

## Post-Mortem Estate Planning Complexities

Strategies for Leveraging Changes in Circumstance and  
Correcting Costly Omissions in the Decedent's Plan

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Today's faculty features:

Michelle L. Ward, Partner, **Keebler & Associates**, Green Bay, Wis.

Michaeline Gordon, Principal, **Dolgin Law Group**, Chicago

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# Post-Mortem Estate Planning Complexities

**Michelle L. Ward, JD, LLM**

Keebler & Associates, LLP

E-mail: [michelle.ward@keeblerandassociates.com](mailto:michelle.ward@keeblerandassociates.com)

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# Required Filings

## Decedent's personal income tax return (1040)

- Due Date
  - April 15 of the year following the year of death
  - Six month extension – Form 4868
- Estimated Payments
  - Surviving spouse

# Required Filings

## Decedent's personal income tax return (1040)

- Who Files
  - With executor
  - No executor
    - With spouse
    - Without spouse
- Income Included
  - Before death
  - After death

# Required Filings

## Decedent's personal income tax return (1040)

- Planning Issues
  - Joint vs. Separate Return
    - Tax Liability
    - Revoking joint return
  - Series E/EE Bonds
    - Accelerating income
    - Available deduction
    - Income in respect of the decedent

# Required Filings

## Decedent's personal income tax return (1040)

- Planning Issues
  - Capital Loss Carryover
    - Terminates at death
    - Spouse's share
    - Use against income and gains of spouse after death
  - Installment Sale
    - Election out and acceleration of gain

# Required Filings

## Gift Tax Return (709)

- Who Must File
  - Exceeding annual exclusion
  - Gift of future interest
- Due Date
  - Earlier of:
    - April 15 with extension
    - Form 706 due date with extension

# Required Filings

## Gift Tax Return (709)

- Planning Issues
  - Gift Splitting – IRC Section 2513
    - Treats all gifts made by one spouse as made half by each spouse
    - Cannot split gifts to spouse
    - Each spouse must be a citizen or resident of the United States
    - Individual considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year

# Required Filings

## Gift Tax Return (709)

- Planning Issues
  - Gift Splitting
    - Only applies if both spouses have signified their consent to gift splitting in the case of all such gifts made during the calendar year by either while married to the other
    - Executor can sign for deceased spouse
    - Each spouse must sign the other spouse's return
    - Mailed to IRS in same envelope

# Required Filings

## Gift Tax Return (709)

- Planning Issues
  - Gift Splitting
    - Consent to gift splitting may be signified at any time after the close of the calendar year in which the gift was made, subject to the following limitations:
    - Consent may not be signified after the April 15th following the close of such year, unless before such day no return has been filed for such year by either spouse, in which case the consent may not be signified after a return for such year is filed by either spouse.
    - Consent may not be signified after a notice of deficiency with respect to the tax for such year has been sent to either spouse.

# Required Filings

## Gift Tax Return (709)

- Planning Issues
  - Gift Splitting
    - Disadvantages:
      - Joint and several liability for gift tax
      - If donor spouse makes a gift and the non-donor spouse consents to gift split, the non-donor using part of the non-donor's spouse unified credit and the donor spouse dies within three years of making the gift, and the donor's gift is includible in the donor's gross estate, the non-donor spouse's unified credit is not restored

# Required Filings

## Gift Tax Return (709)

- Planning Issues
  - GST Elections
    - Purpose of GST tax
    - Lifetime Exemption
      - \$5,250,000 – 2013

# Required Filings

## Gift Tax Return (709)

- Planning Issues
  - GST Elections
    - Skip Person
      - Person 2 or more generations below (Grandchildren)
      - Non-relative more than 37½ years younger
      - Certain trusts – all interests held by skip persons
    - Non-Skip Person
      - Anyone not a skip person
    - Direct skips
      - Gift to skip person
    - Indirect skips
      - Not a direct skip
      - Subject to gift tax
      - Made to a GST Trust

# Required Filings

## Gift Tax Return (709)

- Planning Issues
  - GST Elections
    - Automatic Allocation
      - Lifetime Direct Skips
      - Indirect Skips
        - A transfer that is not a direct skip which is made to a “GST Trust”
        - “GST Trust” - any trust that could have a taxable termination or taxable distribution unless one of six exceptions applies
        - Election in or Election Out

