WEBINAR RESOURCE PAPER

My mom just passed, what tax, legal and financial matters do I need to address?

By Martin M. Shenkman, Esq. and Joy Matak, JD, LLM

INTRODUCTION

Losing a loved one is difficult, but those challenges can be made more challenging by the complex array of income tax reporting, estate tax reporting, state tax reporting, tax elections, financial decisions, legal steps, family dynamics, and more. What are some of the issues practitioners need to consider in order to help clients? What steps can practitioners in the various disciplines take to make this tough life event a little bit easier? When someone passes away, a family member, friend or other person is immediately tasked with the responsibility to evaluate a variety of options that either need to be taken or perhaps should be taken in order to protect and preserve assets for the decedent's heirs.

We will endeavor to demystify some of the complex tax and other issues to be addressed through a conversation focused on the practical steps of an estate administration following the death of a loved one. We'll address a question from an attendee on state inheritance tax (please send your questions into us in advance of each month's program and we'll try to answer them in the program). We'll discuss some of the emotional issues that can make any estate administration more challenging for the client and practitioner alike. We discuss some practical discussions that might help you reduce the potential for conflict between the personal representative and the heirs.

There are a host of tax decisions to be made, such as determining the tax year for the estate, identifying filing requirements, and evaluating various tax elections and opportunities, even if no estate tax will be incurred. If an estate tax might be due, the number of decisions multiplies. From a financial perspective marshalling assets, addressing retirement plan payouts for the decedent, setting up estate bank and other accounts, and other steps all need to be addressed. From an administration standpoint, regardless of the size of the estate, an estate balance sheet should be prepared and detailed regards and account statements obtained for each asset. The personal administrator should likely hire a professional advisory team - even for modest estates.

This paper will explore steps that might reduce the likelihood of unhappy beneficiaries and the risks of litigation.

Table of Contents

I. Practitioners should work with clients to create documents that will assist their loved ones to administer their estates after their deaths.

As a corollary to the old adage that the best defense is a good offense, the best way to administer the estate of a deceased loved one is to start well before death with an appropriate estate plan and more. Hopefully, making the heirs aware of their loved one's wishes and perhaps the broad picture of the dispositive plan, may reduce or even eliminate post-death angst and even conflicts. Apart from wishes and some outline of the plan, if the heirs know the individual's team of advisors and have contact information for each of them: the attorney, tax preparer, financial advisor, life insurance agent, and any other professionals who may be providing relevant advice to the individual, where original documents are located, etc. that may facilitate a more organized handling of the estate.

A. It is vitally important that our clients have instruments that accurately reflect their wishes following their deaths, in accordance with local law.

With limited exceptions, our clients, regardless of the size of their estate, should have some kind of estate plan and instruments to memorialize their wishes. Clients may wish to consider having both a will and a revocable living trust.

A revocable living trust is an arrangement in which the legal title to property is placed in the name of a trustee. A trust instrument is executed that sets forth the terms and conditions under which the title is held by the trustee. The trustee holds title to the property for the benefit of a person known as a beneficiary, who is usually the same person who transfers the property to the trust (the grantor). A revocable living trust is a method commonly used to avoid probate, but there is much more that such an instrument can accomplish.

Unless the client is incapacitated or has other limitations, it is typical for the client to be the initial trustee of the revocable trust for her own benefit. To facilitate administration of the estate upon death, the client may wish to name a co-trustee who can take over upon death or incapacity.

The grantor of a revocable trust retains the right to revoke the trust and reclaim the ownership of trust property during his lifetime. If the grantor does not exercise his right to revoke the trust, it becomes irrevocable at his death and the trust instrument (rather than the will) controls the

disposition of trust property. In limited instances the trust may be made irrevocable in whole or part by the settlor (or perhaps by a third party if such a power was provided for in the instrument) to complete a gift before death (e.g., to use exemption before the reduction to become effective in 2026). The dispositive provisions of the revocable living trust are typically similar to those that normally would have been included in the grantor's will. Practitioners should be alert, however, for instances where there may be more than one revocable trust or the dispositive plan in the revocable trust may differ from that in the will. For example, some clients may isolate separate property into a revocable trust and may have other marital property governed by a different trust. That might be done as an accounting mechanism to endeavor to avoid commingling of marital and separate property. In such instances, those differences, if they can be respected, will affect the administration of the client's estate post-death. If the revocable trust holds title to all of the decedent's assets, the revocable trust accomplishes the same goals as a will without subjecting the decedent's assets to probate. In effect, a fully funded revocable trust may serve as a will substitute. If there is litigation by heirs, or the court surrogate or probate requires filing of the revocable trust the distinctions may be less. Also, if trusts are formed on death for heirs under the revocable trust, court involvement for a future decanting or change in situs might be avoided. Whether or not notice to the court, or court approval is required, might affect the fiduciaries and heirs willingness to pursue post-death changes.

