business of any kind or description, as fully and amply, and with the same effect, as [the principal] might or could do if acting personally."

C. The principal also granted certain specific authorities to the agent, but this grant was not intended to limit in any way the authority quoted above.

D. The principal had a history of making gifts for tax-related reasons.

E. The agent made gifts totaling $85,000 to various individuals related to the principal, including the agent. The purpose of the gifts was, in part, to reduce the value of the gross estate and therefore, in turn, reduce the amount of estate tax due.

F. After the principal's death, a federal estate tax return was filed, and the $85,000 in gifts were not included in the gross estate.

G. The Tax Court held that the gifts were not includible in the gross estate because they were not revocable under Virginia law.

H. The Fourth Circuit upheld the Tax Court's decision and, in so doing, harmonized its decision here with its decision in Casey.

i. "Casey . . . stands for the proposition that to infer an implied gift power, the court must look to the intent of the person granting the power of attorney.

While we found that the instrument and circumstances involved in Casey did not indicate the principal's intent to confer a gift power on the attorney-in-fact, the evidence does support such an intent in the present case." 36 F.3d at 334.

ii. "Furthermore, we found in Casey that the principal's pattern of making gifts did not support an intent to confer a gift power on the attorney-in-fact. . . . These circumstances are clearly distinguishable from Ridenour's case." Id. at 334, 335.

iii. "Looking at the complete text of the instrument and circumstances surrounding its execution, we can infer that [the principal] intended to permit [the agent] to make gifts as [the principal] would do personally." Id. at 335.

1.6.4. Jones v. Brandt, 274 Va. 131 (2007).

A. **Note:** Jones was decided before the enactment of the UPOAA.

B. At the oral direction of the principal, the agent changed the payable on death designation for a certificate of deposit so that the executrix appointed under the principal's last will and testament was named as the beneficiary.

C. The Virginia Supreme Court upheld the agent's action even though the power of attorney did not expressly grant to the agent the authority to change a payable on death designation for a certificate of deposit and despite the principle of construction that powers of attorney are to be strictly construed.

i. The Virginia Supreme Court viewed the agent's action as not the exercise of the authority to make a gift but rather the exercise of the authority to contract on behalf of the principal.

ii. "We are of opinion that . . . the principal, sufficiently expressed the intent to authorize . . . the attorney-in-fact, to make a change in the beneficiary designation under the provisions . . . of the power of attorney when those provisions are considered in concert." Id. at 138.

D. The Virginia Supreme Court distinguished Casey by saying that the change in the payable on death designation transferred only an expectancy and not an actual interest.

1.6.5. Reineck v. Lemen, 292 Va. 710 (2016).

A. Under the power of attorney, the principal granted to the agent:

i. general authority that was broadly applicable (read: do all acts that the principal could do);

ii. general authority that was tied to the principal's IRA (read: do all acts that the principal could do with respect to the IRA);

iii. specific authority to perform certain actions with respect to any revocable trust created by the principal; and

iv. specific authority to create inter vivos trusts for the principal's benefit and the benefit of the principal's descendants.

B. The principal did **not** expressly grant to the agent specific authority to change the beneficiary designation for the IRA.

C. Pursuant to the power of attorney, the agent altered the principal's estate plan by creating new trusts for the benefit of the agent and the agent's sibling, transferring approximately $1,240,000 of the principal's assets to the new trusts, and changing the beneficiary designation of the principal's IRA to name the agent and the agent's sibling as the beneficiaries.

D. The Virginia Supreme Court held that all of the agent's actions were within the scope of the various authorities granted by the principal – including the change to the beneficiary designation for the IRA – and thus not ultra vires. It appears that this holding is inconsistent with the language of Va. Code §64.2-1622, which says that hot powers, such as the authority to change a beneficiary designation, must be expressly granted. Under this holding, a grant of authority whereby the agent is authorized to do all acts that the principal could do may be sufficient to grant the agent one or more hot powers.

E. **Caveat:** It is our opinion that trusts and estates practitioners should not rely on this holding alone as a sufficient reed for the argument or position that the principal has granted hot powers to the agent.

1.6.6. Davis v. Davis, 298 Va. 157 (2019).

A. Under a power of attorney executed in September 1993, the principal (who was the agent's son) granted to the agent (who was the principal's mother) the power to "transact for [the principal], in [the principal's name], place and stead, all business for [the principal] that [the principal] could do if acting personally; to endorse checks, write checks, make deposits in banks or other financial institutions . . . to receive any monies due [to the principal] and receipt for the same, to renew any savings account, certificate of deposit or other time deposit; **to sell and convey any and all personal property and all real property** [the principal] may own and execute and deliver an instrument for the same; . . . and **to execute and perform all and every act or acts**, thing or things in law needful and necessary to be done in about [the principal's] affairs, as fully, largely and amply, and **to all intents and purposes whatsoever as [the principal] might or could do if acting personally** . . . ". Id. at 163.

B. The principal executed a last will and testament in April 2005. At the time of its execution, the agent was unaware of both its existence and its contents.

C. In 2008, the agent became aware of the existence of the principal's last will and testament but did not know its contents.

D. The principal married in October 2013. The agent learned of the marriage soon thereafter.

E. In October 2013, after both the principal's marriage and the agent's knowledge of the same, the agent transferred most of the principal's personal property to herself and transferred all of the principal's real property to the principal's two siblings (who were also the agent's children). The agent did not inform the principal of these transfers.

F. The principal died in November 2013.

G. For the following reasons, the Wythe County Circuit Court held that agent had the authority to make the transfers and hence they were all valid:

   i. First, the "sell and convey" language in the power of attorney was sufficient to authorize the agent to make gifts of the principal's property.

   ii. Second, the grant of general authority in the power of attorney, coupled with Va. Code §64.2-1622(H), authorized the agent to make gifts in accordance with the principal's history of making gifts, and the transfers were in accordance with such history.

H. The Wythe County Circuit Court held as well that the limitation in Va. Code §64.2-1638(B)(1) did not apply to the agent's authority to make gifts in accordance with the principal's history of making gifts.

I. The Virginia Supreme Court reversed the Wythe County Circuit Court on appeal.

   i. First, because the authority to make gifts is a hot power, and a hot power must be expressly granted according to §64.2-1622(A), the "sell and convey" language was to have been strictly construed, and such language "d[id] not include the authority to make gifts or transfers for inadequate consideration." Id. at 169. (**Note:** The Virginia Supreme Court did not reconcile the foregoing with its decision in Reineck).

ii. Second, the transfers were not in accordance with the principal's history of making gifts.

- "When making a Code §64.2-1622(H) determination concerning whether gifts given by an attorney-in-fact pursuant to a power of attorney are in accordance with the principal's personal history of making or joining in the making of lifetime gifts, a circuit court must compare the factual similarities between the principal's prior lifetime gifts and the gifts made by the attorney-in-fact. **The factors the court should consider to determine if the attorney-in-fact's gifts are in accord with the principal's prior lifetime gifts may include, but are not limited to, the purpose, nature, frequency, amount, and recipients of the principal's prior lifetime gifts compared to the gifts made by the attorney-in-fact.**" Id. at 173.

- "The nature, amount, purpose, and timing of the gifts made by [the agent] makes her transfers akin to testamentary gifts, rather than 'lifetime gifts' as contemplated by Code §64.2-1622(H)." Id. at 175.

1.7. Key federal tax law issues and questions.

1.7.1. Plainly, a POA can facilitate and effectuate a number of planning opportunities for the client. The following is a discussion of some of those opportunities when transfer taxes are a primary consideration (and the concomitant hazards trusts and estates practitioners should be aware of).

