

# Estate and Gift Tax Issues

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## Estate, Gift & GST Tax (EGTRRA)

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Year	<u>Estate Tax</u>		<u>GST Tax</u>	<u>Gift Tax</u>	
	Exemption	Highest Rate		Exemption	Exemption
2008	\$2 Million	45%	\$ 2 Million	\$ 1,000,000	45%
2009	\$3.5 Million	45%	\$3.5 Million	\$ 1,000,000	45%
2010	Repealed		Repealed	\$ 1,000,000	35%
2011	\$1 Million	55%	\$1,120,000	\$ 1,000,000	55%

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### Estate Tax on Taxable Estate of \$4 Million

Date of death in:

2

- 2008: \$900,000 (45% rate and 2 mil. exempt.)
- 2009: \$225,000 (45% rate and 3.5 mil. exempt.)
- 2010: zero (unlimited exemption)
- 2011: \$1,495,000 (41-55% rate and 1 mil. exempt)

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111TH CONGRESS  
1ST SESSION

# H. R. 4154

To amend the Internal Revenue Code of 1986 to repeal the new carryover basis rules in order to prevent tax increases and the imposition of compliance burdens on many more estates than would benefit from repeal, to retain the estate tax with a \$3,500,000 exemption, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 19, 2009

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HR 4154

**Would cost  
\$233 billion  
over 10 years**

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U.S. v. Carlton, 512 US 26 (S Ct),  
06/13/1994

**Scalia Concurrence: The reasoning the Court applies to uphold the [retroactive estate tax] statute in this case guarantees that *all* retroactive tax laws will henceforth be valid.**

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Example (1) : 2009 Sale at a Gain.

\$800,000 DOD FMV

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\$500,000 Bill's Adjusted Basis

\$0 Realized Gain

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Example (2) : 2010 Sale at a Gain.

\$800,000 DOD FMV

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\$500,000 Bill's Adjusted Basis

\$300,000 Realized Gain

**Exclude \$250,000 Per Sec. 121(d)(11)**

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**Example (3) : 2010 Sale at a Loss**

\$200,000 DOD FMV

\$500,000 Bill's Adjusted Basis

\$0 Realized Loss

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**Example (4) : 2010 Sale at a Loss**

\$200,000 DOD FMV

\$500,000 Bill's Adjusted Basis

\$0 Realized Loss

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**Example (5) : 2009 Sale**

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\$200,000 DOD FMV

\$450,000 Nonrecourse Debt

\$250,000 Realized Gain?

\$0 Realized Gain?

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**Example (6) : Inherit and Move In**

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\$800,000 DOD FMV in 2006

\$300,000 Sale in Nov. 2009

\$0 Realized Loss

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### Example (7) : Inherit and Rent

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\$800,000 DOD FMV in 2006  
- \$25,000 Depreciation  
\$775,000 Adjusted Basis  
\$300,000 Sales Price in Nov. 2009  
\$475,000 Sec. 1231 Loss

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### Example (8) : Inherit and Hold For Sale

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\$800,000 DOD FMV in 2006  
\$300,000 Sales Price in Nov. 2009  
\$500,000 LTCL

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***Reg §§20.2053-1 to 10  
(10/16/09)***

***Post-Death Events in  
Determining an Estate's  
Deductible Claims***

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### Sec 2031

- **Section 2031(a) provides that the value of the decedent's gross estate must include the value at the time of the decedent's death of all property, real or personal, tangible or intangible, wherever situated.**

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## Sec 2053 Deductions

- 1) Funeral expenses.
- 2) Administration expenses.
- 3) Claims against the estate.
- 4) Unpaid mortgages on, or any debt connected with, property ...is included in the value of the gross estate, as are allowable by the laws of the jurisdiction, ...

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Form **706**  
(Rev. September 2009)

Department of the Treasury  
Internal Revenue Service

## United States Estate (and Generation-Skipping Transfer) Tax Return

Estate of a citizen or resident of the United States (see separate instructions).  
To be filed for decedents dying after December 31, 2008, and before January 1, 2010.