An important step in setting up revocable trusts is to retitle the assets owned by the grantor in the name of the revocable trust. This should allow for control of the assets to transfer more easily upon death of the grantor to the successor trustee, and then to trusts or heirs provided for under the instrument without the formalities of probate and court involvement. That said, there are often assets that do not make their way into the revocable trust despite the best intentions of the planners and the clients. For this reason, even if clients choose to use a revocable trust, they will likely also have a will with pourover provisions to ensure that any asset that has not been retitled in the name of the revocable trust can be poured into the trust following the grantor's death. Practitioners will have to identify title to all assets and determine what actions may be necessary to transfer those assets. In many instances clients create revocable trusts with the intent of avoiding probate, but never take steps to simplify or correct account titles, retitle assets to their trust or update beneficairy designations. That can create some dismay with heirs and fiduciaries who anticipated a "simple" process post-death only to find that despite their loved one having assured them that all was "taken care of" much work remains.

For income tax purposes, the revocable trust is a grantor trust during the lifetime of the grantor. Grantor trusts are not recognized as entities separate from their owners for federal income tax purposes. Accordingly, all items of income and deductions generated by the trust will pass through directly to the grantor. Note that most revocable trusts use the settlor's Social Security Number so that post-death a Tax Identification Number will have to be obtained for the trust. This too may present additional administrative burdens those involved did not anticipate.

At the death of the grantor, the revocable trust ends and the trust becomes irrevocable. The dispositive provisions in the trust document may provide for some combination of the transfer of the assets outright to heirs, for the trust to continue as an irrevocable trust (e.g., funding trusts for each heir), or merely for the trust to become part of the estate. For estate tax purposes, all of the assets in the revocable trust will be included in the decedent's gross estate (unless the power to revoke was terminated during lifetime to make a then completed gift). Because the assets are included in the decedent's estate, they are subject to an adjustment in basis. Thus, assets in the revocable trust will be eligible for the step-up in basis, assuming they have appreciated in value.

B. In addition to a will and/or revocable trust, clients might also consider creating a financial and personal document organizer.

An unexpected or sudden death can force loved ones to make critical decisions at a moment when it is most difficult. When tragedy strikes, it is hard to know where to turn for the information needed to make the "right" decisions.

Practitioners may wish to help their clients to organize important contact and financial information so that their loved ones do not have to struggle to pick up the pieces. By assembling necessary information in a concise and organized way, practitioners can ensure that the loved ones of their clients will have the resources to handle issues swiftly. Consider organizing information that can help heirs with questions such as:

- What are the decedent's bank, investment, and other account numbers and passwords?
- Where are important original documents stored?
- Who are the decedent's advisors, and how can they be reached?
- What are the decedent's wishes upon death?
- What debts and obligations should others be aware of?

With assistance from their planning professionals, clients may wish to make copies of important documents (or just the face page) and retain them together in a central location. Alternatively, clients might simply wish to note where the originals are kept and list the details. Practitioners should encourage clients to revisit the information quarterly to ensure that it is current. Clients may wish to review the information with important loved ones and ensure they know where to find it. To the extent that the client chooses to include personal information including but not limited to account numbers, password/pin numbers, and combinations on a central document, practitioners should remind the client to keep it in a safe and secure location.

If the above pre-death organization was not addressed (and often it is not) practitioners might wish to provide a template to the named personal administrator and/or successor trustee of the

client's revocable trust for that person to organize the information and offer that if they wish the advisers to do so instead they can.

C. Practitioners should encourage the client to communicate her wishes to her loved ones and possibly facilitate a "family" meeting, which should include the client's other advisors.

It may be more efficient for the estate to be administered by advisors who had worked with the decedent, rather than new advisors who had not worked with the decedent. Encouraging a client to introduce loved ones to the client's team of advisors during lifetime should foster professional relationships following death with the client's surviving loved ones. Collaboration among advisors will be a key component to ensure that the client's wishes are carried out and that the estate administration is smooth.

D. Prior to death, consider gifting to mitigate a state inheritance tax.

Currently, there are six states that impose an inheritance tax on transfers made by a decedent: Iowa,[1] Kentucky,[2] Maryland,[3] Nebraska,[4] New Jersey[5] and Pennsylvania.[6] A practitioner should collaborate with local counsel to confirm the rules in any state where an inheritance tax might be assessed before advising the client to make any gifts to mitigate the state inheritance tax.

While none of the states that assess an inheritance tax have a gift tax, transferors need to be cautious of rules that would claw back gifts made "in contemplation of death." Maryland uses a two-year look-back period while New Jersey has a three-year period. For any client who has a terminal illness or other malady for which death seems imminent, there may not be sufficient

---

[1] Note that Iowa is phasing out its inheritance tax which will be fully repealed by 2025. Further, no inheritance tax is due when the estate is worth $25,000 or less. Iowa Code Ann. Sect. 450.4.

[2] See the Kentucky Inheritance tax guide for more information: https://revenue.ky.gov/Individual/Inheritance-Estate-Tax/PublishingImages/Pages/default/Inheritance%20Tax%20Guide%2092F101%20%281-21%29.pdf (visited June 7, 2023).

[3] Maryland collects both an estate and an inheritance tax. Gifts made in contemplation of death will be pulled back into the decedent's estate, generally if made within two years of death. Md. Code. Ann. Sect. 7-201.

