PAST DEATH'S DOOR-POST MORTEM TAX PLANNING

By: Robert D. Kaplow, Esq.

I. GENERAL

A. Planning does not stop just because your client died. There are many planning issues and elections that can be made. This program will discuss some of those issues.

B. Post mortem planning involves income taxes, estate taxes, generation skipping transfer taxes, etc.

C. Some decisions will generate a conflict between beneficiaries – such as deciding between the surviving spouse (of the second or later marriage) and children from the first marriage.

D. Some post mortem planning may involve reformation or modification of the deceased's estate plan documents.

E. Fiduciaries have been sued by beneficiaries in connection with elections that were to the detriment of those beneficiaries or for failure to make an election.

F. Post mortem planning arises from the inability of estate planners to predict the future!

II. PROBATE

A. Probate is required to transfer assets that were owned in the decedent's name alone

B. Probate can be avoided in many ways:

1. Ownership by a Revocable Trust.

2. Joint ownership with rights of survivorship.

3. Beneficiary designation for life insurance, IRA, etc.

4. Title an account as “transfer on death” (TOD) or “payable upon death” (POD).

C. If probate is necessary, Michigan has both unsupervised and supervised court proceedings.

D. Generally, most probate proceedings will be unsupervised.

1. In an unsupervised proceeding, all activity is undertaken by the personal representative of the estate without court supervision.

2. Unsupervised proceedings should be used unless there is a likelihood of a contest over some aspects of the estate administration – such as the validity of the Will, determination of heirs, appointment of the personal representative, etc.

3. An unsupervised probate can later be switched to a supervised proceeding if needed.

III. <u>ESTATE TAX RETURN</u>

A. If the client has a taxable estate (over $12,920,000 for 2023 less any taxable gifts made), an estate tax return (Form 706) is required to be filed even if the estate is non-taxable because of the marital or charitable deduction.

B. The Form 706 is due nine months after death along with payment of the estate tax. An automatic extension of six months can be obtained, but the tax is still due nine months after death.

C. Portability election.

1. Allows a married couple to combine their estate tax exemptions.

2. When the first spouse dies, the amount of the deceased spouse's unused estate tax exemption can generally be used by the surviving spouse. The amount available for the surviving spouse is called the deceased spouse's unused exclusion ("DSUE") amount.

3. The DSUE amount available is the amount from the surviving spouse's most recent spouse to die. Example: Husband dies with no taxable estate. His DSUE is $12,920,000. Wife remarries and her new husband dies before her with a taxable estate of $11,000,000. Assume that on the date of death of husband #2, the estate tax exclusion is $13,610,000 (the estimated exemption for 2024). The DSUE amount now passing to the wife is only $2,610,000 and not $12,920,000.

4. Must be determined by timely filing an estate tax return for the first spouse to die.

5. Note that any unused GST exemption is not portable to the surviving spouse.

6. In order to avoid a flood of non-taxable estate tax returns, the IRS issued Rev. Proc. 2022-32. This provides that a valid DSUE election can be made if the estate tax return is filed within **five years** from the date of death, if the estate tax return has not already been filed.

D. QTIP election ("Qualified Terminable Interest Property).

1. A form of a marital trust which provides income (and possibly principal) to the surviving spouse.

2. However, upon the death of the spouse, assets pass to the individuals named in the QTIP trust. The surviving spouse has no control over the disposition of the principal upon his or her death.

3. Typically used in a second marriage situation, the QTIP allows the surviving spouse to receive the income from the trust but principal then passes to the children of the first marriage.

4. Election must be made on Schedule M of the estate tax return and is irrevocable.

5. A partial QTIP election can also be made.

E. Alternate valuation date.

1. Normally assets of the deceased are valued at fair market value as of the date of death.

2. However, for a taxable estate, assets can be valued at their fair market value six months after the date of death – but only if the alternate valuation date reduces the estate tax liability.

