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After the Client Has Passed

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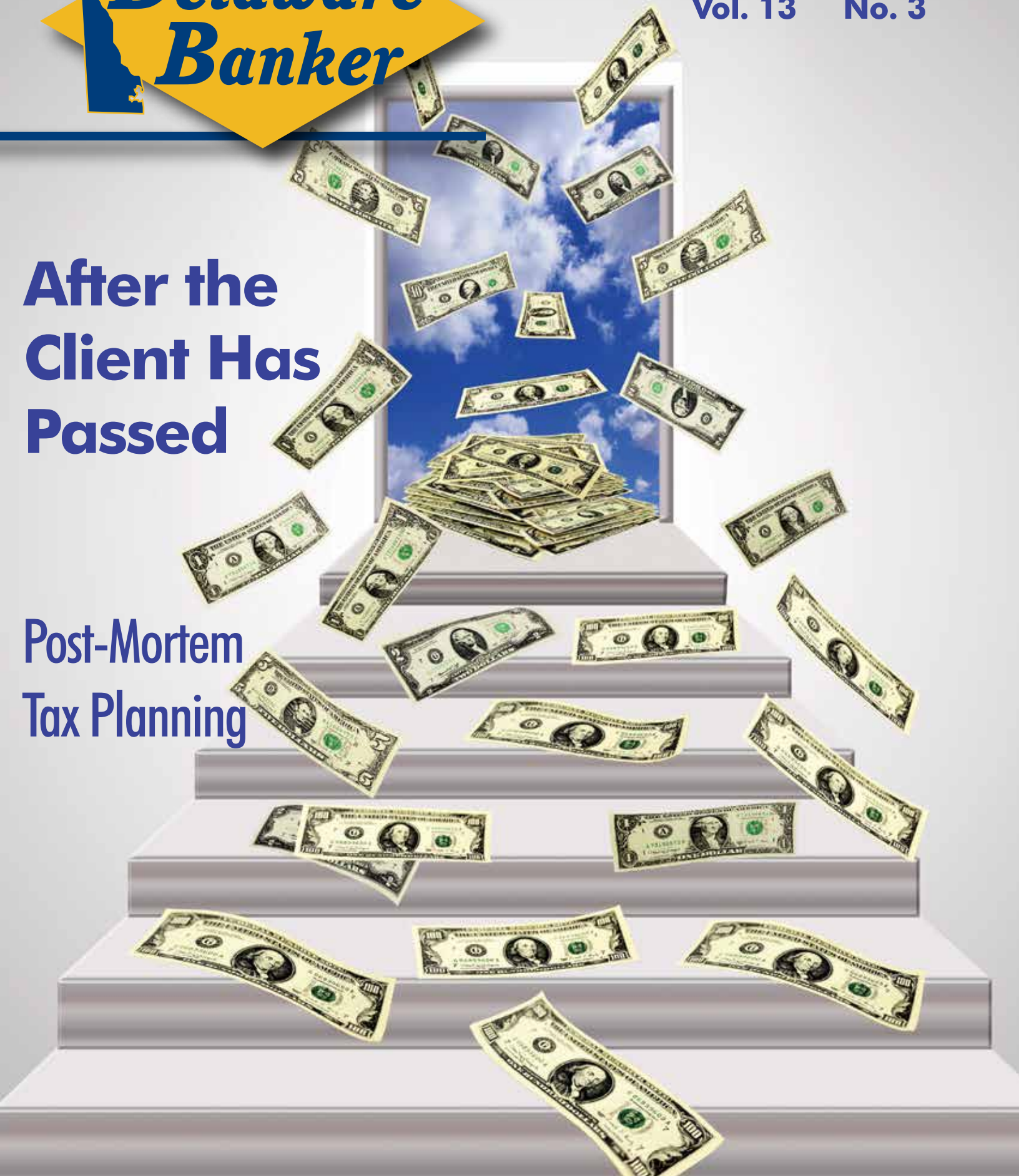

Post-Mortem Tax Planning

A Guide After the Client Has Passed

Part 1 of a 2-Part Series

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While estate planners generally focus on helping their clients with their estate plan while the client is still alive, there are many elections and opportunities to consider after the client has passed. These generally fall into the following categories:

- Electing portability
- Decedent's final income tax return elections
- Administrative elections
- Gift tax elections
- Fiduciary tax elections
- Business related elections
- Elections specific to larger estates

Part I of this series will deal with various fiduciary tax elections, administrative elections, gift tax issues and elections that can protect the trustee. These issues will also be the topic of a session at the upcoming Delaware Trust Conference in October.