Item number	Deductions
13	Schedule J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims . . . . .
14	Schedule K—Debts of the Decedent . . . . .
15	Schedule K—Mortgages and Liens . . . . .
16	Total of items 13 through 15 . . . . .
17	Allowable amount of deductions from item 16 (see the instructions for item 17 of the Recapitulation) . . . . .
18	Schedule L—Net Losses During Administration . . . . .
19	Schedule L—Expenses Incurred in Administering Property Not Subject to Claims . . . . .
20	Schedule M—Bequests, etc., to Surviving Spouse . . . . .
21	Schedule O—Charitable, Public, and Similar Gifts and Bequests . . . . .
22	Tentative total allowable deductions (add items 17 through 21). Enter here and on line 2 of the Tax Computation

**IRS estimates it takes 15 minutes to learn the law relating to Sch J and Sch K.**

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## Sch L -- Sec 2053(b)

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Amounts representing expenses incurred in administering property which is included in the gross estate but which is not subject to claims and which—

- i. Would be allowed as deductions in the first category...; and
- ii. Were paid before the expiration of the period of limitation for assessment....

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## Sec 2053(c)(2)

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Deductions of the first category are limited to:

- 1) The value of property included in the decedent's gross estate and subject to claims, plus
- 2) Amounts paid, out of property not subject to claims against the decedent's estate, within 9 months (plus filing extension) ...after the decedent's death

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## 1) General Rule

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**All Sec. 2053 deductions are limited to the amount paid.**

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## 2) Unpaid But Ascertainable

**Can deduct unpaid amounts that are ascertainable with reasonable certainty.**

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**Ex: legal fees are 2% of probate estate.**

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## 3) Unpaid But Deemed Ascertainable

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**Certain debts are deemed ascertainable with reasonable certainty.**

**Ex: Legal claims of not more than \$500,000.**

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## 4) Protective Claims For Refund

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**If the requirements for deductibility cannot be satisfied prior to the expiration of the statute of limitations on refunds, then file a protective claim.**

**The preamble suggests that IRS may create a separate Schedule on Form 706 for protective claims.**

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**Claim for Refund and Request for Abatement**

▶ See separate instructions.

**Type of tax.** Indicate the type of tax to be refunded or abated or to

Employment       Estate       Gift

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**Reg. 20.2053-1(d)(4)**

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**Protective Claim For Refund**

Although the protective claim need not state a particular dollar amount ... a protective claim must identify each outstanding claim or expense that would have been deductible under section 2053(a) or (b) if such item already had been paid and must describe the reasons and contingencies delaying the actual payment of the claim or expense.

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**5) Post-Death Events**

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- Events occurring after a decedent's death are to be considered until the statute of limitations on assessment expires.

**Reg. 20.2053-1(d)(2).**

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**Post-Death Deficiencies**

- Post-death events that reduce the deduction (and increase estate tax), are only a threat if they occur within the S of L on assessment.

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## Post-Death Refunds

- Post-death events that increase the deduction (and reduce estate tax), are allowed beyond the S of L on refunds provided the estate files a protective claim for refund.

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## Final Regulation Effective Date

**The regulations apply to estates of decedents dying after Oct. 19, 2009.**

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### *Estate of McMorris, 243 F3d 1254* (10<sup>th</sup> Cir. March 2001)

- Donn McMorris died owning stock in a closely held company.
- His widow, Evelyn, died one year later.
- Before her death, Evelyn reported a gain on a stock redemption using the value reported on Donn's estate tax return as her basis.

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### *Estate of McMorris, 243 F3d 1254* (10<sup>th</sup> Cir. March 2001)

- After her death, her outstanding income tax liability was paid, and claimed as a deduction on her estate tax return.
- Meanwhile, Donn's estate tax return was audited and resulted in an increased value for the stock in his estate.

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**Estate of McMorris, 243 F3d 1254**  
**(10<sup>th</sup> Cir. March 2001)**

- This raised the basis of Evelyn's stock to an amount in excess of the redemption price, and her estate claimed a refund of the income tax paid on the redemption gain.
- The IRS then disallowed the deduction to Evelyn's estate for the now-refunded income taxes originally deducted by her estate.