1.7.2. If the requisite authority has been granted:

A. Consider making gifts that qualify for the annual exclusion under I.R.C. §2503(b). (See discussion, infra, at 2.2.)

i. In 2024, the annual exclusion amount, as adjusted for inflation, is $18,000 per donee in each calendar year.

ii. The number of donees to whom an annual exclusion gift can be made is unlimited.

iii. In order for a gift to qualify for the annual exclusion, it must be a gift of a present interest. I.R.C. §2503(b)(1); Treas. Reg. §25.2503-3(a). A present interest is "an unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (such as a life estate or term certain)." Treas. Reg. §25.2503-3(b). A gift of a future

interest is therefore not eligible for annual exclusion treatment. A future interest "includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time." Treas. Reg. §25.2503-3(a).

iv. Intermediaries cannot be used to increase the number of annual exclusion gifts to a donee. Heyen v. U.S., 945 F.2d 359 (10th Cir. 1991).

v. A gift that qualifies for the annual exclusion:

- Should also be exempt from the GST tax, provided it was a direct skip, but if it was not a direct skip, will need to satisfy additional requirements in order to be exempt from the GST tax; I.R.C. §2642(c); and

- should not be includible in the principal's gross estate, even if it was made from the principal's revocable trust, provided the principal was treated as the owner of the revocable trust under I.R.C. §676 at the time the gift was made; See I.R.C. §§2035(c)(3) & (e).

B. Prior to the enactment of I.R.C. §2035(e), there were a number of IRS rulings and court decisions that addressed whether annual exclusion gifts made from a donor's revocable trust within three years of the donor's date of death were includible in the donor's gross estate under I.R.C. §§2035 and 2038. The question at the heart of those rules and cases was whether the annual exclusion gifts represented relinquishments of the power to revoke. With the enactment of I.R.C. §2035(e), the application of those rulings and decisions has been largely precluded because annual exclusion gifts from a revocable trust are treated as having been made directly by the donor. **Remember:** The availability of §2035(e) treatment is dependent on the donor being considered the owner of the revocable trust for income tax purposes under I.R.C. §676. **Caveat:** If the trustee of a revocable trust does not have the power to make gifts or payments to third-parties, the grantor is deemed to have exercised the power to withdraw assets from the revocable trust and to have made the gifts or payments directly. Estate of Jalkut v. Comm'r, 96 T.C. 675 (1991). If the grantor of a revocable trust is incapable of exercising the power to withdraw assets though, gifts or payments made by the trustee of the revocable trust to third-parties are

characterized as relinquishments under I.R.C. §2038 and therefore includible in the grantor's gross estate. Id.

C. Consider making payments that qualify for treatment under I.R.C. §2503(e). (See discussion, infra, at 8.3.) Namely:

i. "Any amount paid on behalf of an individual as tuition to an educational organization described in section 170(b)(1)(A)(ii) for the education or training of such individual" does not constitute a gift for gift tax purposes. I.R.C. §2503(e)(2)(A).

ii. "Any amount paid on behalf of an individual to any person who provides medical care (as defined in section 213(d)) with respect to such individual as payment for such medical care" does not constitute a gift for gift tax purposes. I.R.C. §2503(e)(2)(B).

iii. Payments made pursuant to I.R.C. §2503(e), whether for tuition or medical care, can be unlimited in amount, do not count against the annual exclusion but rather are additional, Treas. Reg. §25.2503-6(a), may be made from a revocable trust, See I.R.C. §2035(e), are "excluded in determining the total amount of gifts in a calendar year", Treas. Reg. §25.2503-6(a), and are exempt from the GST tax, I.R.C. §2642(c).

iv. The relationship between the principal and the donee is immaterial. Treas. Reg. §25.2503-6(a).

D. Consider making a gift to a 529 Qualified Tuition Program account. A gift to a 529 Qualified Tuition Program account qualifies for the annual exclusion. See I.R.C. §529(c)(2)(A)(i). (See discussion, infra, at 2.2.4.)

E. Consider making a gift to a 529A Qualified ABLE Program account. A gift to a 529A Qualified ABLE Program account qualifies for the annual exclusion. See I.R.C. §529A(c)(2)(A)(i). (See discussion, infra, at 2.2.5.)

F. **Note:** If the principal's spouse is not a U.S. citizen, any gift to the spouse will not qualify for the unlimited gift tax marital deduction. (See discussion, infra, at 2.2.3.)

G. Does the authority to make gifts constitute a general power of appointment? Although the law is unclear, it is nonetheless prudent for trusts and practitioners to give due consideration to this question.

i. Review the POA to confirm whether it contains any applicable carve back or savings provision, such as an ascertainable standard or the ability to appoint a special or independent agent. **Note:** The UPOAA does not have any carve backs or savings provisions that would apply by default or as gap fillers. Furthermore, if the POA was deemed to constitute a power of appointment, the POA would presumptively be a general power of appointment.

ii. Analyze the authority to make gifts under federal transfer tax law.

- "The term 'general power of appointment' means a power which is exercisable in favor of the individual possessing the power . . . , his estate, his creditors, or the creditors of his estate." I.R.C. §2514(c).

- The substance – and not the form – of the power matters. Treas. Reg. §25.2514-1(b)(1) ("The term 'power of appointment' includes all powers which are in substance and effect powers of appointment received by the donee of the power from another person, regardless of the nomenclature used in creating the power and regardless of local property law connotations.").

- A power **limited by an ascertainable standard** is not a general power of appointment. I.R.C. §2514(c)(1).

- A power created after October 21, 1942 that is exercisable **only in conjunction with the person who created the power** is not a general power of appointment. I.R.C. §2514(c)(3)(A).

- A power created after October 21, 1942 that is exercisable **only in conjunction with a person who has a substantial interest in the property which is subject to such power and whose interest is adverse to the exercise of the power in favor of the powerholder** is not a general power of appointment. I.R.C. §2514(c)(3)(B).

- **Note:** A POA that is revocable by the principal may not necessarily mean that the agent's authority to make gifts is exercisable in conjunction with the principal. See GCM 37428 (1978).

1.7.3. Does the agent possess any incidents of ownership over any life insurance policies where the agent is the insured? If the principal owns a policy insuring the agent and the agent can exercise authorities granted under the POA with respect to such policy for the agent's personal benefit, it is arguable that the agent possesses incidents of ownership over such policy. See Rev. Rul. 84-179, 1984-2 C.B. 195.

2. MINIMIZATION OF ESTATE, GIFT, & GST TAX

2.1. For the last several years, it was only a microscopic percentage of the population that had to be concerned about transfer taxes, whether estate, gift, or GST. In response, trusts and estates practitioners pivoted to income tax planning as that had more relevancy to most clients. With a change in both the White House and Congress and with what the Biden-Harris administration has floated in their tax proposals, a partial pivot back to transfer tax planning by trusts and estates practitioners may be appropriate and ultimately necessary. This back to the future moment we find ourselves in is the impetus for the discussion that follows, and this discussion is intended to function as a preliminary refresher of techniques that we might not have taken off the shelf in a while and the adjacent issues to consider. As before, to emphasize what we consider to be important points or salient features of the applicable law, we have bolded certain words.

2.2. Annual exclusion gifts.

2.2.1. See discussion, supra, at 1.7.2(A).

2.2.2. Remember:

A. In order for the gift to qualify for the annual exclusion, it must be a gift of a present interest;

B. Annual exclusion gifts are tabulated on a per donee per calendar year basis;

C. The annual exclusion amount in 2024 is $18,000 per donee;

D. Annual exclusion gifts can be made to an unlimited number of donees;

E. The use of intermediaries to increase the number of annual exclusion gifts to a donee is verboten; and

F. Annual exclusion gifts are not brought back into the donor's gross estate (unless they are deemed void or the donor has retained impermissible strings under either I.R.C. §2036 or §2038).