[4] In Nebraska, close relatives (other than a surviving spouse) will incur a tax of 1% on inheritances over $40,000. Neb. Rev. Stat. Ann. Sect. 77-2004. Surviving spouses are exempt from the Nebraska inheritance tax. Neb. Rev. Stat. Ann. Sect. 77-2003.

[5] New Jersey will pull back gifts and impose an inheritance tax if made "in contemplation of death," generally within three years. N.J. Rev. Stat. § 54-34-1. Note that it is a rebuttable presumption so that the gifts might be exempt from NJ inheritance tax if not made in contemplation of death.

[6] See Pennsylvania Form REV-1500 which can be found here: https://www.revenue.pa.gov/FormsandPublications/FormsforIndividuals/InheritanceTax/Documents/rev-1500.pdf.

time to gift away assets in order to avoid an inheritance tax. But it may be advisable to caution clients of that possibility in all events.

As with all planning, the client should confirm that it makes sense to make gifts and that doing so will not interfere with her lifestyle. Practitioners should encourage the client to have a cash flow analysis prepared . When gifts are contemplated, especially those intended for the benefit of a non-relative, the client should consider using a trust with provisions that would enable the trustee to hold back or divert (e.g., through a sprinkle power to a group or class of beneficiaries) distributions in the event that the client's relationship with the intended beneficiary had soured between the date of the gift and the date of the client's death.

Finally, the practitioner should make sure that the client understands that the basis of inherited property (other than some exceptions such as IRD) is different from the basis of gifted property. The basis of gifted property, including gifts to a trust, is generally the same as the basis to the donor. Estate inclusion may be desirable even if an inheritance tax might be incurred. Capital gains and income taxes generally exceed state inheritance taxes, particularly for assets with little or no basis. By including the assets in the estate, as a matter of current federal tax law, there will be a step-up in the basis of appreciated assets at the client's death. Clients should likely choose to gift assets with the highest possible basis in order to mitigate state inheritance taxes.

One of the issues raised in many estate tax proposals by the Democrats has been the concern about the perceived abuse of practitioners taking the position that assets in an irrevocable grantor trust can obtain a step-up in income tax basis at the grantor's death even though those assets are not included in the taxpayer's taxable estate. Revenue Ruling 2023-2 makes the IRS position now clear that there's no step-up in basis for such assets. Some commentators, however, suggest that despite this recent Revenue Ruling that the IRS is wrong and a step-up may be feasible. Proceed with caution.

II. A practitioner might best assist in the smooth administration of a client's estate by reviewing important administrative matters with surviving loved ones.

After the funeral and an appropriate grieving period, the executor, trustee, and/or personal representative who is tasked with administering the estate (the "estate representative") will need to attend to important administrative matters. This time frame will vary dramatically for various clients and practitioners should endeavor to identify the perspective of those involved. In some instances, the surviving spouse is named as personal representative and in all other capacities and is simply unable to address legal, tax and other matters for an extended period of time. In such cases it may be necessary to reach out and encourage action to avoid delays that could have a detrimental effect. In other cases, those involved may be prepared rather soon after the client's death to being taking steps. Also, the time frame will depend on the assets, claims, issues, etc. that are involved. In some cases, securing the

decedent's residences and documenting the contents quickly may be important. Some decedents have not updated property, casualty or liability insurance in decades and there may be an urgency to addressing that. Is there a pet that may require immediate care? While some clients have family that might address these matters, sometimes it is family members that are the concern that property, e.g. jewelry and collectibles, must be protected against. And many clients are isolated and may not have nearby family or even any family, so a pet or other urgent issues will need to be tended to.

In general the estate representative should engage an attorney and other advisors to assist in the estate administration effort. As mentioned previously, it might be most efficient to use the same advisors as had worked with the decedent, particularly if the decedent had introduced the estate representative to her team of advisors and the estate representative is able to establish a good working relationship with them.

Following is a non-exhaustive checklist to help the estate representative get started:

1. Locate the original will, revocable trust, and other important legal documents. Direct the named fiduciaries to look for estate planning documents and other items in safe deposit boxes, home safes, or filing cabinets in home offices, etc. Consider that depending on title and signers on the safe deposit box access may require that the will first be admitted to probate, creating a conundrum about accessing the box. Practitioners should also consider the potential risks for the persons contacted not being forthcoming about documents identified, or their pilfering assets or documents during such investigations. For example, it may be appropriate in some instances to have counsel or an independent inventory company present when a safe deposit box or home is first accessed.
2. If assets will pass under a will, the estate representative should consult legal counsel about initiating probate proceedings. An estate representative has no authority to act on behalf of the estate until a court accepts the will as valid and issues letters testamentary or similar authorization to allow the estate representative to act in that capacity. Many heirs/family members do not understand these requirements and may scoff at the formalities as it is "just family," and practitioners may wish to caution them, ideally in writing, about the need to adhere to formalities.

3. If the decedent died without a will, counsel may need to initiate court administration of the estate in order to have the estate representative properly appointed in accordance with local law. Unfortunately, even in circumstances where many assets were titled to avoid probate, it often becomes necessary to have a formal appointment.