Electing Portability

In short, the portability election allows a surviving spouse to utilize their last deceased spouse's unused exclusion amount (DSUE), by adding it to their own basic exclusion amount (currently $5,490,000 in 2017). Unlike the basic exclusion amount, any DSUE amount is stagnant and is not adjusted for inflation. An exception to this rule is in the case of a surviving spouse who is not a U.S citizen and is the beneficiary of a qualified domestic trust (QDOT). In this case the initial DSUE calculation is on a preliminary basis and adjusted each time a distribution is made from the QDOT. The surviving spouse is not allowed to offset any portion of the DSUE against lifetime gifts until such time as the DSUE is finally determined, which would be at such time when the trust terminates or the surviving spouse becomes a U.S. citizen. It should also be noted that the portability election is only relevant to the regular estate exclusion amount, and not to any unused GST amount at the decedent's death.

The portability election needs to be made on a complete and properly prepared Form 706 that is timely filed. An estate that is required to file Form 706 cannot elect portability on a late filed return, although Section 9100 relief may be available. Such relief, however, is not available to smaller estates that are only filing Form 706 to elect portability. In several cases, however, the IRS has granted an extension of time to file to elect portability to smaller estates (see PLR 201722021). On June 9, 2017 the IRS issued Rev. Proc. 2017-34, providing a simplified procedure for obtaining an extension of time for estates that otherwise don't have to file Form 706 but are doing so just to elect portability. The Rev. Proc. states that an extension of time will be automatically granted if the return is filed before the later of January 2, 2018 or on the second anniversary of the decedent's death. This allows smaller estates that have not yet filed (going back to 2011) to timely file and make the portability election. If the estate has an open request for a private letter ruling on file with the IRS as of June 9, 2017, the IRS will close the case, refund any fees paid in with the request and require the executor to file the return in accordance with the new revenue procedure. If a return has been filed under this revenue procedure and later found that it was otherwise required to file an estate return, the extension will be nullified.

Does electing portability make sense and how does it compare to using a credit shelter trust or qualified terminable interest property (QTIP) trust? In the case of smaller estates, the better choice may be to elect portability, although there may be other overriding concerns such as family dynamics and creditor protection that dictate otherwise. Below are some of the considerations:

- Advantages of electing portability
  - o Gets a second basis step-up at the surviving spouse's death
  - o Saves federal and state capital gains tax savings
  - o Lowers administrative expenses
  - o Allows for spousal rollover of IRA/retirement plan assets
  - o Saves income and net investment surtax due to larger individual tax brackets
- Advantages of a credit shelter trust
  - o Asset protection
  - o Appreciation exempt from surviving spouse's estate
  - o GST protection

The use of a QTIP trust which combines many of the features of both strategies may be a good alternative since the assets in the trust will qualify for the marital deduction, will receive a second basis step-up since they will be included in the surviving spouse's gross estate and will enjoy creditor protection within the trust.

A few last thoughts on making the portability election:

- The election can only be made (or opted-out) by the executor, which may not be in line with the wishes of the surviving spouse (but see the case of Vose, 2017OK3, case No. 115424, decided 1/17/2017). The takeaway from this case is to clearly state in the will if the decedent wishes to require the executor to make the portability election (consider going back on existing wills to address this point as well).
- The executor can opt-out of electing portability on the Form 706.
- If your client does not want to elect portability, get it in writing to avoid problems with future beneficiaries.
- Electing portability keeps the statute of limitations open on the first spouse's estate return until such time as the statute has run on the second spouse's estate return, but only with respect to the DSUE computation.

Decedent's Final Income Tax Return

There are several basic considerations that the executor needs to keep in mind when preparing the decedent's final income tax return –

Filing status election. Generally, filing a joint return results in the lower overall tax liability for a married couple. However, consideration needs to be given in cases where the decedent may have little income, but high medical expenses (which are subject to a 7½ or 10 percent AGI floor) which would otherwise be lost or greatly reduced if filing a joint return with a surviving spouse who had high income.

Medical expense election. Section 213(c) allows the executor to deduct medical expenses on the decedent's final income tax return for the year the expense was incurred if it was paid by the estate within one year of death. The election must be filed in duplicate, which includes a statement of the nature and amount of the medical expenses and that the deduction against the gross estate for those expenses has not been taken and waives the right to claim them at any time for estate tax purpose.