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**Estate of McMorris**

- The Tenth Circuit overruled the Tax Court and found in favor of the taxpayer that the deduction for income taxes owing must be valued at the date of death without considering the post-death results.

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**After October 19, 2009**

- Provided her tax liability is reduced within the three year statute of limitations on assessment, post-death events would be considered--the deduction would be limited to the net amount of income tax paid.

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**Estate of Van Horne, 720 F2d 1114**  
**(9<sup>th</sup> Cir, 1983)**

The issue was whether a premature death should be taken into account.

The estate was legally obligated under a divorce decree to pay support to the decedent's ex-spouse, who had died within a year from cancer that had not been diagnosed as of the valuation date.

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## Estate of Van Horne

The Ninth Circuit agreed that the estate's use of the life expectancy tables--deduction \$600,000--rather than considering the post-death events (which resulted in an actual payment of only \$35,000 one year later).

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## Reg. 20.2053-1 General Rule

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### Deduct if:

Actually paid -1(d)(1)

or

Unpaid but reasonably ascertainable and will be paid. -  
1(d)(4)

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## Reg. 20.2053-4(d)(6)(i) (25/26)

Special rule for obligations to make a recurring payment:

if contingent on death or remarriage of the claimant, then the claim is deemed ascertainable with reasonable certainty..

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## Van Horne Facts With Final Regs.

**Reg. 20.2053-4(d)(7) --**  
**Example (8)**

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## **Variation on Example (8):**

**What happens when she dies 1 year after D dies?**

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## **DOD Before October 20, 2009:**

**No need to amend per *Van Horne*. Ignore post-death events.**

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## **DOD After October 19:**

**Amend and pay additional estate tax. The post-death event rule of Sec. 20.2053-1(d) applies.**

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## **DOD After October 19:**

**What if she died 1 day after the statute of limitations on assessment expired?**

**No obligation to amend says the preamble!**

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**Reg. 20.2053-4(d)(6)(ii)** (26)

The purchase of a commercial annuity to satisfy a recurring obligation, whether or not contingent, is deductible.

See Example (9) (30)

**SCHEDULE J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims**

**Note.** Do not list on this schedule expenses of administering property not subject to claims. For those expenses, see the instructions for Schedule L.

If executors' commissions, attorney fees, etc., are claimed and allowed as a deduction for estate tax purposes, they are not allowable as a deduction in computing the taxable income of the estate for federal income tax purposes. They are allowable as an income tax deduction on Form 1041 if a waiver is filed to waive the deduction on Form 706 (see the Form 1041 instructions).

Item number	Description	Expense amount	Total amount
<b>A. Funeral expenses:</b>			
Total funeral expenses			
<b>B. Administration expenses:</b>			
1	Executors' commissions—amount estimated/agreed upon/paid. (Strike out the words that do not apply.)		
2	Attorney fees—amount estimated/agreed upon/paid. (Strike out the words that do not apply.)		
3	Accountant fees—amount estimated/agreed upon/paid. (Strike out the words that do not apply.)		
4	Miscellaneous expenses:	Expense amount	16

**Reg 20.2053-3** (20)

**Reg. 20.2053-1**  
**General Rule** (15)

**Deduct if:**

Actually paid -1(d)(1)

or

Unpaid but reasonably ascertainable and will be paid. - 1(d)(4)

**Reg. 20.2053-1(d)(7) Example (1)** (17)

**Legal fee Ascertainable—2.5% of the probate estate.**

**What if the attorney or executor is paid on an hourly rate and has not performed any services as of the due date of the return?**

**Reg. 20.2053-1(d)(4)(i)**

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“...For example, executors' commissions and attorneys' fees that are not yet paid, and that meet the requirements for deductibility under § 20.2053-3(b) and (c), respectively, are deemed to be ascertainable with reasonable certainty and may be deducted if such expenses will be paid.”

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**Reg. 20.2053-1(d)(4)(i)**

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“...no deduction may be taken upon the basis of a vague or uncertain estimate. To the extent a claim or expense is contested or contingent, such a claim or expense cannot be ascertained with reasonable certainty.”