4. If the decedent created and funded a revocable trust, the successor trustee may be able to begin managing the decedent's affairs once a death certificate is obtained confirming that their appointment is activated, without the need for court proceedings. But practitioners should always carefully review the document first to confirm who has what authority and when. Also, the successor executor should be cautioned as to limitations to consider. For example, if the decedent's residence contains collectibles or other tangibles that were not transferred to the revocable trust, the authority over those assets may be under the personal representative named under the decedent's will.

5. The advisors should assist the estate representative in preparing an inventory of the decedent's assets and liabilities, paying particular attention to assets that may require immediate attention, such as life insurance policies, stock options and retirement plans. If probate is required, counsel should mindful of any time deadlines affecting stock options and other time-sensitive assets. In general, the estate representative should not pay any outstanding bills before taking inventory of all the decedent's assets and compiling a complete list of the decedent's creditors. Beneficiaries may pressure the personal representative for distributions. Counsel should caution that if distributions are made and inadequate resources are left to meet estate obligations, the personal representative may be personally liable for the shortfall.

6. The advisors should assist the estate representative with estimating the number of death certificates that may be necessary to marshal all estate assets, address probate, etc. and then obtaining multiple originals of the death certificate. Given the modest cost of death certificates it may be advantageous to order more than the estimated need to avoid the costs and time of having to reorder more in the future.

7. Counsel and the estate representative should review any relevant, employment contracts, bonus arrangements, etc. It may also be advisable to contact the decedent's employer or business associates to obtain information about:
    - Group life, accidental death or disability insurance,
    - Contributions to pension funds or other retirement plans,
    - Accrued vacation and sick pay,
    - Unpaid commissions, and
    - Health insurance covering the surviving spouse or dependents.

8. Counsel and the estate representative should review any relevant business

agreements (e.g., shareholder agreements, buy out agreements, etc.). Endeavor to identify any rights or obligations the decedent may have had under such agreements. If the decedent was a business owner, the team of advisors should include the business accountant who prepared the tax returns and any CFO or bookkeeper who handled the books and records of the business. The advisors should help the estate representative to determine the obligations to continue the business's operations. Counsel should review any succession planning documents prepared by the business and coordinate with the business's remaining owners and advisors. All of this should consider implications to valuations for an estate tax return.

9. The estate representative should contact the decedent's insurance agents to file any life insurance or other death benefit claims by furnishing relevant information and documentation, as follows:
    - Death certificate;
    - Insurance policy numbers and amounts;
    - Decedent's full name, address, and date and place of birth;
    - Decedent's occupation and last place of employment; and
    - Claimant's name, address, age and Social Security number.

10. The surviving spouse and dependents should contact the U.S. Social Security office to apply for spousal and dependent benefits, by furnishing relevant information and documentation, as follows:
    - Certified copy of death certificate;
    - Decedent's Social Security number, proof of age and marriage certificate;
    - Decedent's employer information, approximate earnings in the year of death and earnings records for the previous year; and
    - Social Security numbers and proof of age for the decedent's surviving spouse and dependents.

Keep in mind that this list is by no means exhaustive, but it provides many of the financial and legal steps the advisers will want to guide the family/fiduciaries to address when a family member dies.

Losing a loved one is an extremely stressful experience, but advisers can ease some of the strain on family by guiding clients to organize documents that will be needed well in advance and consulting experienced advisors to guide you.

III. Practitioners should consider and discuss with the estate representative various income tax elections and opportunities available.

A. Determine whether an election under IRC Sect. 454 is available and would be advantageous to the estate.

When the decedent owns U.S. Savings Bonds (in general, Series EE, E, and/or I Savings Bonds), the estate representative should consider whether to make an election under IRC Sect. 454, in consultation with tax advisors. A Section 454 election allows all accrued interest earned on bonds through the date of death to be included in current income by a cash basis taxpayer who would not otherwise include the income until the bonds are redeemed.

The tax preparer for the decedent and the estate should coordinate and evaluate the advantages of any such election before the final form 1040 for the decedent and the first form 1041 for the estate is filed.

Where the decedent had minimal other income through her date of death or sufficient deductions to reduce her taxable income, it is likely advantageous to include the accrued bond interest on the final Form 1040. Where inclusion of the accrued interest results in a tax at the decedent's individual income tax level, the tax liability can be used as a deduction on the estate tax return, thereby reducing the overall estate taxes due. Note that when a Sect. 454 election is made, no part of the accrued interest will be treated as income in respect of the decedent when collected by the beneficiary or estate upon redemption of the bonds.

In the absence of a Sect. 454 election, the interest collected by the beneficiary or estate upon redemption will be treated as taxable to the recipient. Note that an IRD deduction (discussed in C, below) would only be available for interest accrued through date of death and not for interest accrued after death.