2.2.3. **Note and Remember:** Although a gift to a spouse who is not a U.S. citizen does not qualify for the gift tax marital deduction, it may nonetheless qualify

under the exclusion set forth in I.R.C. §2523(i)(2) (which is $185,000 in 2024).

2.2.4. **Caveat:** Although five years of annual exclusion gifts can be frontloaded to a 529 Qualified Tuition Program account, do not frontload them when the client is near death because part – if not all – of those gifts will be brought back into the donor's gross estate due to the donor not having survived the five-year period.

2.2.5. **Caveat:** Annual exclusion gifts cannot be frontloaded to a 529A ABLE Program account.

2.2.6. **Caveat:** Annual exclusion gifts may create problems around equality or fairness if members of one specific family line receive, in the aggregate, more annual exclusion gifts than the members of another specific family line. These problems can be addressed by gifting the same aggregate amount to each specific family line or through an equalization provision in the client's estate plan.

2.3. Direct payments of educational and medical expenses.

2.3.1. See discussion, supra, at 1.7.2(C).

2.3.2. **Note and Remember:**

A. "Section 2503(e) provides that any qualified transfer after December 31, 1981 shall not be treated as a transfer of property by gift . . . . Thus, a qualified transfer on behalf of any individual is excluded in determining the total amount of gifts in calendar year 1982 and subsequent years. This exclusion is available in addition to the . . . annual gift tax exclusion. Furthermore, an exclusion for a qualified transfer is permitted without regard to the relationship between the donor and the donee." Treas. Reg. §25.2503-6(a).

B. "The term 'qualified transfer' means any amount paid on behalf of an individual as **tuition** to a **qualifying educational organization** for the **education or training** of that individual or to any person who provides **medical care** with respect to that individual as payment for the **qualifying medical expenses** arising from such **medical care**." Treas. Reg. §25.2503-6(b)(1).

C. "A qualifying educational organization is one which **normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on**. **See Section 170(b)(1)(A)(ii) and the regulations thereunder.** The unlimited exclusion is permitted for **tuition expenses of full-time or part-time students paid directly to the qualifying**

educational organization providing the education. No unlimited exclusion is permitted for amounts paid for books, supplies, dormitory fees, board, or other similar expenses which do not constitute direct tuition costs." Treas. Reg. §25.2503-6(b)(2).

D. **Note:** "According to Rev. Rul. 78-446, [1978-2 C.B. 257], a nursery or pre-school administering a group day care program may satisfy §2503(e) if (1) it has a regular enrollment of children aged three to six years who attend all day, five days a week, up to 52 weeks a year, (2) it is operated in an open classroom setting with various groups having different instruction, (3) it has planned educational activities including exercises in listening skills, exposure to numbers, letters, concepts, mathematics, science, arts and crafts, and problem solving, and (4) the instruction is provided by a head teacher and at least two assistants for each classroom. Conversely, a family day care program providing child care in the homes of a staff of child-care trained personnel and including story reading, projects involving science or art, letters, and numbers may not satisfy the requirements of §2503(e) because the primary purpose of the program is custodial, not the presentation of formal instruction, even though the program has some educational activities." Lischer, 845-3rd T.M.P., *Gifts*, Educational Expense, Detailed Analysis, IX.B.1.

E. "Qualifying medical expenses are limited to those expenses defined in Section 213(d) (Section 213(e) prior to January 1, 1984) **and include expenses incurred for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body or for transportation primarily for and essential to medical care**. **In addition, the unlimited exclusion from the gift tax includes amounts paid for medical insurance on behalf of any individual. The unlimited exclusion from the gift tax does not apply to amounts paid for medical care that are reimbursed by the donee's insurance.** Thus, if payment for a medical expense is reimbursed by the donee's insurance company, the donor's payment for that expense, to the extent of the reimbursed amount, is not eligible for the unlimited exclusion from the gift tax and the gift is treated as having been made on the date the reimbursement is received by the donee." Treas. Reg. §25.2503-6(b)(3).

F. **Note:** "The term 'medical care' does **not** include cosmetic surgery or other similar procedures, **unless** the surgery or procedure is necessary to ameliorate a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or disfiguring disease. For purposes of this paragraph, the term 'cosmetic surgery' means any procedure which

is directed at improving the patient's appearance and does not meaningfully promote the proper function of the body or prevent or treat illness or disease." I.R.C. §213(d)(9).

G. In order to qualify for exclusion treatment under I.R.C. §2503(e), payments, whether for tuition or medical care, must be made directly to the service provider.

H. Advance, non-refundable payments of tuition for future years qualify for exclusion treatment under I.R.C. §2503(e). TAM 199941013.

I. **Caveat:** Like with annual exclusion gifts, tuition and/or medical care payments may create problems around equality or fairness if more of such payments are made for the benefit of the members of one specific family line than the members of another specific family line. These problems can also be addressed by making payments in the same aggregate amount for the benefit of each specific family line or through an equalization provision in the client's estate plan.

2.4. If any are in existence, consider making gifts to a trust that has Crummey withdrawal rights.

2.5. Ensure that any gift made is complete under state law and for federal gift tax purposes.

2.5.1. State law requirements (Virginia).

A. There must have been donative intent at the time the gift was made. Knop v. Knop, 297 Va. 553 (2019).

B. There must have been actual or constructive delivery of the property that is the subject matter of the gift. **Note:** In Knop, shares of stock were the subject matter of the gift, and the Virginia Supreme Court held that, even though the purported donees had been treated as the owners of such shares of stock on the company's books and records and in its tax filings, the delivery requirement had nonetheless not been met because the certificates for the shares of stock had not been delivered to the purported donees.

C. The donor must have been divested of all dominion and control over the property that is the subject matter of the gift.

D. The donee must have been vested with all dominion and control over the property that is the subject matter of the gift.

2.5.2. Federal gift tax requirements.

A. Donative intent is immaterial.

B. Has the donor relinquished all dominion and control over the transferred property?

C. Has the donor retained any legal right or beneficial interest to or in the transferred property?

D. The answer to each of the preceding questions is dependent upon whether the state law requirements have been satisfied or not. In other words, whether the donor has any dominion, control, and/or legal right or beneficial interest to or in the property is determined under state law.

E. **Note:** A gift may be complete for federal gift tax purposes but incomplete for federal estate tax purposes, e.g., property over which the donor has retained the power to affect the time or manner of enjoyment and thus is includible in the donor's gross estate pursuant to I.R.C. §2038.

F. **Note:** Under Revenue Ruling 96-56, 1996-2 C.B. 161, "delivery of a check to a **noncharitable** donee will be deemed to be a completed gift for federal gift and estate tax purposes on the **earlier** of (i) the date on which the donor has so parted with dominion and control under local law as to leave in the donor no power to change its disposition, or (ii) the date on which the donee deposits the check (or cashes the check against available funds of the donee) or presents the check for payment, if it is established that: (1) the check was paid by the drawee bank when first presented to the drawee bank for payment; (2) the donor was alive when the check was paid by the drawee bank; (3) the donor intended to make a gift; (4) delivery of the check by the donor was unconditional; and (5) the check was deposited, cashed, or presented in the calendar year for which completed gift treatment is sought and within a reasonable time of issuance." In light of the foregoing, if the client wants to write a check to a non-charitable donee as a gift at the end of his or her life, consider using and delivering a cashier's or certified check.