# Required Filings

## Gift Tax Return (709)

- Planning Issues
  - Adequate Disclosure
    - Statute of limitations is ordinarily three years after the later of:
    - Time period increases to six years after the later of filing or due date if amounts omitted from the return exceed 25% of the amount reported
    - Without adequate disclosure, additional tax could be assessed or a proceeding in court for collection of tax without assessment could be commenced at any time

# Required Filings

## Gift Tax Return (709)

- Planning Issues
  - Adequate Disclosure
    - A description of the transferred property and any consideration received by the transferor
    - The identity of, and relationship between, the transferor and each transferee
    - If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument
    - A description of the method used to determine the fair market value of the property transferred or, in lieu thereof, a qualified appraisal; and
    - A statement describing any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer

# Required Filings

## Gift Tax Return (709)

- Planning Issues
  - Adequate Disclosure
    - Valuation discounts
      - Appraisal recommended
  - Non-gift transfers
  - Defined value gift

# Required Filings

## Estate Tax Return (706)

- Federal Filing Requirement
  - 2013: \$5,250,000 Exclusion Amount
  - 2014: \$5,340,000 Exclusion Amount
  - Threshold: includes lifetime taxable gifts
- State Filing Requirement
- Due Date
  - Nine months from date of death
  - Six month extension

# Required Filings

## Estate Tax Return (706)

- Planning Issues
  - QTIP
    - Qualifies for marital deduction
    - Requirements
      - spouse must be US citizen
      - the property must pass from the decedent;
      - the surviving spouse must receive all income from the property for life, payable at least annually or at more frequent intervals; and
      - no person has the power to appoint the property to any person other than the surviving spouse.
  - Must be listed on Schedule M

# Required Filings

## Estate Tax Return (706)

- Planning Issues
  - GST
    - When allocated
    - Direct skips
    - Indirect skips
    - Automatic allocation
    - Schedule R

# Required Filings

## Estate Tax Return (706)

- Planning Issues
  - Reverse QTIP
  - GST

# Required Filings

## Estate Tax Return (706)

- Planning Issues
  - Paying the Estate Tax
    - 6166 Installments
      - Requirements
      - Bond and lien
    - Graegin Loan
      - Deductibility
    - 6161 Extension
      - Reasonable cause
      - Form 4768

# Required Filings

## Estate Tax Return (706)

- Planning Issues
  - Portability
    - How elected
      - The executor is considered to have elected to allow the surviving spouse to use the decedent's unused exclusion amount by filing a timely and complete form 706.

# Required Filings

## Estate Tax Return (706)

- Planning Issues
  - Portability
  - Election Out:
    - If the filing of a Form 706 is not otherwise required for the decedent's estate, not filing a timely and complete Form 706 will effectively prohibit the surviving spouse's use of the decedent unused exemption.
    - If estate tax return is otherwise required to be filed, mark the election out box on the Form 706

# Dolgin Law Group, LLC

*Attorneys at Law*

## **Post-Mortem Estate Planning Complexities**

**Michaeline Gordon, JD, LLM**

Dolgin Law Group, LLC

E-mail: [mgordon@dolginlawgroup.com](mailto:mgordon@dolginlawgroup.com)

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# **DISCLAIMERS**

## What is a Qualified Disclaimer?

If an heir does not want or need an inheritance

- under a trust
- or a will
- or by intestacy (no will or trust)

The heir may “disclaim” it -- allowing the inheritance to pass to the next line of heirs -- often children of the disclaimant.

Disclaimer is one of the most powerful strategies available for postmortem planning.

The use of disclaimers in a timely manner may allow for the “rewriting” or at least the redistribution of an estate plan after death.

**Example:** Suppose your wealthy uncle, a widower without children, has named you as the beneficiary of his entire estate, but has also stipulated that should you die before him, his estate will be distributed to your children.

Sadly, your uncle passes away unexpectedly, and at a time when you are financially comfortable and really don't need the money. Accepting your inheritance will just increase the value of your estate, and, hence, your potential tax bill, when it ultimately passes to your children.

A better alternative might be to benefit your children today by disclaiming the inheritance, with no associated gift tax imposed as a result of the transfer—assuming all qualified disclaimer requirements are satisfied.