B. Should the estate representative make an election under IRC Sect. 645?

For income tax purposes, the trustee of a living trust may make an election under IRC Sect. 645 to treat the revocable trust and the estate as a single taxpayer. This allows the trust to enjoy the primary benefits of being an estate for income tax purposes:

- Choosing a non-calendar fiscal year for income tax purposes. Using the estate's fiscal year may provide deferral of income. Reg. Sec. 1.645-1(e)(3)(i).
- Avoiding estimated income tax requirements for the first two taxable years of the trust. Estates, unlike trusts, are exempt from estimated tax requirements for two years. This can be used to avoid penalties on overlooked estimated taxes or be used affirmatively to preserve cash flow. Reg. Sec. 1.645-1(e)(4).

- Obtaining a current deduction for funds set aside for charity that are not yet paid to charity. IRC Sec. 642(c)(2).
- Qualifying for a medical expense deduction for decedent's medical expenses.
- Estate tax losses may offset income from the revocable trust.
- Permits the trust to be a qualified S corporation shareholder. PLR 200529006.
- Automatic eligibility, without making any election (i.e. QSST or ESBT election), as a qualified S corporation shareholder for the duration of the period of estate administration. IRC Sec. 13651(c)(2)(A). Since the QRT was a grantor trust before death it is only post-death that the issue of qualifying for as an S corporation shareholder becomes a concern. PLR 200529006.
- Utilizing the active real estate exception to the passive loss limitation rules for two years post-death. IRC Sec. 469(i)(4)
- Recognition of a loss on satisfaction of a pecuniary bequest. IRC Sec. 267(b)(13). This might occur if a pecuniary bypass trust is funded with depreciated assets. With the large current exemption amount this is more likely than it might have been in prior years. If the exemption amount is significantly reduced in future years this might become less of a consideration.

To make the election the personal representative and the trustee of a qualified revocable trust elect to treat the trust as part of the estate for income tax purposes. If there is no executor appointed (e.g., all assets pass under the revocable trust) the trustee alone is authorized to make the election. The election made on Form 8855. The election must be filed by the extended due date of Form 1041 for the estate. IRC Sec. 6072; Reg. Sec. 1.645-1(c). The election, once made, is irrevocable. IRC Sec. 645(a). The election must end by 12 months after the issuance of a closing letter. Reg. Sec. 1.645-1(f)(2)(ii).

If there is no federal estate tax return required the election is for all tax years of the estate ending before two-year anniversary of the date of death. IRC Sec. 645(b)(2). Since with portability, returns will be filed with no tax due, likely the two year rule will apply.

The Regulations provide rules for the taxation of electing trusts during the election period. Reg. Sec. 1.645-1(e). A single Form 1041 is filed by the estate and all QRTs. When a single Form 1041 is filed the executor and trustee both remain responsible for filing and paying tax. If different fiduciaries are involved this could be difficult. The tax due on the combined 1041 must be allocated reasonably as between the estate and QRTs. Reg. Sec. 1.645-1(c)(1)(ii) and (2)(ii). Rules are provided for the taxation of the electing trusts at the termination of the election period. Reg. Sec. 1.645-1(h). On last day of election period the estate and all electing QRTs are deemed to distribute all assets and liabilities to a new trust. The estate and electing QRTs have a distribution deduction under IRC Sec. 661. The new trust includes the deemed distribution in income under IRC Sec. 662.

C. Advisors should be sure to advise the estate representative about the applicability of IRC Sect. 691(c) (Deduction for Estate Taxes paid on Income in Respect of a Decedent).

Amounts of gross income that a decedent was entitled to receive but were not includible in their final tax return, are considered income in respect of a decedent (IRD). Common examples of IRD include wages, retirement plan distributions, interest, dividends, gain on sales of property, installment notes collected, sales of farm crops and livestock, and royalties. These amounts must be reported when received by the decedent's estate or beneficiaries. The income has the same character in the hands of the recipient as it had in the hands of the decedent. The IRD may be taxable for estate tax purposes as an asset of the decedent's estate, to the extent that the net value of the decedent's estate exceeds the decedent's federal lifetime exemptions and also subject to income taxes as the IRD is paid out to the beneficiaries.

IRC Sec. 691(c) provides relief in the form of an income tax deduction for federal estate tax paid on the IRD. The concept of an IRD deduction is only relevant for estates that are taxable for federal estate tax purposes. There is no IRD deduction for state estate or inheritance taxes paid; only for federal estate taxes paid.

Individual retirement accounts or qualified retirement plan accounts are considered IRD under IRC Sec. 691(a)(1) to the extent of the balance in the account at the date of death less any nondeductible contributions made by the decedent. To the extent that the decedent contributed towards a qualified retirement savings plan (such as a 401K), a non-qualified plan, or an individual retirement account (any one of which is referred to as an "Annuity Plan"), the estate representative should obtain copies of the beneficiary designation forms and the value of any such Annuity Plan as of the date of death. A competent tax preparer should calculate the IRD deduction available to the beneficiaries so that this information may be communicated to the estate representative.