G. In Estate of Demuth v. Commissioner (T.C. Memo 2022-72), the Tax Court clarified the rules surrounding gifts made by checks written but not deposited prior to death. In *Demuth*, the taxpayer's son wrote and delivered eleven checks totaling $465,000 that all represented annual exclusion gifts to various individuals. The taxpayer died five days following the writing of the checks. At the time of his death, the checks were at various stages in being cashed or deposited:

i. 1 check had been paid by the "drawee bank"—the bank from which the checks were written;

ii. 3 checks had been deposited into the donees' banks and credited by those banks, but the drawee bank had not paid the depositors' banks; and

iii. 7 checks had not been deposited by the donees.

The seven checks that had not been deposited clearly were not completed gifts and were included in the taxpayer's estate.

The question was which of the four checks that had been deposited by the donees was to be included in the taxpayer's estate. This case is further complicated because the IRS unintentionally conceded that the three checks that had been deposited but not yet paid were not to be included in the gross estate because of a confusion of terms. The Tax Court stated that only the one check that had actually been paid by the drawee bank was a complete gift for gift tax purposes but ruled that the three checks that had been deposited pre-death were not included in the taxpayer's estate because of the IRS' unintentional concession.

Note: Demuth was decided under Pennsylvania state law, so a different state law could yield a different result. The Tax Court based its ruling on Pennsylvania law that stated a check is irrevocable when a stop order payment can no longer go through—once the drawee bank has paid out the funds.

2.6. If the client's estate plan includes pecuniary bequests, consider funding those bequests in advance if they can be covered by the annual exclusion and then amend or modify the client's estate plan accordingly, whether by amendment or by treating the transfers as advancements.

2.7. If the client is philanthropically inclined, consider making charitable contributions to an eligible organization under I.R.C. §2522 possibly in lieu of existing charitable bequests. **Note:** The relation-back doctrine applies to charitable contributions made by check. Accordingly, a check issued to a charity is deemed to have been delivered even though it is not deposited or cashed until after the donor's death. Estate of Belcher v. Comm'r, 83 T.C. 227 (1984); AOD 1989-014.

2.8. If the client is married and a bypass trust is established under the client's estate plan, consider having the client's spouse transfer assets to the client so that the bypass trust can be fully funded. **Note:** Under portability, the DSUE refers to the unused exclusion amount of the last deceased spouse. Accordingly, if the surviving spouse remarries, and the new spouse predeceases the surviving spouse, the surviving spouse can only port over the DSUE of the new spouse, and the DSUE of the previous spouse is lost. In other words, the surviving spouse cannot

aggregate the DSUEs but is limited to only the DSUE of the last spouse who predeceased.

2.9. If the client is married and the client's estate plan establishes continuing trusts for the benefit of the client's spouse, consider having the client's spouse transfer assets to the client so that a valuation discount can eventually be obtained through the principle of non-aggregation of interests. Estate of Mellinger v. Comm'r, 112 T.C. 26 (1999); AOD 1999-006. **Note:** The principle of non-aggregation of interests is not available when an outright disposition is made to the surviving spouse, nor is it available when portability is used in lieu of continuing trusts for the benefit of the surviving spouse.

2.10. If the client is a beneficiary of a QTIP trust, consider having distributions made from the QTIP trust to the client in order to obtain valuation discounts based on the principle of non-aggregation of interests.

2.11. Consider gifting fractional interests in real property to obtain valuation discounts. See generally, Farhad Aghdami, Estate Planning for Real Estate Investors, 47 William & Mary Annual Tax Conference (2008). Gifts of fractional interests in real property will qualify for the annual exclusion. Rev. Rul. 83-180, 1983-2 C.B. 169.

2.12. If the client is married, consider splitting gifts with the client's spouse. But see, Diana S.C. Zeydel, Gift-Splitting? A Boondoggle or a Bad Idea? A Comprehensive Look at the Rules, Journal of Taxation (June 2007) (discussing problems that occur when gifts that have been gift-split are brought back into the donor-spouse's estate).

2.13. If it is known that a beneficiary plans on buying a depreciating asset, such as a car or a boat, consider having the client purchase the depreciating asset and then bequeathing the same to the beneficiary under the client's estate plan in order to lower the value of the client's gross estate.

2.14. If the client owns any interests in closely-held entities:

2.14.1. Consider gifting such interests as they may qualify for the annual exclusion and to generate valuation discounts for what is gifted and what is retained. TAM 9131006. **Caveat:** If the sole purpose of such gifts is to obtain a minority interest valuation discount, that stratagem may fail. Estate of Murphy v. Comm'r, T.C. Memo 1990-472. That does not mean, however, that minority interest valuation discounts are completely off the table. Deathbed gifts have still been held to result in minority interest valuation discounts. E.g., Estate of Frank v. Comm'r, T.C. Memo 1995-132.

2.14.2. Consider altering or modifying the governing documents with respect to such entities or, if such interests represent controlling interests, consider gifting them in order to obtain valuation discounts.

2.14.3. In light of the decision in Estate of Powell v. Commissioner, consider altering or modifying the governing documents with respect to such entities

or selling such interests for adequate and full consideration in order to avoid estate inclusion. In Powell, the Tax Court held that assets contributed to a family limited partnership were includible in the decedent's gross estate under I.R.C. §2035(a) even though the decedent owned only a limited partnership interest because I.R.C. §2036(a)(2) applied. Namely, by being able to dissolve the family limited partnership in conjunction with the other partners, the decedent had the right "to designate the persons who [could] possess or enjoy the [contributed assets] or the income therefrom." 148 T.C. 392 (2017). See also Estate of Moore v. Comm'r, T.C. Memo 2020-40 (holding that assets transferred to a family limited partnership were includible in the decedent's gross estate under I.R.C. §2036(a)(1) and then applying I.R.C. §2043 to determine the value to be included which can lead to unexpected results).

2.15. If eligibility for treatment under either I.R.C. §303 or §6166 is a relevant consideration, consider what measures can be taken to qualify for such treatment.

2.15.1. Under I.R.C. §303, the redemption of a decedent's shares of stock are treated as a capital transaction and not a dividend payment up to an amount equal to the sum of all estate taxes and all allowable funeral and administration expenses. In order to be eligible and thus qualify for treatment under I.R.C. §303, the value of the decedent's shares of stock must exceed 35% of the value of the adjusted gross estate. Appropriate pre-death planning measures could involve increasing the value of such shares of stock vis-à-vis the value of the adjusted gross estate by transferring assets into the company.

2.15.2. Under I.R.C. §6166, the payment of estate tax attributable to a closely-held business interest may be deferred for up to fourteen years. As with I.R.C. §303, the value of the closely-held business interest must exceed 35% of the value of the adjusted gross estate. Because the closely-held business must be engaged in an active trade or business, appropriate pre-death planning measures taken may include enhancing that particular feature of the closely-held business by disposing or reducing assets from the closely-held business or adding assets to the closely-held business.

2.16. If a *Graegin* loan is a relevant consideration, consider what steps can be taken to render the client's estate even more illiquid. In Estate of Graegin v. Commissioner, the estate borrowed money from a family-owned company to pay the estate tax due, and the interest on the promissory note, which had yet to be paid and which was to take the form of a balloon payment at the end of a fifteen-year term, was allowed to be deducted as a reasonable and necessary administration expense under I.R.C. §2053(a)(2). T.C. Memo 1988-477. **Note:** Regulations proposed by the Service on June 28, 2022 under I.R.C. §2053 may limit the use of *Gragein* loans in the future. The proposed regulations provide that interest on an obligation of an estate used to pay estate tax liability can only be deducted if the loan's terms are actually and necessarily incurred in the administration of the decedent's estate and are essential

to the proper settlement of the decedent's estate. The proposed regulations specifically target loans by related parties and loans structured to create or increase the amount of interest that is deductible. See Guidance Under Section 2053 Regarding Deduction for Interest Expense and Amounts Paid Under a Personal Guarantee, Certain Substantiation Requirements, and Applicability of Present Value Concepts, 87 Fed. Reg. 38331 (proposed June 28, 2022) (to be codified at 26 CFR 20)

2.17. If the client is married, consider having the client's spouse transfer assets to the client so that the client's exemption from the GST tax can be fully used. **Note:** A portability election cannot be made for unused GST exemption. Because unused GST exemption is not portable, consider other ways as well that the client's unused GST exemption can be preserved, such as through the use of inter vivos QTIP trusts.