3. Election is made on the estate tax return.

F. Administration expenses.

1. These can be deducted either on the estate tax return or on the estate income tax return.

2. If taken on the income tax return, an irrevocable waiver of the right to claim them as estate tax expenses must be filed timely.

G. Extension to pay estate taxes.

1. As noted above, estate taxes are due nine months after death.

2. However, IRC §6166 provides for a 14-year extension of the tax attributable to closely held businesses that constitute more than 35% of the adjusted gross estate.

3. There are complicated rules dealing with attribution of stock owned by family members and combining of companies in order to meet the 35% test.

4 The value of the closely held business does not include any passive assets that are not used in the trade or business.

5. Election must be made by the due date (including extensions) for filing the Form 706.

H. Qualified domestic trust election (QDOT).

1. A marital deduction is not allowed for transfers to a non-U.S. citizen spouse.

2. However, creation of a Qualified Domestic Trust (QDOT) marital trust postpones the imposition of estate taxes on the marital trust assets.

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3. The QDOT:

    a. Requires at least one trustee to be either a U.S. citizen or a domestic corporation.

    b. Requires that no distributions of principal can be made unless the trustee has the right to withhold from the distribution the tax imposed on the QDOT.

4. The QDOT requires an election to be made on Schedule M of the estate tax return. The election is irrevocable.

5. If the assets of the QDOT are more than $2 million, then the QDOT must satisfy one of the following requirements:

    a. At least one U.S. trustee is a bank.

    b. A bond must be posted in favor of the IRS in an amount equal to 65% of the value of the QDOT. The bond is generally required to be filed with the estate tax return.

    c. A letter of credit must be provided in favor of the IRS in an amount equal to 65% of the value of the QDOT. Again, this letter of credit is filed with the estate tax return.

IV. <u>INCOME TAX RETURNS</u>

A. Return for deceased.

1. While marital status is determined at the end of the tax year, a joint return can be filed for the year of death even if the deceased died on January 1st of that year.

2. The joint return will include the deceased person's income through the date of death and the income of the surviving spouse for the full year.

3. A determination should be made whether to file a joint return or file as married filing separately.

4. If decedent had net capital losses, it will be advantageous to file a joint return if the surviving spouse has capital gains or vice versa.

B. Estate and trust tax returns.

1. The estate of the deceased and a revocable trust of the deceased are separate tax reporting and paying entities and separate returns are required for each.

2. However, the estate and trust can make a §645 election to combine the estate and trust income and file one income tax return.

3. An advantage of making the §645 election is that it allows the trust to utilize a fiscal year. Generally, a trust is required to report on a calendar year basis. An estate can report on a fiscal year basis. By making the §645 election, the trust is able to use a fiscal year.

4. The use of the fiscal year allows for deferral of income to beneficiaries as the beneficiary reports income based on the fiscal year K-1, not based on when distributions were received by the beneficiary.

5. The election is made no later than the time prescribed for filing the income tax return for the estate (with extensions). Once made, the election is irrevocable.

C. Section 754 elections.

1. A section 754 election allows a partnership (or LLC) to adjust the basis of property within a partnership when there is a transfer of a partnership interest such as a transfer because of death of a partner.

2. This allows a higher basis to be used for the transferee partner, which can result in higher depreciation being allocated to that partner, or less gain to the partner.

3. The transferee of the partnership interest must notify the partnership of the transfer within one year of the date of death of the partner. A sample form is attached as Exhibit A.

4. The partnership must consent to allow Section 754 elections by filing a statement with the partnership's income tax return. Once made, the election applies to all distributions and transfers relating to the partnership in that year and all future years and cannot be revoked without permission of the IRS Commissioner.

V. **POST DEATH CHANGE IN DOCUMENTS**

A. There are a number of ways that the distribution plan for the decedent's assets can be changed after the death of the decedent.