D. IRC Sect. 754 – Basis Adjustment of underlying assets of a partnership

The election to adjust the LLC's/partnership's tax basis is made by filing a written statement with the LLC's/partnership's tax return, Form 1065, for the year in which the transfer occurs, e.g., for the tax year in which a member/partner dies. A valid election must be included in a return filed on time, including extensions. The election must provide the name and address of the LLC or partnership, it should be signed in a manner permitted under the Operating Agreement for the LLC, e.g., by the manager, or the Partnership Agreement, and it should state that the LLC, as a partnership for federal income tax purposes, or the partnership, makes an election to adjust tax basis under Code Section 743(b); Treas. Reg. §1.754-1(b)(1).

E. Choosing a fiscal year end, rather than a calendar year

An estate may elect any fiscal year, so long as:

1. Initial year is not longer than 12 months;
2. Fiscal year ends on last day of month;
3. Election made on Estate's timely filed Fiduciary Income Tax Return (Form 1041) or some other evidence of intent (Form SS4). IRC Sec. 441(e); Reg. Sec. 1.441-1T(b).

This could be a good opportunity for the estate to defer income taxes.

IV. Estate tax elections

A. For federally taxable estates, estate representatives ought to consider whether to elect the alternative valuation date under IRC Sect. 2032.

In valuing the estate for estate tax purposes, the estate representative should first gather the date of death value of all of the assets included in the decedent's taxable estate. Once the estate representative confirms that the estate is taxable for federal estate tax purposes, that is, to the extent that the net value of the estate exceeds the basic exclusion amount available to the decedent as of the date of her death, the estate representative should consider whether the estate tax liability would be lower by electing to use the alternative valuation date under Sect. 2032. This election allows the estate representative to calculate the estate tax liability based upon the values of the estate assets as of the date which is six months after the date of death.

Further, the estate representative must be alerted that, notwithstanding the Sect. 2032 AVD election, the estate tax will be calculated based on the date of death value for any property that was distributed, sold, exchanged or otherwise disposed prior to the alternate value date. Likewise, any property for which the value changes due to a "mere lapse of time" such as life estates, remainders, or similar interests will be valued as of the date of death.

An estate representative can be held personally liable if the alternate valuation could lower taxes and it is not elected.[7] Conversely, the estate representative is not permitted to use the alternate valuation date values unless the estate tax liability is lowered by doing so. Nonetheless, electing the alternate valuation date might be trickier than ever given the incremental cost of updated appraisals and professional fees and the offset of potentially higher capital gains if there is a lower basis step up. Note that an alternate valuation date cannot be used to increase the value of the estate and get a higher basis step up.

[7] See Re Lohm Est., 269 A.2d 451 (Pa. 1970).

B. IRC Sect. 6166 – Installment Payment Plan of Estate Tax Due

Estate tax attributable to interest in a closely held business can be paid in 2 – 10 installments, and deferred up to 4 years after the date the tax is due. In applying the rules under IRC §6166, the Internal Revenue Service has carefully considered Congressional intent of preventing estates from having to liquidate businesses in order to satisfy estate tax liabilities.

IRC §6166 applies when:

1. The decedent's interest in the entities will comprise at least Thirty Five (35%) percent of the value of her gross estate.
2. Eligibility requirements of §6166(b) regarding the number of owners (partners, members or shareholders) have been met, by way of example, for a corporation, 20 percent or more in value of voting stock of such corporation must included in determining the gross estate of the decedent OR such corporation must have 45 or fewer shareholders.

Under §6166(b)(2)(C), property owned by a trust where a beneficiary has a present interest in that trust will be considered as owned by that beneficiary.

A Sect. 6166 election provides up to a 14-year deferral of time to pay estate taxes, with a preferred interest rate and no tax penalty. In order to qualify, the estate representative must apply for an extension of time to pay estate tax under Sec. 6166 and must file an agreement with the Service as described in Code Section 6324A(c).

In order to maximize basis step up client may wish to retain business interests in the estate and gift other assets. In contrast, the family business was often the target asset removed from the estate using discounts, etc.How will this affect 6166 for those estates subject to estate tax? Many inter-vivos transfers of business interests were likely to grantor trusts with swap powers. The proper exercise of those swap powers will be integrally related to the ability to qualify for 6166.

C. The practitioner may wish to advise the estate representative to consider using a *Graegin* loan to obtain an additional estate tax deduction under IRC Sect. 2053.

Section 2053 allows for the deduction of administration expenses from the value of the gross estate that are "actually and necessarily" incurred in the administration of the estate (i.e., the collection of assets, payments of debts, and distribution of property to beneficiaries). The courts and the IRS will consider a loan to be "actually and necessarily" incurred if a majority of the estate assets are illiquid and borrowing is necessary to avoid a forced sale of those assets to pay estate tax. In those situations, a deduction for the loan interest will be allowed. Estate of Graegin v. Comm'r, 56 T.C.M. (CCH) 387 (1988); Rev. Rul. 84-75, 1984-1 C. B. 193. By way of example, an insurance trust or other existing trust may loan funds to the estate so that the estate may pay estate tax. If structured properly, all interest to be paid under the *Graegin* loan

may be deducted against the gross estate, thereby reducing the overall estate taxes due. A qualifying Graegin loan should satisfy the following:

- The loan cannot be capable of prepayment for any reason.
- If the estate as borrower defaults on the loan, the loan instrument should require the estate to pay interest due until the loan is repaid.
- The terms of the loan should be commercially reasonable.
- Both the borrower and the lender should adhere to all the formalities of the loan.
- The interest rate must be reasonable.