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# Filing a Protective Claim For Refund

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**Reg. 20.2053-1(d)(4)**  
**Refund Claim Allowed When Paid**

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If a deduction is ... disallowed in whole or in part (or if no deduction is claimed on Form 706), then if the claim or expense subsequently satisfies the requirements of this paragraph (d)(4) or is paid, relief may be sought by filing a claim for refund.

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# “Claims”

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- Liabilities imposed by law, or
- Arising out of contract
- Arising out of tort

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Form **706**  
(Rev. September 2009)

## United States Estate (and Generation-Skipping Transfer) Tax Return

Department of the Treasury  
Internal Revenue Service

Estate of a citizen or resident of the United States (see separate instructions).  
To be filed for decedents dying after December 31, 2008, and before January 1, 2010.

Estate of: \_\_\_\_\_ Decedent's Social Security Number \_\_\_\_\_

### SCHEDULE K—Debts of the Decedent, and Mortgages and Liens

Item number	Debts of the Decedent—Creditor and nature of claim, and allowable death taxes	Amount unpaid to date	Amount in contest	Amount claimed as a deduction
1				

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## Reg. 20.2053-4(a) General Rule

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### Deduct if:

Actually paid

or

Unpaid but reasonably ascertainable and will be paid.

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## Deduct Even if Unpaid and Not Ascertainable:

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# Claims Totaling not more than \$500,000 (-4(c))

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Reg. 20.2053-4(c)(3) Example (1) (23)

**Exception for  
claims not in  
excess of \$500,000  
(-4(c))**

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Deduct Even if Unpaid and Not  
Ascertainable: (21)

**Claims and Counterclaims  
in related matter if value of  
related asset in GE exceeds  
10% of GE  
(-4(b))**

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Reg. 20.2053-4(c)(3) Example (3) (24)

**\$750,000 Gross Estate (Claim)**

**Sec. 2053 Deductions:**

- **\$750,000 Counterclaim (- 4(b))**
- **\$250,000 excess counterclaim  
over claim (-4(c))**

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(31)

**Estate of Malkin v.  
Comm'r,  
  
Indirect Gifts Through  
LLC and FLP**

## **Key Point – Similar to Sheperd**

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...the children's trusts were already partners in CRFLP when the property (Malkin LLC) was transferred to the FLP.

Therefore, D made an indirect gift to the childrens' trusts.

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# **Heckerman v. U.S.**

## **Indirect Gifts**

## **Estate of Jones v. Comm'r**

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...the taxpayer therein contributed property to family partnerships that were completely reflected in the capital accounts of the taxpayer and, therefore, 'the value' of the other partners' interests was not enhanced by the contributions."

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## **Beware of Step Transaction Doctrine**

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The Eighth Circuit [in Senda] also held that even if the taxpayers' contributions of stock had been properly reflected in their capital accounts before the gifting, "this formal extra step does not matter" because, under the step transaction doctrine, ...

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## Linton v. U.S.

### Transfers To LLC Were Indirect Gifts –Step Transaction Doctrine

## Beware of Step Transaction Doctrine

*Linton* discusses the importance of **establishing real economic risk during the interim between funding the LLC and gifting interests in it.**

**No such economic risk in *Linton*.**

## Compare Gross

37 Top

In Gross, the taxpayer and her daughters formed a limited partnership into which they each contributed a small amount of cash, which was reflected in their respective capital accounts. Over the course of three months following the formation of the partnership, the taxpayer transferred various securities to the partnership, each time receiving credit for the contributions on her capital account.

## Compare Gross

37 Top

The last of these transfers occurred eleven days before the taxpayer gave each daughter, by way of a "Deed of Gift," a 22.25% limited interest in the partnership. In Gross, the Tax Court cited to Holman as support for its decision that the step transaction doctrine did not apply, focusing on the passage of eleven days between the last transfer of securities and the gifts of partnership interests, ...

## Compare Gross

37 Top

... as well as on the status of the securities at issue as "common shares of well-known companies." The Tax Court in Gross concluded that "[t]he form of the transactions . . . accords with their substance."