2.18. Consider mechanisms to cause estate inclusion at the next generation's level to reduce exposure to the GST tax, such as the granting of a general power of appointment to a non-skip person who has an interest in a non-GST-exempt trust.

2.19. Consider making transfers to a health and education exclusion trust (a "HEET"), such as through the exercise of a power of appointment, to avoid the GST tax.

2.20. If (1) the client is subject to state estate tax, (2) there is no state gift tax, (3) the state does not have a clawback for deathbed gifts, and (4) the estate tax base for state estate tax purposes does not include adjusted taxable gifts, consider making gifts to reduce the client's exposure to the state estate tax by capitalizing on the non-congruence between the estate tax base for state estate tax purposes and the estate tax base for federal estate tax purposes (which includes adjusted taxable gifts).

2.21. If (1) the client is subject to state estate tax and (2) the state estate tax liability arises because of tangible personal property located in the state, consider moving the tangible personal property to a different state that does not have an estate tax.

2.22. If (1) the client is subject to state estate tax and (2) the state estate tax liability arises because of real property located in the state, consider transferring the real property to an entity. **Caveat:** The state may look through the entity and impose estate tax nonetheless.

2.23. If the client has IRD, consider accelerating the IRD so that the income tax paid can be claimed as a deduction for federal and state estate tax purposes.

2.24. For gift giving purposes, gift the client's assets that have a high basis.

3. INCOME TAX PLANNING AT THE END OF LIFE

3.1. Core Final Individual Income Tax Return Concepts.

3.1.1. We have to know the income tax basics prior to engaging in planning.

3.1.2. The income, deduction and credit activity of a decedent received or paid prior to death are reportable on the final individual income tax return ("Final Return") for the time period of January 1 through the date of death.

3.1.3. The method of accounting (either cash method or accrual method) regularly utilized by the decedent before death also determines the income includible on the Final Return. Under the cash method, only those terms actually or constructively received before death are included in the Final Return. https://www.irs.gov/taxtopics/tc356; IRS Publication 559 (2023), Survivors, Executors, and , p. 5. Generally, under an accrual method of accounting, income is reported when it is earned. If the decedent used an accrual method, only the income items normally accrued before death are included in the Final Return. Id.

3.1.4. Decedent's medical expenses may be deducted on either the decedent's income tax return for the year in which they were incurred provided they are paid by the estate (or trust) within one year after the decedent's death, or on the estate tax return. I.R.C. §213(c); Rev. Rul. 77-357, 1977-2 C. B. 328.

3.1.5. The personal representative (or trustee) may elect to report all previously unreported E or EE bond interest accrued to the date of death, even if a cash basis taxpayer. I.R.C. §454(a); Rev. Rul. 79-409, 1979-2 C. B. 206; PLR 9232006.

3.2. Special Rules For Income on the Final Return.

3.2.1. Trusts

In general, only distributable net income represented by actual distributions from an estate or trust to a decedent prior to his or her death is included on the Final Return.

If the decedent was the beneficiary of a simple trust, the Final Return will also include all distributable net income of the trust for a trust taxable year ending on or before the date of decedent's death. Treas. Reg. §§1.652(a) – 2 and 1.662(c)-2.

3.2.2. Partnerships

The death of a partner closes the partnership's tax year for that partner. Generally, the death of a partner does not close the partnership's tax year for the remaining partners. The decedent's distributive share of partnership items must be figured as if the partnership's tax year ended on the date the partner died. I.R.C. §706(c). More specifically, the allocation for the short year is made by an interim closing of the partnership's books or, if all of the partners agree, on a pro rata basis based on the number of days in each period. See Treas. Reg. §1.706-1(c)(2)(ii). In general, it is preferable to

elect out of the 'exact method' in order to avoid the expensive accounting costs of preparing a mid-year closing.

As a result, in the year of death, a deceased partner's share of the partnership should generate two Forms K-1 in the year of death – one to partner for his or her Final Return and one to his or her estate or trust.

3.2.3. S Corporations

The deceased shareholder of an S Corporation must include on his or her Final Return the decedent's pro rata share of the S corporation's income for the period from the beginning of the year to the date of death, on a number of days allocation basis. I.R.C. §1377(a)(1). If all the shareholders agree, the allocation for the short year is made by an interim closing of the books. I.R.C. §1377(a)(2).

3.3. Carry-Overs and Carry-Forwards

3.3.1. General

Net operating loss carry-overs, charitable deduction carry-forwards and capital loss carry-forwards from a prior year are deductible only on the Final Return and any unused losses or deductions are lost upon death as only the taxpayer who sustains the loss is entitled to take a deduction. Rev. Rul. §74-175, 1974-C.B. 52; Treas. Reg. §1.170 A-10(d)4; See ILM 201047021 (estate's beneficiaries could not use estate's unused capital loss carryover).

3.3.2. Joint Return Exception

If a decedent was married and the surviving spouse files a joint return, then the surviving spouse may utilize losses generated by his or her deceased spouse to offset tax attributes generated in the same tax year as the tax year of the deceased spouse is deemed to have ended with the end of the relevant tax year for the surviving spouse. I.R.C. §1.2-1 (b).

3.4. Passive Losses.

3.4.1. Passive activity losses and passive activity carry-overs relate to activities that are passive in nature in which a taxpayer does not materially participate. These types of losses cannot offset non passive income but are suspended until the taxpayer has passive income or fully disposes of the investment from which such losses were generated. I.R.C §469 (g)(1). Upon disposition, the suspended passive activity losses can be utilized against other income. If passive activity loss property is sold to a related party, then loss is disallowed under related party rules. I.R.C §267 (a). The disallowed loss is added to the basis of the related person and the related person recognizes gain to the extent such gain exceeds the disallowed loss upon the later sale of that property. I.R.C §267(d)(1).

3.4.2. If an interest in a passive activity is transferred by reason of the owner's death, the unused suspended losses are allowed as a deduction against non-passive income in decedent's Final Return but only to the extent that such losses exceed the amount by which the transferee's basis in the passive activity has been "stepped up" under I.R.C. §1014. I.R.C. §469(g)(2). Any losses not in excess of the basis step-up are lost.

3.4.3. There is some uncertainty as to the applicability of the I.R.C. §469 (g)(2) treatment of assets owned by a grantor trust for income tax purposes at the death of the grantor. It has been suggested that if the assets of a grantor trust are not to be included in the gross estate of the taxpayer, then the suspended losses attributable to those assets should be triggered and allowed on the Final Return. See FSA 200106018; Cal Fiore, You Can't Take It With You (But Don't Have To Lose It): Pre and Post Mortem Planning For Income Tax Attributes, Estate Planning (Feb. 2021), p. 19.

3.5. Basis Adjustments at Death.

3.5.1. In general, property acquired from a decedent has an income tax basis equal to its fair market value as of the decedent's date of death or at the alternate valuation date, if applicable. I.R.C. §1014(a)(1). The fair market value is deemed to be the value as finally determined for federal estate tax purposes or "if no estate tax return is required to be filed," then as determined for state death taxes. Treas. Reg. §1.1014-3(a). If no federal or state estate tax return is required to be filed, fair market value would, of course, not be reported initially but still be ascertained using federal estate tax valuation principles.