On June. 24, 2022 Treasury issued proposed regulations, REG-130975-08 that provided guidance under Sect. 2053 regarding deduction for interest expense and amounts paid under a personal guarantee, certain substantiation requirements, and applicability of present value concepts. The application of present value concepts to certain liabilities will effectively eliminate the benefits of most Graegin loans if these Proposed Regulations are finalized.

The following outline is an excerpt from a recently published article:[8]

a. The proposed regulations [under Sect. 2053] would require consideration of present-value concepts in calculating deductible expenses reported on an estate tax return (Form 706). Specifically, where some part or all of an expense will not actually be paid until three years or more after death, the proposed regulations would require that the estate discount the estate tax deduction to account for the time value of money.

b. The preamble to the proposed regulations explains that infusing present value concepts into the deductibility of expenses would "more accurately reflect the economic realities of the transaction, the true economic cost of that expense or claim, and the amount not passing to the beneficiaries of the estate."

c. If the proposed regulations are adopted in their current form, all claims and expenses that would be paid more than three years after the decedent's death would be required to be reduced by present-value concepts, whether the claims were contingent or non-contingent. Thus, no reduction in the value of a deduction would be required for any expense or claim paid within three years of the decedent's death. Additional valuation analysis may be needed if these regulations are adopted. This might add expense to an estate administration since practitioners

[8] Martin M. Shenkman, Joy Elizabeth Matak and Mary Vandenack, Meeting Notes from the 57thAnnual Heckerling Institute on Estate Planning (Steve Leimberg's Estate Planning Newsletter dated January 23, 2023).

will likely need to engage professionals to run the appropriate calculations to discount expenses to present value.

d. Among other things, the proposed regulations appear designed to affect the deductibility of interest on Graegin loans, whereby an estate has historically been permitted to deduct fixed and determinable interest on a fixed debt incurred by the estate to pay estate taxes and other reasonably and necessary expenses of administration, so long as such debt may not be prepaid.

e. Proposed rules appear to affect the deductibility of Graegin loan interest adversely. That is, under the proposed regulations, the ability of estates to deduct interest expenses paid more than three years after the decedent's death would be affected by the following circumstances:

i. The interest arises from a bona fide debt memorialized in an instrument laying out the terms of the arrangement.

ii. The loan must be bona fide in nature based on all facts and circumstances.

iii. The loan must be actually and necessarily incurred and the loan terms must be essential to the administration of the estate. If the estate qualifies for Sect. 6166 deferral, then it is possible that the Service might argue that a Graegin loan may not be essential. Given that it can sometimes take years for a Sect. 6166 deferral to be granted, would it be acceptable for an estate to enter into a Graegin loan for the period before Sect. 6166 approval?

iv. The interest rate and loan terms must be reasonable, comparable to arms-length, commercial loans.

v. The lender must include the interest as income.

vi. The repayment schedule should not be longer than reasonably necessary for the estate to satisfy the debt.

vii. The only practical alternative to the loan would be the sale of the assets at significantly below market value.

viii. The estate's illiquidity was not self-created. The proposed regulations appear to prevent deductibility of Graegin loan interest where an estate was purposefully designed to be illiquid, either as part of estate planning or post-mortem planning.

ix. The estate does not have significant liquid assets or control over an entity with significant liquid assets.

x. The lender is not a beneficiary of the estate or an entity in which a beneficiary has a controlling interest.

V. There are different considerations for the estate representative when there is a surviving spouse.

A. Funding marital trusts and QTIP elections

The myriad of options of how the estate plan may provide for funding a martial deduction trust should be evaluated so that the actions that are permitted under the will/revocable trust, and that are likely preferable for the estate, are taken. If the decedent was domiciled in a decoupled state there may be a traditional mandatory funding of a credit shelter trust to the state exemption amount then one or more QTIP trusts above that amount to capitalize on portability and preserve the ability for basis step-up on the death of the second spouse. Many plans include a so-called Clayton QTIP in which the executor's actions determine whether and if so the amount of funding of a credit shelter trust. Practitioners should consider that before that action may be taken whether the person in that role is independent as some commentators suggest that an independent person, not the suriviving spouse for example, make that decision.

Another concept that might be addressed in the probate process is whether the surviving spouse assure use of the ported exemption before remarriage and avoid the risk of the new spouse dying and hence cancelling the prior spouse's DSUE? Consider surviving spouse disclaiming income interest to trigger gift of entire QTIP to use DSUE IRC Sect . 2519. Surviving spouses that are beneficiaries of a marital QTIP trust, could consider giving away their entire income interest in that trust. While some commentators had in the past suggested that the surviving spouse perhaps only disclaim say 1% of their income interest in the QTIP the anti-clawback regulations might make that approach inadvisable. Final "Clawback" Regulations were published: 11/26/2019 and exceptions to those rules were published April 27, 2022. Unlike other techniques attacked in the anti-clawback regulations the IRS issued several PLRs approving division of QTIPs followed by 2519 disclaimers. Does that matter?

