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THE ROBERT KEEBLER TAX & ESTATE PLANNING BULLETIN

A Consolidated Monthly Update for Estate Planning Professionals

FILING RELIEF – KENTUCKY

In IR 2021-248, the IRS announced that victims of the recent tornadoes in Kentucky will have until May 16, 2022 to file various individual and business tax returns and make tax payments.

This relief applies to taxpayers affected by storms, tornadoes and flooding that took place starting on Dec. 10 in parts of Kentucky. Currently, relief is available to affected taxpayers who live or have a business in Caldwell, Fulton, Graves, Hopkins, Marshall, Muhlenberg, Taylor and Warren counties. But the IRS will provide the same relief to any other localities designated by FEMA in Kentucky or neighboring states.

This also means that affected taxpayers will have until May 16 to make 2021 IRA contributions. In addition, farmers who choose to forgo making estimated tax payments and normally file their returns by March 1 will now have until May 16, 2022 to file their 2021 return and pay any tax due.

The May 16 deadline also applies to quarterly estimated income tax payments due on Jan. 18 and April 18. Among other things, this means that individual taxpayers can skip making the fourth quarter estimated tax payment, normally due Jan. 18, 2022, and instead include it with the 2021 return they file, on or before May 16. In addition, the quarterly payroll and excise tax returns normally due on Jan. 31 and May 2, 2022 are also now due on May 16.

REQUIRED MINIMUM DISTRIBUTIONS

In IR 2021-245, the IRS reminded taxpayers that required minimum distributions (RMDs) must be taken from retirement plans and IRAs by December 31.
RMDs are the minimum amounts that retirement plan owners must withdraw on an annual basis beginning when they reach 72 (or, if later, the year they retire). If the account is an IRA or the retirement plan owner is a 5% owner of the business sponsoring the retirement plan, the RMDs must begin once the account holder is age 72, even if they are not retired.
The RMD rules apply to:

- Owners IRAs
- Owners of traditional SEP IRAs

- Owners of SIMPLE IRAs
- Participants in various workplace retirement plans, including 401(k), Roth 401(k), 403(b) and 457(b) plans

Roth IRAs do not have RMDs while the original owner is alive.
While an IRA owner must calculate the RMD separately for each IRA owned, they can choose to withdraw the total amount from one or more of the IRAs. RMDs required from workplace retirement plans, however, must be taken separately from each plan. Not taking the proper RMD will subject the taxpayer to a 50% excise tax on the amount not distributed.

ROLLOVER RELIEF

In PLR 202147015, the IRS waived the 60-day rollover requirement where the taxpayer's failure to timely roll over funds was due to error by his financial institution.

In 2011, Taxpayer established a designed Roth account his 401(k) plan. After Taxpayer left his employment, he decided directly rollover his designated Roth contributions to a Roth IRA with Financial institution F. Taxpayer had three IRAs with Financial Institution F, two traditional IRAs, and the Roth IRA.

Taxpayer completed a request for a direct rollover. On October 14, [Redacted Text], Financial Institution F received two checks from the plan. One check was for contributions and earnings in the designated Roth account. The other check represented pre-tax elective deferrals and earnings thereon under the plan. Accompanying the checks was a letter from the plan that explained the two checks. Financial Institution F, however, deposited both checks into Taxpayer's Traditional IRA rather than his Roth IRA.

The IRS found that the information presented by Taxpayer was consistent with his assertion that the failure to accomplish a timely rollover was due to an error made by Financial Institution F, which deposited the funds into a traditional IRA rather than a Roth IRA. Accordingly, the IRS granted relief.

ROTH RELIEF

In PLR 202146009, the IRS granted extensions for taxpayers to recharacterize their Roth IRAs to traditional IRAs. In this case, the taxpayers, based on advice from their financial advisor, authorized nondeductible contributions be made to their traditional IRAs and then converted to their Roth accounts. However, the financial institution instead mistakenly put the contributions directly into their Roth IRAs. Taxpayers' gross income exceeded the modified adjusted gross income limit for making Roth IRA contributions. The taxpayers did not discover this error until after the deadline for making a timely recharacterization had passed. The IRS found the taxpayers satisfied the requirements of section 301.9100-3(b)(1).