B. Disclaimer.

1. Pursuant to Michigan statutes and the Internal Revenue Code, an heir can disclaim his or her rights to receive estate or trust assets, provided that the qualified disclaimer is made within nine months of the date of death of the decedent.

2. If a disclaimer is made, it is treated as if the intended beneficiary died before the decedent. In such case, the provisions of the Will or trust determines the disposition of the assets, as if the intended beneficiary was not surviving.

3. A disclaimer may save income, estate, gift and generation skipping taxes on large estates.

4. To be effective:

   a. The disclaimer must be irrevocable.

   b. The disclaimer must be in writing.

   c. The disclaimer must be received within nine months of the date of death of the decedent.

   d. The donee must not have accepted any interest in the property or any of its benefits prior to the disclaimer.

   e. As a result of the disclaimer, the property must pass to a person other than the disclaimant without any direction on the part of the disclaimant. A partial disclaimer can also be made.

   f. Example: A trust provides for assets to pass to the grantor's son A. Son A does not need the assets. He can execute a qualified disclaimer. The trust provides that if A is not surviving, the assets pass to A's child Z. The assets would then pass to Z without any gift tax consequences.

C. Non-judicial settlement agreement.

1. The Michigan Trust Code allows voluntary changes of a trust agreement provided that the changes do not violate a trust's purpose. This is called a non-judicial settlement agreement (NJSA).

2. The Michigan statute (MCL 700.7111) is not as broad as similar provisions in other states.

3. The NJSA must be executed by all interested persons. An interested person is someone whose consent would be needed to achieve a binding settlement if the settlement were to be approved by the probate court.

4. The advantage of the NJSA is that it is an out of court agreement binding on the parties.

5. A NJSA cannot be used to modify or terminate an irrevocable trust. Also, it cannot violate a material purpose of the trust.

6. Typical subjects of a NJSA are:

    a. Interpretation of the trust.

    b. Approval of trust accounting.

    c. Direction to the trustees to perform or refrain from performing certain actions.

    d. Resignation or appointment of a trustee or determination of the trustee's compensation.

    e. Transfer of a trust's principal place of administration.

    f. Liability of a trustee for an action relating to the trust.

7. Basically, only administrative provisions should be the subject of the NJSA.

D. Modifications.

1. The Michigan Trust Code also provides for the modification of an irrevocable trust.

2. Generally, the modification of the trust requires consent of the probate court, the trustee, and the qualified beneficiaries.

3. The court must determine that the modification is consistent with the material purposes of the trust.

4. The statute does not apply to irrevocable trusts that were created before April 1, 2010.

EXHIBIT A

NOTIFICATION PURSUANT TO TREASURY REGULATION SECTION 1.743-1(k)(2)(ii)

1. Name and Address of the Deceased Partner (Member) and Transferee:

   Deceased Partner (Member): **Ima Taxpayer**

   Transferee: **Yura Taxpayer**

   Address of both Deceased Partner and Transferee: **28400 Northwestern Highway, Southfield, MI 48034.**

2. Taxpayer Identification Number of Deceased Partner (Member) and Transferee:

   Deceased Partner (Member): **123-45-6789**

   Transferee: **9876-54-321**

3. Relationship between Transferee and Transferor:
   The Transferee is the surviving spouse of the Transferor.

4. Date of Death of Deceased Partner (Member):
   November 11, 2023

5. The Date on Which Transferee Became the Owner of the Partnership Interest:
   November 11, 2023

6. Description of Transferor's Interest:
   A 7.5% Membership Interest in Pie In The Sky, LLC

7. The Fair Market Value of the Partnership (Membership) Interest on the Applicable Date of Valuation:
$100,000

8. The Manner in Which the Fair Market Value of the Partnership (Membership) Interest was Determined:
Appraisal by Unbiased Accountant Service, LLC

Under penalties of perjury, I declare that this notice has been prepared to the best of my knowledge and belief and the facts and information contained therein are true, correct, and complete.

____

Yura Taxpayer