Section 2519 of the Code provides that this is to be treated as a gift of the entire value of the QTIP trust, not just of the life estate. 2519 provides that a gift of any part of the qualifying QTIP income interest will be treated as a transfer of the entire QTIP property. Reg. Sec. 25.2519-1(g). This would require the surviving spouse to sign an appropriate disclaimer document and deliver it to the trustee. The law of many states, and often the terms of the trust itself (e.g., a spendthrift provision), may prohibit the transfer of an interest in the trust.

B. Estate representatives should be mindful of the purposes of the original planning documents when administering an estate for the benefit of a surviving spouse.

Hopefully, the estate planning documents will describe the decedent's intentions as it relates to the surviving spouse. Was this the decedent's first marriage? Did the decedent have children from a prior marriage or other relationship? Does the surviving spouse have sources of income and assets outside of the marriage to the decedent? Was there a prenuptial agreement between the decedent and the surviving spouse?

In the case where the taxpayer is married but subject to a prenuptial or postnuptial agreement governing their financial arrangements, a preparer should obtain a copy of those agreements. The preparer should review the agreement to determine:

a. What financial obligations (if any) does the agreement create upon death?
b. Are there specific insurance requirements? Who is responsible for collecting the insurance proceeds and how are such proceeds required to be paid?
c. Had the prenuptial agreement required the deceased taxpayer to keep certain assets separate? Were these assets, in fact, kept separate?

Consideration should be given to involving matrimonial counsel to confirm the interpretations and application of those marital agreements. The practitioner should consider whether the decedent's will and/or revocable trust supersedes the prenuptial agreement, as it relates to the disposition of the assets.

Where the taxpayer was paying and deducting alimony payments (for divorce settlements prior to 2019), the practitioner should consider whether alimony ceases on death or whether there is an additional payment that is required to be paid. The practitioner should request a copy of the property or marital settlement agreement in order to confirm the obligations of the deceased taxpayer's estate.

Where dependent children are identified on the tax return, it will be necessary to resolve issues of custody and support. These issues are beyond the scope of this paper.

C. Representatives should tread carefully when considering a disclaimer on behalf of an incapacitated surviving spouse.

Where the surviving spouse has not been appointed to serve as the estate representative due to incapacity or other reasons, the chosen estate representative quite likely has to consider both the needs of the surviving spouse and the remainder beneficiaries of the estate in navigating the myriad of options available. Such cases can complicate the administration of the estate, particularly where the interests of the surviving spouse and the other beneficiaries of the estate are incongruous.

Perhaps the estate plan hinges on the disclaimer of the surviving spouse to fund a credit shelter trust. In such a case, if the surviving spouse does not have capacity to disclaim, it might be necessary for a personal representative to assist the surviving spouse in making the decision to disclaim. Unfortunately, it may be difficult to discern whose interests are best served by making any such disclaimer.

On the one hand, disclaiming interests in a deceased spouse's estate can afford the surviving spouse a measure of asset protection to the extent that those disclaimed assets fund a trust outside of the reach of the surviving spouse's creditors. Perhaps the disclaimed assets might fund a credit shelter trust that provides for income and principal distributions to or for the benefit of the surviving spouse, thereby protecting his interests in the assets and potentially providing a stream of income for the rest of his life.

On the other hand, where a credit shelter trust restricts distributions of principal and/or allows distributions of income and principal to multiple beneficiaries, the surviving spouse might not have sufficient access to resources necessary to support his lifestyle following the passing of his deceased spouse.

Representatives and their advisors should pay close attention to plans put into place prior to 2018 and not updated once the federal estate exemption was effectively doubled. While the decedent may have been happy to fund a credit shelter trust with limited reach by her surviving spouse when the exemption was $5 million (indexed for inflation), it may be that the decedent would have changed her mind about such planning once the exemption increased to $10 million (indexed for inflation).

To the extent that the personal representative for the surviving spouse with authority to disclaim on his behalf is also a beneficiary of the credit shelter trust funded by the disclaimed assets, the personal representative should be very careful to serve the needs of the surviving spouse first. Ideally, such an individual would avoid serving in both capacities and seek an independent person to handle the estate while resolving the affairs of the surviving spouse and determining whether it is in his best interests to disclaim. Either way, advisors should help the representative document how the needs of the surviving spouse were considered in making any such decision to disclaim the assets of the deceased spouse. Specifically, a representative should prepare a comprehensive cash flow analysis, based on the surviving spouse's health and maintenance needs.

Ultimately, a representative acting on behalf of a surviving spouse has a fiduciary obligation to consider the needs of such a surviving spouse during his lifetime as paramount to any estate tax savings that might be achieved from disclaiming the assets.

VI. Conclusion

When a client passes, family, fiduciaries, heirs are all significantly affected. This is often an emotionally challenging time, which can be made more difficult by the myriad of legal, tax and financial matters that need to be tended to. The advisory team can help ease these challenges considerably by proactively planning before, and assisting after, the death. This outline has endeavored to highlight a few of the many steps that might be considered.