3.5.2. For estate tax purposes, the fair market value of an asset is "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Treas. Reg. §20.2031-1(b). This is the "willing buyer/willing seller" test which is the cornerstone of the valuation process. The treasury regulations provide some fairly specific guidance as to some particular types of assets, including promissory notes and closely held business interests. The valuation of real estate is not addressed in depth in the relevant regulations.

3.5.3. The fair market value of an interest in a business is the "net amount which a willing purchaser whether an individual or a corporation, would pay for the interest to a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Treas. Reg. §20.2031-3. This is just a slight variation on the test. Relevant facts may include an appraisal of the business's assets, the business's earning capacity, and the factors set forth in paragraphs (f) and (h) of Treas. Regs. §20.2031-2. Id. The instructions to form 706 require that "complete financial and other data used to determine value, including balance sheets

(particularly the one nearest to the valuation date) and statements of the net earnings or operating results and dividends paid for each of the 5 years immediately before the valuation date" be included with the return. See instructions to Form 706. Generally, business valuations may be based on asset value or earnings or a combination of both.

3.5.4. The fair market value of real estate is determined under the general willing buyer/willing seller test. Treas. Reg. §20.2031-9. Appraisals typically reflect closed sales of comparables and may be inaccurate in an improving market. By way of circular reasoning, the regulations assert that "[p]roperty shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value as of the applicable valuation date." Caselaw provides additional guidance, including "highest and best use" where the real estate is reasonably subject to development. The appropriate method for valuing real estate depends on the type of real estate (undeveloped land, commercial, residential, etc.). E.g. Estate of Pattison v. Comm'r., T.C. Memo 1990-428; Estate of Necastro v. Comm'r, T.C. Memo 1994-352; Rev. Proc. 79-24.

3.5.5. There are two significant exceptions to the general rule relating to basis adjustments at death.

A. First, property constituting income in respect of decedent ("IRD") does not receive a basis adjustment at death. I.R.C. §1014(c); Treas. Reg. §1.1014-1(b). See Estate of Cartwright v. Comm'r, T.C. Memo 1996–286, aff'd in part and remanded in part 183 F.3rd 1034 (9th Cir. 1999). Generally, IRD is income earned before the decedent's death but is received after death and is taxed upon receipt by the estate or other beneficiary. I.R.C. §691(a)(1). Some examples of IRD include salary or wages, post-death bonuses, stock options, installment obligations, retirement plans and tax deferred annuities. The recipient of an IRD amount is entitled to an income tax deduction for estate tax attributable to IRD, if any. I.R.C. §691(c); FSA 20011023.

B. Second, appreciated property acquired by a decedent does not receive a basis adjustment when such property:

(1) passes to an individual from whom or from whose spouse the decedent acquired property by gift within one year before the decedent's death; and

(2) the fair market value of the property exceeds its adjusted basis. I.R.C. §1014(e).

In such cases, the basis of the property is the basis in the hands of the decedent at the time of his or her death.

3.5.6. There are further exceptions to the basis adjustment rule including but not limited to (a) the use of the special use valuation (I.R.C. §2032A); (b) basis in stock of a domestic international sales corporation (I.R.C. §1014(d)); and (c) the estate's executor election carry-over basis for property passing through a decedent dying in 2010 known as a modified carry-over basis regime. I.R.C. §1022.

3.5.7. In general, the basis of property acquired by gift equals the donor's basis in the property, or the basis of the last preceding owner who did not acquire the property by gift. I.R.C. §1015(a); Treas. Reg. §1.1015-1(a)(1). If the donor's basis is greater than fair market value at the time of the gift, the taxpayer's basis for purposes of determining loss is fair market value of the gifted property. Id. Gifts to spouses are not subject to the rules under I.R.C. §1015 which can otherwise eliminate the ability to take the loss. See I.R.C. §1015(e); I.R.C. §1014(c) and I.R.C. §1041(b)(2).

3.5.8. Importantly, the gift basis rules under I.R.C. §1015 do not apply if the value of the property is includible in the donor's gross estate for estate tax purposes. Treas. Reg. §1.1014-1(d); Rev. Rul. 55-531, 1955-2 C.B. 520. Classically, gifted property may be included in the donor's estate if the donor retains certain types of powers and benefit. See I.R.C. §§2035, 2036 and 2038.

3.5.9. The Internal Revenue Service will not rule on whether assets owned by intentionally defective grantor trust which is not in gross estate of the grantor for estate tax purposes will receive an I.R.C. §1014 basis adjustment a death. Rev. Proc. 2024-1.

3.5.10. There is a basis adjustment for assets owned by non-exempt generation skipping transfer tax trusts if generation skipping transfer tax is imposed on such assets. I.R.C. §2654(a)(2).

3.6. Important Tax Rates for 2024

3.6.1. The United States income tax brackets have become progressively more graduated since the 1986 Tax Act.

3.6.2. The key 2024 income tax rate schedules can be found in Rev. Proc. 2023-34. The top thresholds for core taxes are as follows:

Type of Tax	Highest Tax Rate	Joint Filers	Individuals	Trusts & Estates
Ordinary Income (based on Taxable Income)	37%	>731,200	>609,350	>15,200
Qualified Dividends and Long-Term Capital	20%	>583,750	>518,900	>15,450

Gains (based on Taxable Income)				
Surtax on Net Investment Income ("NII") (based on Modified Adjusted Gross Income)	3.8%	>250,000	>200,000	>15,200

3.6.3. An example of graduated income tax rate structure is that the 24% tax rate bracket for joint filers covers the spectrum of taxable income of $201,050 to $383,900.

3.6.4. As a further example, for capital gains tax rates, the maximum zero rate amount is $94,050 in the case of a joint return or surviving spouse ($47,025 in the case of a married individual filing a separate return), $63,000 in the case of an individual who is a head of household (I.R.C. §2(b)), $47,025 in the case of any other individual (other than an estate or trust), and $3,150 in the case of an estate or trust.

3.6.5. As a final example of the rate structure, for taxable years beginning in 2024, the threshold amount under I.R.C. §199A is $383,900 for married filing joint returns and $191,950 for all other returns (other than for an estate or trust).

4. MINIMIZATION OF INCOME TAX

A major goal of end of life estate planning is to attempt to minimize overall income tax and avoid creating inadvertent negative income tax consequences through actions taken. More specifically, as planners, our goal is to create value by minimization of income tax and maximizing basis.

Any analysis of income tax options requires the availability of accurate information including but not limited to (1) current asset and liability information; (2) basis information; (3) charitable carry forwards; (4) suspended losses; (5) capital loss carry forwards; (6) net operating loss carry forwards; and (7) current year income, deduction and credit activity. It will be critical to review prior year tax returns. Further, any proper planning will want to include the dying client's accountant and investment advisor. Given the short timeframe and potential capacity issues at the end of life, many of these techniques will not be feasible.

4.1. Acceleration of Income onto Final Return

An evaluation will need to be made to determine the existing income tax attributes to determine whether there is a tax advantage to accelerating income prior to death onto the final return. The "bunching" of income onto the Final Return can lower overall income tax by utilizing decedent's charitable deduction carry forwards,

capital loss carry forwards, net operating loss carry-overs, large medical deductions (which are common in the final year of life) and current year charitable contributions which cannot otherwise be claimed. Further, as the Final Return constitutes a partial tax year, a decedent may not have significant income in the year of death.

In terms of estate tax planning, the planner should consider any tax liability on the Final Return is a debt deduction for estate tax purposes, including for state estate tax.

Often given the graduated income tax rates structure and the high income thresholds for certain taxes (such as the net investment income tax), it could be advisable to recognize income on the Final Return rather than on an estate income tax return, trust income tax return, or a beneficiary's individual income tax return after the death of a decedent. The planner should evaluate whether the dying client would be in a lower tax bracket from the beneficiaries and the pre-death income realization could "soak-up" the lower rate structures.