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## Suzanne Pierre

### Gift tax valuation based on Value of LLC Interest

## Tax Court Holding

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The Tax Court majority agreed with the taxpayer that for gift tax purposes, the transfers were to be valued as transfers of interests in Pierre LLC. The LLC was not disregarded under the check-the-box regulations so as to treat the transfers as transfers of a proportionate share of assets owned by Pierre LLC.

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## It Ain't Over -- Footnote 3

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"In this Opinion, we decide only the legal issue set forth above. The following issues ...will be addressed in a separate opinion:

- (1) Whether the step transaction doctrine applies to collapse the separate transfers to the trusts and
- (2) the appropriate valuation discount, if any."

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**Estate of Jorgensen v.  
Comm'r, (March 26, 2009)**

**FLP Estate Tax Discounts  
Denied But Equitable  
Recoupment Allowed**

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**Keller v. U.S  
(Aug. 20, 2009)**

**Discount Allowed Despite The  
Lack of Some Formalities**

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**Estate of Litchfield v. Comm'r,  
(Jan. 29, 2009)**

**Tax Court Allows Discount For  
Hypothetical Income Tax**

**Estate of Jelke III,  
(11<sup>th</sup> Cir. 11/15/07)**

**Discount for Appreciated  
Assets in C Corp**

Decedent

C corporation

Assets FMV \$11,000,000

Assets Basis \$1,000,000

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Decedent

C corporation

Assets FMV \$11,000,000

Assets Basis \$1,000,000

Estate Tax Value = \$7,500,000\*

FMV \$1,000,000

\*\$11,000,000 – 3,500,000 (Corp Tax Discount)

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**Estate of Jelke III, (11<sup>th</sup> Cir. 11/15/07)**

...recalculate the net asset value of CCC on the date of Jelke's death, ...using a dollar-for-dollar reduction of the entire \$51 million built-in tax liability of CCC, under the arbitrary assumption that CCC is liquidated on the date of death and all assets sold.

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**Judge Carnes Dissent**

- The majority makes that assumption despite the fact that: historically the company has sold only 5.95 percent of its investments and therefore precipitated only that small portion of the total built-in capital gains liability per year,...

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### Judge Carnes Dissent

- Teddy Roosevelt is not the only one who extolled the virtue of toil and effort. Henry James once advised a young friend that, "I have in my own fashion learned the lesson that life is effort, unremittingly repeated, and . . . I feel somehow as if real pity were for those who had been beguiled into the perilous delusion that it isn't." ... I dissent from the majority's perilous delusion.

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### Litchfield Ducks The Bigger Issue

- In *Litchfield*, the co-executors of the estate lived in the Third and Fourth Circuits, where neither court of appeals has addressed this issue.
- However, the estate, consistent with the IRS, set the discount based on the present value of projected future corporate taxes, which were expected to be incurred over a period of years

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### *Negron v. U.S.*

**Sixth Circuit Sides With Fifth Circuit On Valuation of Lottery Payments**

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### **Estate of McCoy**

**Full Marital Deduction Allowed**

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**PLR 200919002**

**No Gift On Creation Of QPRT**

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*Estate of Christiansen*  
*Eighth Circuit (11/13/2009)*

**Partial Disclaimer OK  
For Property disclaimed  
directly to Charity**

	<u>Form 706</u>	<u>IRS Position</u>
FMV	6,500,000	\$9,500,000
Charity Deduction		<u>&lt;\$3,000,000&gt;</u> \$6,500,000

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### IRS Argument

- “[The Court] should disallow fractional disclaimers ....[because] such disclaimers fail to preserve a financial incentive for the Commissioner to audit an estate's return. With such a disclaimer, any post-challenge adjustment to the value of an estate could consist entirely of an increased charitable donation.”

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## Eighth Circuit Holding

- “For several reasons, we disagree with the Commissioner's argument that we must interpret the statute and regulations in an effort to maximize the incentive to audit.”

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## Estate of Anne Y. Petter v. Comm’r, TC Memo 2009-280

Dec. 7, 2009

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## Overview of Intentionally Defective Irrevocable Trusts (IDITs)

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