## Requirements for “Qualified Disclaimer”

Under Internal Revenue Code Section 2518, a Qualified Disclaimer is an irrevocable, unqualified refusal to accept an interest in property that meets the following conditions:

1. Signed written refusal identifying interest disclaimed;
2. The refusal is received by transferor (or legal representative) not later than nine months after the later of: a) the date on which transfer is made; or b) or the date on which disclaimant turns 21;
3. Disclaimant has not accepted the interest or benefits; and
4. Disclaimed interest passes, **without any direction on the part of the disclaimant**, to a person other than the disclaimant.

## **“Acceptance” will be found if :**

- The donee uses the property
- Accepts income
- Pledges property for a loan
- Directs others to act with respect to property
- Accepts consideration for disclaimer; or receives reciprocal benefits

## **Surviving Spouse Exception:**

Under IRC Section 2518 (b)(4)(A), a surviving spouse can disclaim property that passes to a trust for the spouse's benefit, such as a Credit Shelter Trust.

However, if the surviving spouse is trustee, with a discretionary power to distribute to self and others, must be limited to an ascertainable standard (health, education, support, maintenance).

If spouse also has a power of appointment over disclaimed interest, must disclaim as well.

## **Result of Disclaimer:**

Will be governed by trust or will provisions providing for contingent takers.

**Example:** “All of my Apple share of stock to my daughter if she survives me, and, if she does not survive me to “The Hunger Project.” If the daughter disclaims, the shares go to the Hunger Project.

The governing instrument may also expressly provide for who takes the disclaimed interest. “If my daughter disclaims her interest, such interest shall go to the Hunger Project.”

A Disclaimer which does not meet the requirements of a Qualified Disclaimer will be treated as a gift.

## **Partial Disclaimer:**

Fractional disclaimers are permissible.

For example, one can disclaim percentage of a trust (but not the income/principal from a particular asset in the trust).

Severable property such as shares of stock or parcels of land may be disclaimed as to the severable portions.

## Potential Pitfalls:

- State laws vary.
- Generally Illinois law is more liberal. The nine month requirement does not apply, but should be exercised in a reasonable manner, and the federal requirements could be looked to as a standard.
- Watch out for anti-lapse statute applicable to wills, but not to living trusts. (Multiple disclaimers may be necessary.)
- Disclaimer may need to be filed with Executor of will and Probate Court.
- Disclaimer of real estate may need to be filed with Recorder of Deeds.

## Uses of Disclaimer:

- Estate Tax Avoidance
- Generosity
- Alter disposition of beneficiary designation assets
- Avoid creditors
- Estate tax planning – fund Credit Shelter Trust
- Generation Skipping Tax Purposes
- Cure beneficiary designation problems such as cashing out an estate or a charity by September 30th of the year following death of the owner

## Duties of Fiduciaries:

- It is important to note that a disclaimer can also be elected by an executor or trustee if authorized by the will or trust instrument or applicable law.
- A disclaimer exercised by a fiduciary is not treated as acceptance even though the fiduciary may also be a trustee or executor. For example, the regulations provide that: “an executor who is also a beneficiary may direct the harvesting of a crop or the general maintenance of a home. A fiduciary, however, cannot retain a wholly discretionary power to direct the enjoyment of the disclaimed interest.”  
Reg. Sec. 25.02518-2(d)(2)

# **INCOME IN RESPECT** **OF A DECEDENT**

## Income in Respect of a Decedent (“IRD”):

- Reg. §1.691(a)-1(b) provides that: the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but that were not properly includible in computing the decedent's taxable income for the taxable year ending with the date of death or for a previous taxable year under the method of accounting employed by the decedent.
- The rules governing IRD in Internal Revenue Code Section 691 and the regulations basically shift the income to the beneficiaries. In order to avoid allowing a cash basis taxpayer to avoid paying tax on such items of income, the Code provides that IRD is taxed upon receipt by the estate or other beneficiary. (IRC Section 691(a) (1)).

## Taxation:

- IRD is subject to both estate tax and income tax.
- To avoid double income taxation on the same amount, an income tax deduction allowed against IRD income by estate or beneficiary in the year IRD is received. (IRC Section 691(c).
- May not completely offset tax because there may be state inheritance tax, which is not deductible and because state estate tax is a deduction under IRC Section 2058, not a credit.
- The IRD deduction is not subject to the 2% floor, as are other miscellaneous itemized deductions.