A careful review of the tax rate schedule in Rev. Proc. 2023-34 shows that taxpayers can pay drastically different tax rates on the same income. In fact, ability to pick a taxpayer could easily save a 20% tax.

Any pre-death tax planning must carefully consider the impact of the proposed transactions upon the dispositive plan of the dying client.

If advisable, there are a variety of mechanisms to accelerate income onto the Final Return:

4.1.1. Withdraw funds from qualified plans such as traditional individual retirement accounts and 401(k)s or tax deferred annuities to generate income.

4.1.2. Converting all or a portion of a traditional IRA into a Roth IRA. A Roth conversion may be particularly beneficial due to the limitation imposed on post death minimum required distributions on account of the SECURE ACT. Post-death distribution from Roth accounts are not subject to income tax if distributed more than five years from the initial contribution to the Roth. Please note that Roth conversions are no longer "reversible."

4.1.3. Sell assets to generate capital gains (a) if have available losses, (b) the zero capital gains bracket is applicable or (c) offsetting deductions exist. The sales could be beneficial in anticipation of estate/trust liquidity and cash needs. The benefit of the triggering capital gains immediately prior to death is limited due to the basis adjustment at death rules.

4.1.4. Evaluate if certain partnership or S corporation elections would be beneficial, to the extent the client (or his or her family) has some element of control of the closely held business. Often, partnership or S corporations

may earn proportionately more income in a given tax year after the date of death than before the date of death. In that case, if the income is allocated on a pro rata per day basis (rather than using an interim closing of the books), more income will be allocated to the deceased partner's or shareholder's Final Return. For a general discussion of planning strategies for partnership interests following death, See S. M. Jones & D. M. Maloney, Transfer of a Partnership Interest at Death Creates Tough Issues for the Successor, 94 J. of Taxation (Jan 2001).

4.1.5. Consider accelerating gain on installment obligations. The executor could choose to elect out of the installment method for an installment sale made in the year of death. This would result in the gain being taxed on the decedent's Final Return. In addition, no IRD income recognition would occur after death. Further, if there is an existing installment obligation, the obligation could be transferred in a way which would transfer the gain, i.e., by transferring it to the obligor.

4.2. Accelerate Deductions

In certain circumstances, it may be advisable to accelerate deductions or generate losses on the Final Return in order to lower overall income tax. Mechanisms to accelerate deductions include the following:

4.2.1. Make contributions to charities pre-death in order to obtain income tax charitable deduction on the Final Return. This type of transfer would generate a current income tax deduction and the donated sums would be excluded from the dying client's estate for estate tax purposes. One iteration of this approach is to transfer a portion of an individual retirement account owned by a dying client prior to death directly to a public charity (excluding donor advised funds), if the client has reached the age for required minimum distributions. Such transfer counts towards the client's required minimum distribution while avoiding the income tax on the withdrawal. There are a variety of issues with these approaches including whether someone has authority to make the transfer and the lack of time to implement prior to the impending death of the client. Further, a planner should consider the impact such a transfer would have on the estate plan and the avoidance of "doubling up" a charitable bequest. One idea is for the transfer to constitute an advancement in lieu of an otherwise existing testamentary disposition.

4.2.2. Dispose of the taxpayer's entire interest in a passive activity in order to utilize suspended losses. There are issues with this approach, including the availability of a reasonable buyer and existence of transfer restrictions in the governing instruments as the passive activity.

4.2.3. "Harvest" capital losses before death to generate a loss deduction and avoid step down in basis upon death. The deduction can be utilized in the year of sale, including by the surviving spouse on a jointly filed Final Return. The

planner should remember that such losses can offset up to $3,000 of other income (or $1,500 for single taxpayers).

4.3. Income Tax Basis Planning

4.3.1. In recent years, the tax picture associated with estate planning has changed. In most cases, the focus now is away from minimizing estate taxes and towards obtaining the highest defensible step-up in the tax bases of capital assets owned by the decedent at death.

Because of the increased federal estate tax exemption (currently $13.61M), which is indexed for inflation, and the new portability rules (which, if elected, permits aggregation of the decedent's exemption with that of his or her predeceased spouse), most estates now escape the imposition of estate tax altogether. Of course, the Biden-Harris administration has proposals to make significant changes to the tax system.

4.3.2. In this current environment, increases in estate asset values or the transfer of additional assets into an estate may have little or no estate tax cost. Since the tax basis of a decedent's capital asset is equivalent to its estate tax value, and any valuation is not exact but generally accurate within a range of numbers, there is a premium on obtaining a higher-side value which is defensible from an audit point-of-view and protectable from penalties. This premium is enhanced by the current income tax climate where capital gains bear higher income taxes.

4.3.3. As described above, death triggers an adjustment of basis for capital assets. In a world where planners have control, we would want to have as high a basis possible. In general, any planning to maximize basis must compare the estate tax cost of inclusion of an asset with the benefit of basis step-up.

4.3.4. Basis planning at the end of life benefits from availability of concrete information in terms of knowledge of estate size, the available amount of estate tax exclusion, generation skipping transfer tax exemption and current income tax rates and brackets. In light of the above, the planner should consider whether the following transactions would mitigate overall tax:

A. Evaluate whether low basis (or appreciated) assets owned by irrevocable trusts which are not includible in the dying client's estate should be includible in the dying client's estate for estate tax and basis adjustment purposes. There are a variety of circumstances where this could be applicable:

i. Irrevocable trusts which benefit the dying client (such as classic bypass trusts) often have existing distribution standards which would permit a trustee to distribute property to the dying client. The potential trust standards of distribution range from health, education, maintenance and

support (possibly considering the impact of other resources prior to making such a distribution) or to an independent trustee, trust director or trust protector having the discretion to make distributions for the dying client's best interests or any other broad-based purpose. Any distributions to the dying client must weigh the impact of the distribution on the ultimate dispositive plan. A basic question to be asked prior to such a distribution is who will be negatively impacted by such a distribution and obtain necessary consents if possible.

ii. An independent trustee, trust protector or trust director may have the power and authority to grant a general power of appointment to the dying client over all or part of the irrevocable trust and, if so, such a grant may be advisable. The grant of a general power would generate a basis adjustment of the assets subject to the general power. I.R.C. §2041. Again, the interests of anyone could be negatively impacted by an exercise of such power should be considered.

iii. An independent trustee, trust protector or trust director may have the authority to amend the irrevocable trust under certain conditions. In such circumstances, an amendment should be considered to enable low basis assets to be included in the dying client's estate for estate tax purposes and could include an expansion of the distribution standards.

iv. The irrevocable trust may be terminated (in whole or in part) and distributed to the dying client utilizing a nonjudicial settlement under the Uniform Trust Code. See UTC §111. This approach would require consent of all the beneficiaries, which is problematic given short timeframes at the end of a client's life. Further, a termination and distribution could generate unanticipated estate, gift and income tax consequences.

v. Enter into transactions where low basis assets owned by the irrevocable trust (over which the dying client is the grantor for income tax purposes) are exchanged for high basis assets owned by dying client. These transactions should be disregarded for income tax purposes. Rev. Rul. 85-13, 1985-1 C.B. 1984. One type of transaction could be implemented where the dying client has the power to substitute assets of equivalent value with assets owned by the trust. This power is often called a swap power. If a swap power does not exist, then the dying client could purchase assets from the irrevocable trust. Issues with these types of transactions include (a) whether the dying client has sufficient high basis

assets to implement such a transaction and (b) whether the transfer is of equivalent value and fair market value. Where there is little liquidity or a lack of high basis assets, the dying client could attempt to borrow the funds to make the swap/purchase by pledging assets as collateral for a short term loan. Hard to value assets create issues regarding what constitutes equivalent value and fair market value. Failure to utilize correct value creates fiduciary risk and potential negative transfer tax consequences. The fiduciary risk could be mitigated by consent of all the parties in interest and the transfer tax consequences could be reduced through the use of a Wandry style valuation formula clause. See Wandry v. Comm'r, T.C. Memo 2012-88; AOD 2012-004.

vi. Consider the exercise of a limited power of appointment held by the dying client in order to trigger the Delaware Tax Trap and have such property includible in the dying client's estate for estate tax purposes.

