

## Post Mortem Estate Planning Class 3-4

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## Section 6161: Extensions of Time for Payment

- Section 6161(a)(1): Secretary may extend the time for payment of the estate tax for up to 12 months.
  - Regulations require reasonable cause
- Section 6161(a)(2): Secretary may extend an the time for payment for up to 10 years if the taxpayer shows reasonable cause.
  - Examples are litigation over estate assets, difficulty in marshaling assets, inability to borrow, assets are future royalty rights, etc.

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## Section 6166: Estate Taxes for Closely-held Business

- Section 6166(a)(1): value of closely-held business interest is 35% or more of the adjusted gross estate, executor may elect to pay estate taxes over 10 years with a 5 year interest deferral.
- Section 6166(a)(2): amount of tax attributable to business interest is the proportion of the value of the business interest to the value of the adjusted gross estate.
  - Section 6166(b)(2)(6): defines adjusted gross estate.

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## Section 6166: Estate Taxes for Closely-held Business cont.

- Section 6166(a)(3): Date for First Installment: first installment is due not more than 5 years from the due date of the estate tax return. Each subsequent Installment is 1 year later.
- Section 6166(b)(1): Interest in closely-held business
  - 20% or more of value is in gross estate **AND**
  - 15 or fewer owners (45 after 12/31/01)

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## Section 6166: Estate Taxes for Closely-held Business cont.

- Section 6166(b)(2): allows attribution for spousal, indirect, and family 267 attribution.
- Section 6166(c): allows aggregation if 20% or more of the total value of the interest of each business is included.
- Section 6166(b)(7): if elected, partnerships and non-readily-tradable stock are treated as owned by the decedent for purposes of the 35% gross estate inclusion, but no 2% benefit and no 5 year deferral.

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## Section 6166: Estate Taxes for Closely-held Business cont.

- Section 6601(j): interest rate on the loan
  - 2% Interest Rate: the tax attributable to the first \$1,000,000 of value over the applicable exclusion amount
    - Increased for inflation \$1,140,000 for 2004
  - Balance: 45% of the annual rate provided in 6601(j).
    - Underpayment rate is currently 6% (annual rate)

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## Section 6166: Estate Taxes for Closely-held Business cont.

- Steps to Calculate 45% Interest Rate
  - Step 1: Determine Underpayment Rate
  - Step 2: Multiply Underpayment Rate by 45%
  - Step 3: Convert from Annual Rate to Daily Compound Rate using this formula  $((1 + (i/365))^{365}) - 1$ , where (i) is the interest rate from Step 2.
- You Would Also Daily Compound the 2% Interest Rate under Step 3.

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## Section 6166: Estate Taxes for Closely-held Business cont.

- Acceleration of Payment: Sec. 6166(g)(1)(A):
  - If more than 50% of the business is sold or money distributed equals or exceeds 50% of the value of the business, then unpaid amount is accelerated.
- Section 303 Redemptions: Sec. 6166(g)(1)(B):
  - Do not count as acceleration, and the value of the business for purposes of (g)(1)(A) is the value reduced by the Section 303 redemption. Estate taxes must be paid equal to the amount redeemed.

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## Disclaimers

- Section 2518(a):
  - if a person makes a qualified disclaimer, then for transfer tax purposes it shall be treated as if the interest had not been transferred to such person.
  - Treas. Reg. Sec. 25.2518-1(b): a person making a qualified disclaimer is not treated as making a gift. If the disclaimer is not qualified, the disclaimer is disregarded and the disclaimant is treated as having received the interest.

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## Qualified Disclaimer

- Section 2518(b): irrevocable and unqualified refusal to accept an interest and:
  - Such refusal is in writing;
  - Received by the transferor of the interest within 9 months after the interest was created;
  - The interest and any of its benefits have not been accepted; and
  - The interest passes without any direction from the disclaimant to the spouse of the decedent or a person other than the disclaimant.

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## Qualified Disclaimer

- Writing: Treas. Reg. Sec. 25.2518-2(b):
  - Must identify interest in property disclaimed and signed by disclaimant.
- Time Limit: Treas. Reg. Sec. 25-2518-2(c):
  - Timely mailing is treated as timely delivered.

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## Starting Point of the Transfer?

- When does the time period for disclaiming begin? 25.2518-2(c)(3):
  - Inter vivos transfers begin with a completed gift
  - Testamentary transfers begin on decedent's death
  - General power of appointment:
    - Holder's time period begins when the power was created.
    - Person who gets the interest upon the exercise, release, or lapse has 9 months from the exercise, release or lapse.
  - Nongeneral power of appointment:
    - Holder, appointees, or taker in default must disclaim within 9 months from creation of power.