## **Examples of IRD include, but are not limited to:**

- Salary, commissions, professional fees and bonuses
- Accounts receivable for a cash basis sole proprietor
- Distributions from Retirement Plans and IRAs
- Deferred Compensation Benefits
- Accrued but unpaid interest, dividends, rent and royalties
- Qualified employee benefits

- Statutory stock options
- Alimony arrears
- Trust or Estate Income
- Certain damage claims
- Gain from the sale of property if the sale is deemed to occur before death, but proceeds are not collected until after death
- Difference between the face amount and the decedent's basis in an installment sales obligation
- Interest accrued through the date of death on Series EE bonds, unless (1) decedent elected to report interest annually, or (2) the interest was reported on the decedent's final Form 1040
- Annuity payments in excess of decedent's investment in the contract

## Charitable Planning:

- Gifts to charity can minimize the tax loss by funding a planned gift to charity with IRD rather than other assets. A promissory note or right to collect on an installment sale may be good assets to allocate to a beneficiary for in kind distribution.
- However, funding a testamentary gift to charity made in a client's trust would trigger immediate taxation by using IRD to fund a pecuniary amount.

The most common IRD assets are qualified retirement plan and IRA assets.

Planning for deferral is important to minimize income tax.

Typically, a spouse is named as beneficiary because a spouse can defer income tax longest for three reasons:

- Can roll retirement into his or her IRA
- Does not have to begin withdrawing until he or she turns 70-1/2
- Upon rollover can name beneficiaries to “stretch” longer

A key aspect of post mortem planning will be to address a surviving spouse's best option regarding large IRA and qualified plan assets:

- Disclaimer can be an important tool for these assets to avoid estate tax and defer distributions.
- A surviving spouse may be able to defer Minimum Required Distributions even if the deceased spouse was over 70-1/2, by treating the inherited IRA as his or her own.

## **Post-Mortem Planning to Establish a “Designated Beneficiary” (“DB”):**

- By having a DB as defined in the IRC Section 401(a)(9) regulations, the plan or IRA owner can “stretch” the income taxation over the life expectancy of the DB, rather than paying it out over five years after the decedent’s death, or the decedent’s remaining life expectancy, depending on whether the decedent was over 70-1/2.
- This determination is not made until September 30th of the year following the decedent’s death.

## **Cashing Out Certain Beneficiaries:**

- Beneficiaries named in the will/trust will not be considered when determining the “designated beneficiary” if they are “cashed out” by the September 30 deadline.
- This can be an effective strategy when a decedent has named charities or older persons, such as parents or siblings, to receive a portion of the retirement benefits along with children.

## **Separate IRAs or Sub-Accounts:**

- A decedent's IRA or account may be divided into separate accounts under the regulations, if established before December 31 of the calendar year after the year of the decedent's death; (Treas. Reg. Sec. 1.401 (a) ((Q)-8, Q & A-2 and 3).
- Once created, the separate accounts are permitted to satisfy the minimum distribution rules independently and each beneficiary will have the right to direct their separate IRA or sub-account.

## **Rollover from Marital Trust or Decedent's Estate:**

A spousal rollover may be possible if the trustee has no discretion over the allocation of the IRA proceeds to the trusts or over payment of the IRA proceeds to the spouse; (PLRs 200934046; 200950053).

A surviving spouse who files a renunciation against a decedent's estate may be able to roll over her elective share of IRAs payable to the estate into an IRA in the spouse's name; (PLR 200150036).

## **Special Needs Planning:**

Private letter rulings have allowed the establishment of a self-settled special needs trust on behalf of a disabled child to receive transfer of the decedent's IRA; (PLR 200620025).

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# Valuation

- In General
  - Willing buyer/willing seller
  - Reading ascertainable values
  - Other assets - appraisal
- Alternate Valuation
  - Six month date
  - Date of distribution/sale
  - Basis

# Deductions

- Administration Expenses
  - Estate Tax Return vs. Income Tax Return
- Debts of Decedent
  - Personal obligations of the decedent existing at time of death
  - Only claims enforceable against the estate
  - Amount of deduction is value of the claim
  - Medical expenses from last illness

# Deductions

- Marital Deduction
  - Unlimited deduction
  - Spouse must be U.S. Citizen
  - Schedule M used to report marital deduction property
  - Special rules for terminable interest property

# Deductions

- Charitable Deduction
  - Only allowed if made by the decedent not the estate or beneficiaries
  - A deductible charitable remainder interest must be in the form of an annuity trust, a unitrust or a pooled income fund
  - Charitable promise or agreement

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