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Interest on Series E/EE Bonds. Section 454(a) allows the executor to elect to report all previously accrued, but otherwise unreported Series E/EE U.S. bond interest through the date of death on the decedent's final income tax return. This would be advantageous where the decedent died early in the year or otherwise had little income or high deductions. Without the election, such income would be considered income with respect to a decedent (IRD) and taxed to the beneficiary who may be in a much higher tax bracket. Interest accruing after the date of death is not IRD and the beneficiary is not bound by the estate's election.

Election out of installment sales treatment. In the case where there is a sale in the year of death where proceeds are being paid out over time, the executor can elect out the installment sale treatment on the decedent's final income tax return by merely reporting the entire gain in that year. This could save taxes in the case where the decedent is otherwise in a low tax bracket or has other losses to offset the gain.

Administrative Elections

Creating or terminating the fiduciary relationship. Form 56 is used to notify the IRS of the creation or termination of a fiduciary relationship by the executor of trustee (IRC Sections 6903 and 6036). The fiduciary should also separately file Form 2848 (Power of Attorney) with the IRS under separate cover. The filing of Form 56 provides the IRS with the fiduciary's address to avoid notices (especially 90-day notices) being sent to the wrong address. If there is more than one fiduciary, each should file a separate Form 56.

Requesting a prompt assessment of tax. The executor of fiduciary uses Form 4810 to request a prompt assessment of the decedent's income, estate or gift tax liability by filing the form within the 3-year statute of limitations. The form is filed after filing the decedent's final income tax return, or Forms 706 (Estate Tax Return) and 709 (U.S. Gift and GST Tax Return). Once filed, the IRS has 18 months (rather than the usual 3 years) to make an assessment of tax or start court proceedings. Filing Form 4810 is useful where there may be questionable issues on the tax returns and the executor wants to limit the exposure to an audit.

Request to discharge the executor from personal liability. The executor or trustee can limit their exposure to personal liability with regard to the tax on the decedent's final income tax return or with regard to Forms 706 and 709 by filing Form 5495 after filing each respective return. The executor or trustee is discharged from personal liability (but not fiduciary liability) upon the subsequent payment of taxes as notified by the IRS, or, if no such notice is received within 9 months after Form 5495 is filed.

Election to Split Pre-Death Gifts

Regulation Section 25.2513-2(c) allows the executor or administrator of a deceased spouse to consent to gift-splitting with the surviving spouse, but only with respect to pre-death gifts. Furthermore, the spouse may not elect to split gifts with a deceased spouse if he/she remarries before the end of the calendar year.

Fiduciary Tax Elections

Taxable Year of Estate. Generally, an estate's tax year begins on the day following the date of death. For tax reporting purposes, the executor may select either a calendar year or a fiscal year ending on the last day of any month, but not beyond the first anniversary of the date of death. The election to select a fiscal year can be made on a late-filed return and is not bound by the date selected on Form SS-4, the payment of estimated taxes or the filing of an application for extension. The advantages of choosing a fiscal year include (1) the possible deferral of the estate's income tax, (2) allowing a yearend that best matches income and deductions to minimize the estate's liability and (3) possible deferral of the beneficiary's income tax liability since the beneficiary includes K-1 income in the calendar year which includes the last day of the estate's taxable year.

Treating a Revocable Trust as Part of the Estate. Section 645 allows the trustee to treat a qualified revocable trust (basically, a revocable trust owned by the decedent at the time of death) as part of the estate for income tax purposes. Both the executor and the trustee of all qualifying trusts that want to be a part of the estate's income tax filing must sign and file Form 8855 by the due date, including extension, of the estate's first income tax return. If there is otherwise no estate, the trustee can sign in place of the executor. All qualifying revocable trusts must obtain a new EIN after the decedent's

death, even if had a prior EIN assigned. The election is effective as of the date of death and ends on the earlier of the date when all asserts of the electing trust and estate have been distributed and (1) the second anniversary of the decedent's death if no estate return is required and (2) if an estate return is required, the later of 2-years or all taxable years of the estate until 6 months after the final determination of the estate's tax liability. Upon termination, the final distribution to a new trust carries out distributable net income (DNI) and capital gain of the trust as if the estate was in its termination year.

Advantages of making the 645 election include:

- The trust can use the fiscal year of the estate to defer income
- The trust can utilize the estate's charitable income tax deduction or set-aside
- The trust, as part of the estate, can own S corporation stock
- Only one tax return is required to be filed
- The trust can benefit from the estate's $25,000 rental loss allowance for the first 2 years after death (Section 469(h)(4))
- Payment of the decedent's medical expenses made by the trust within 1 year after death can be claimed on the decedent's final income tax return.
- Business related elections
- Elections specific to larger estates

Part II of this series will be published in the Fall issue and will cover business related elections and elections specific to larger estates.

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