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## Starting Point of the Transfer?

- Joint Assets: 25.2518-2(c)(4):
  - 25.2518(c)(4)(iii): Joint bank, brokerage and other investment accounts, if the transferor may regain his or her contributions without the consent of the other cotenant (i.e. not a gift), then the interest occurs on the death of the cotenant.
  - 25.2518(c)(4)(i): Other joint tenancies, whether severable or not under local law, may be disclaimed 9 months after the death of the cotenant.

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## How Much Can Be Disclaimed?

- Joint Assets: 25.2518-2(c)(4):
  - 25.2518(c)(4)(iii): Joint bank, brokerage and other investment accounts: surviving cotenant can disclaim everything except his or her contributions.
    - See Examples 12, 13 & 14.
  - 25.2518(c)(4)(i): Other joint tenancies: surviving cotenant can disclaim 50%.
    - See Examples 7, 8 & 10.

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## No Acceptance of Benefits

- 25.2518-2(d): the disclaimant may not accept the interest or any of its benefits.
  - Acceptance is an affirmative act consistent with ownership of the of the interest in the property.
  - Acts indicative of acceptance are using the property; accepting dividends, interest or rent; directing others to act with respect to the property.
  - In the case of residential property, a cotenant is not considered to have accepted merely because they resided on the property prior to disclaiming.
  - Examples 2, 4, 5, & 6

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## Passage Without Direction By The Disclaimant

- 25.2518-2(e):
  - Property must pass without any direction on the part of the disclaimant to a person other than the disclaimant (except to the surviving spouse). See Example 1.
  - If spouse disclaims, and retains beneficial enjoyment not subject to an estate or gift tax (whether as trustee or otherwise), then the spouse is treated as directing beneficial enjoyment unless the power is limited by an ascertainable standard. See Examples 4, 5 & 6.

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## Uses of the Disclaimer

- Salvage the Unified Credit
- Equalize estates, thereby saving estate taxes
- Correct errors in the estate plan
- To pass property to heirs who can better use the property.

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## Qualified Terminable Interest Property: 2056(b)(7)

- QTIP property: 2056(b)(7)(B)(i):
  - Passes to the decedent;
  - Surviving spouse has a qualifying income interest for life; and
  - An election has been made under this Section.
- Qualifying Income Interest for Life: 2056(b)(7)(B)(ii):
  - Spouse is entitled to all the income from the property annually or more frequently; and
  - No person has a power to appoint any part of the property to any person other than the surviving spouse.

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## Qualified Terminable Interest Property: 2056(b)(7)

- Election: 2056(b)(7)(B)(v):
  - An election shall be made by the executor on the estate tax return. Once made, the election is irrevocable.
- Section 2044(a): QTIP Estate Tax Inclusion
  - Value of the Gross Estate includes the value of any property where the decedent had a qualifying income interest for life.

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## Qualified Terminable Interest Property: 2056(b)(7)

- Estate Liquidity: Section 2207A
  - Estate may recover taxes caused by estate tax inclusion of the QTIP trust from the persons receiving the property
  - The amount recovered is the “incremental tax”
  - Decedent may direct otherwise in his will or revocable trust.

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## Qualified Terminable Interest Property: 2056(b)(7)

- Post Mortem Planning Opportunities:
  - Since the marital deduction is contingent on the making of the election, a failure to make the election in whole or in part will prevent the marital deduction.
  - The election (or partial election) must cover the entire trust property, a percentage or a fractional share of the entire property. Any appreciation or depreciation from date of death is allocated pro rata to the elected portion.
  - Unlike a disclaimer, a QTIP election can be delayed until the time for filing the estate tax return plus extensions.

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## Qualified Terminable Interest Property: 2056(b)(7)

- Hypothetical:
  - John Smith died on June 30, 2004. At death, his estate was valued at \$4,800,000. Under John’s will, property passes to a trust for the benefit of his wife with income paid to her annually.
  - What if John’s estate was worth \$1,500,000 instead?

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## Qualified Terminable Interest Property: 2056(b)(7)

- Division of Trusts: 20.2056(b)-7(b)(2)(ii):
  - A trust may be divided into separate trusts to reflect a partial election that has been made, or is to be made, if authorized under the governing instrument or local law.

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## Qualified Terminable Interest Property: 2056(b)(7)

- Caution: Avoid giving the Spouse a General Power of Appointment
  - What if the QTIP trust permitted the spouse to appoint the assets to herself or himself during life or at death? What if the trust permitted the trustee to withdraw the principal not subject to an ascertainable standard and the spouse was trustee?
  - See 2056(b)(5).

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