B. Family members could consider transferring low basis assets to the dying client in order to achieve a step-up in basis at the time of death. The dying client would have to leave the transferred property to someone other than the initial donor or that donor's spouse in order to avoid the application of I.R.C. §1014(e) carry-over basis rules. Some planners have suggested utilizing cross-gifts to a terminally ill client so that a donor does not receive property gifted upon the death of the dying client. Of course, the step transaction analysis by the Internal Revenue Service could be an issue with these types of transactions. Another idea to avoid 1014(e) treatment is for the donor to disclaim the transfer of the gifted asset back to him or her from the dying client. Any pre-death tax planning must carefully consider the impact of the proposed transactions upon the dispositive plan of the dying client. For more information on I.R.C. §1014(e) issues, we suggest the following: An Oxymoron? The Deathbed Lifetime QTIP for Basis Adjustment and Asset Protection, Richard S. Franklin and George D. Karibjanian, Estates, Gifts & Trusts Journal, Bloomberg, November 10, 2016, page 7; Mark R. Sigel, I.R.C. Section 1014(e) and Gifted Property Reconveyed in Trust, 27 Akron Tax J. 33 (2011-2012).

C. Consider changing bank/brokerage accounts from joint ownership between spouses into the dying spouse's name, if the dying spouse contributed all the funds for those assets and, in those circumstances, the basis step up is available.

D. Consider amending existing executory sales contracts in order to avoid income in respect of decedent treatment for the sales proceeds

and the resulting loss of step-up in basis for the sale completed after death. For instance, a contract of sale will not generate a step-up basis if all major contingencies have been fulfilled at the time of death. If a contingency could be amplified or clarified (possibly with the consent of the buyer), then there is a possibility the asset could receive a step-up in basis. This technique is limited in utility and would require significant confidence in the buyer of such property if the contract is to be amended.

E. Consider alteration of existing business governing instruments in order to reduce the application and scope of valuation discounts on those business interests at the time of death. Potential alterations could include providing the interest owned by the dying client with enhanced management rights, right to have his or her interest purchased and broader rights on transferability. Any changes would need to be evaluated outside of the narrow confines of tax savings.

F. In terms of discounted assets, it may make sense for the dying client to acquire fractional interests in land (in order to own 100% interests in the property) or receive an interest in an entity to obtain control of the entire entity. These types of transfers can be made between spouses without transfer tax and the increase in the value of the asset may outweigh the potential loss in step up under I.R.C. §1014(e) if applicable. The income tax planning goal would be for the dying client's interests to not be discountable or to minimize the discount on such property. The planner would need to run tax calculations to determine utility.

G. With regard to outstanding installment sales to intentionally defective grantor trusts, the planner should consider having the irrevocable trust repaying the outstanding note before death to remove the argument of whether there would be gain recognition with respect to post-death payments on that obligation. If needed, the irrevocable trust could borrow money from a third party to pay off the note.

H. If an intentionally defective grantor trust will be selling assets in the near future, the planner should consider the sale of the assets in the trust prior to the grantor's death, so that the income taxes will be payable by the grantor's estate rather than being a liability of the irrevocable trust following the grantor's death.

I. Consider amplifying and clarifying the existence of prior transfers where a retained interest is present triggering the estate tax inclusion of such assets and resulting basis adjustment for previously gifted property into the taxable estate of the dying client under I.R.C. §§2036 and 2038. See discussion of *Powell* case, infra at 8.14.3.

J. As previously discussed, if a dying client owns depreciated assets, the unrealized loss is lost at death because of the step-down in basis rules. In order to avoid the step-down, the planner could consider having the dying client:

i. Harvest losses by selling the asset prior to death if the loss is usable on the Final Return;

ii. Gift assets to the dying client's spouse as the transfer carries over basis for all purposes under I.R.C. §1015(e) and I.R.C. §1041(b)(2);

iii. A dying client could sell the depreciated asset to an intentionally defective grantor trust or a non-grantor trust and not lose the unrealized loss as I.R.C. §1015 applies only to gifts not to sales. A sale to a grantor trust is a disregarded transaction and that trust would acquire the seller's basis, thereby preserving the loss. A sale to a non-grantor trust would generate a disallowance under the related party rules of I.R.C. §267 but such loss is preserved for the future by being added to the basis of the asset purchased.

5. AVOID INCOME TAX PITFALLS

A mantra for any planner who is trying to assist a dying client and his or her family should be to do no harm. Harm can be generated by unnecessary income tax. Pre-death transfers of property can create negative income tax consequences under a variety of circumstances.

5.1. The transfer of low basis (appreciated) assets prior to death can create a major negative income tax result. As discussed above, the lifetime transfer generates carryover basis into the gifted property under I.R.C. §1015 and a resulting loss in step-up in basis at death. The loss in step-up increases future capital gains tax while reducing ongoing depreciation deductions for that property.

5.2. A transfer of an asset in which liability exceeds basis can generate a taxable transaction. The classic example is the transfer of a negative capital account partnership or limited liability company interest will trigger gain to the donor.

5.3. Certain transfer of installment obligations could transfer acceleration of gain imbedded and deferred by such obligation. I.R.C. §453. Acceleration can occur when obligations are transferred to the obligor.

5.4. Any transfer of S corporation stock to an ineligible S corporation will result in loss of S corporation status.

6. INCOME TAX RESOURCES

6.1. For more information relating to immediate pre-death planning, we suggest a review of the following:

6.1.1. Edwin P. Morrow III, L. Paul Hood, Jr., JD, LL.M., CFRE, FCEP, For Whom the Bell Tolls: Pre-Mortem Planning Options and a Look Forward at Post-Mortem Estate Planning, Leimberg Information Services Webinar Feb 25, 2021;

6.1.2. David A. Handler and Kristen Curatolo, Planning at the Eleventh Hour, A Practitioner's Checklist for Clients Near Death, Trusts & Estates, June 2016 and April 2019 (Part II); and

6.1.3. L. Paul Hood, SNAP, Crackle, SWAP: The Substitution Power in Grantor Trusts, 2019.

6.2. For more information on basis planning issues, we suggest the following authorities:

6.2.1. Paul S. Lee, Run the Basis and Catch Maximum Tax Savings – Part 1, 42 Est. Plan J. (January 2015);

6.2.2. Paul S. Lee, Run the Basis and Catch Maximum Tax Savings – Part 2, 42 Est. Plan. J. (February 2015); and

6.2.3. Michael A. Yuhas and Carl C. Radom, New Estate Planning Frontier: Increasing Basis, 42 Est. Plan. J. (January 2015).

6.3. For more information relating to valuation and basis, we suggest the following authorities:

6.3.1. John A. Bogdanski, Federal Tax Valuation (Thomson Reuters/Tax & Accounting, 2020); and

6.3.2. Howard M. Zaritsky and Lester B. Law, Fundamentals Program: Basis – Banal? Basic? Benign? Bewildering? (Focus Series), 49 U. Miami Heckerling Inst. on Est. Plan. ch. 1.

6.4. IRS Valuation Guide For Income, Estate and Gift Taxes (CCH).