NET NET GIFTS

Lifetime gifts produce substantially lower wealth transfer tax than transfers at death. While the stated rates are the same for the gift tax and the estate tax, the gift tax has a lower *effective* rate because it is applied on a tax-exclusive basis, while the estate tax is applied on a tax-inclusive basis. The estate tax applies to the full value of the property included in the gross estate, including the amount used to pay the estate tax. By contrast, the gift tax applies only to the amount received by the donee after the tax has been paid. An example will make the difference clear:

- Ellen has used her applicable exclusion amount and has $14 million she wishes to transfer to her children.
- The current gift and estate tax rate is 40 percent.
- If the property is transferred at death, the full $14 million is subject to tax, and Ellen's estate pays $5.6 million in estate tax (0.4 x $14,000,000), leaving $8.4 million for the heirs.
- If Ellen transfers the property during life and the tax is paid out of the property transferred, only the net after-tax amount received by the children is subject to tax.
- The children will receive $10 million and the gift tax payable will be $4 million (0.4 x $10,000,000).
- Thus, the effective gift tax rate is 28.5714 percent ($4,000,000/$14,000,000).
- By making the lifetime gift, Ellen pays tax of $4 million instead of $5.6 million and the children receive $10 million instead of $8.4 million.

Note that the tax-exclusive rate applies to a lifetime gift regardless of whether the donor makes a gift of the net amount and pays the gift tax herself, as in this illustration, or transfers the full $14 million amount to the donee and requires the donee to pay the tax. The latter arrangement is referred to as a net gift. In either case, only $10 million is subject to the gift tax. The $4 million used to pay the tax is removed from the tax base.

There is one important caveat, however. Under Code Sec. 2035(b), the donor will only receive the benefit of the tax-exclusive rate if he lives for more than three years after the gift is made. If not, the amount of gift tax paid is added back to the donor's estate and she would basically be treated as if she had died with the property. Under the facts assumed above, if Ellen died within three years after making the gift, the $4 million of gift tax paid on the lifetime transfer would be added to her estate. Assuming that the tax rate remained constant, this would add $1.6 million of estate tax to Ellen's estate, making the total transfer tax paid the same $5.6 million that would have been payable if she had died with the assets instead of gifting them ($4,000,000 gift tax + $1,600,000 estate tax).

The net, net gift carries the net gift strategy one step further. The donee agrees not only to pay the gift tax but also the 2035(b) gross-up amount if the donor dies within three years after making the gift. Until recently, it appeared that a donor couldn't claim a deduction for the Code Sec. 2035(b) contingent liability. This issue was first squarely addressed in *C.T. McCord, Jr.*, 120 TC 358, Dec. 55,149 (2003), in which the Tax Court ruled that a net, net gift provision, requiring the donee to pay the Code Sec.2035(b) gross-up if the donor died within three years after making the gift, did not reduce the value of a gift for gift tax purposes because the value of the promise to pay was too speculative.

This decision was later reversed by the Fifth Circuit in *Succession of C.T. McCord*, CA-5, 2006-2 USTC ¶60,530, 461 F3d 614. The court reasoned that a condition subsequent—like an agreement by donees to pay the Code Sec. 2035(b) gross-up—was not too speculative to value if a willing buyer would insist that a seller provide a discount with respect to the potential liability. The Fifth Circuit held, as a matter of law, that a willing buyer would demand that the three-year exposure to the Code Sec. 2035(b) gross-up be taken into account, so a discount was allowable. In *J. Steinberg*, 141 TC No. 8, Dec. 59,654 (2013), the Tax Court reversed its position and approved the concept of a net, net gift, agreeing to follow the Fifth Circuit analysis in *McCord*.

The size of the benefit produced by a net, net gift varies substantially based on the facts of the case. The age of the donor is one key variable. The older the donor is, the larger the tax savings that can be produced by using a net, net gift. Of course, there is a trade-off. The older the donor, the less likely it is that the donor will live for more than three years after making the gift. If the donor dies before the end of the requisite period, the benefit of the tax exclusive rate will be lost.

It seems that a taxpayer who is old enough to derive a substantial benefit from adding a 2035(b) provision to a net gift may be too old to do a net gift in the first place because the risk of dying during the term and losing the benefit of the tax-exclusive rate is too great. Such a taxpayer may be ill-advised to make a net gift. On the other hand, making a net gift might make sense for a younger person (e.g. a 50-year-old) but adding a Code Sec. 2035(b) provision to make it a net, net gift would provide a minimal additional benefit. Perhaps the technique would work best for someone in the middle. Although it is not yet certain that it will ultimately be accepted by the courts, the net, net gift appears to be a strategy that estate planners may want to consider.

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ABOUT KEEBLER & ASSOCIATES, LLP

Keebler & Associates, LLP is a tax advisory and CPA firm located in Green Bay, Wisconsin that provides family wealth transfer and estate tax planning and retirement distribution planning. Keebler & Associates, LLP's private practice clients are high net worth individuals from across the United States who come to us seeking advice and insight on preserving accumulated wealth. The members of the firm serve as a trusted advisor with specialization that is nationally recognized in the areas of tax and estate planning.

Keebler & Associates, LLP was started by its current partners and some of the nation's leading tax and estate planning experts - - Robert S. Keebler, CPA/PFS, MST, AEP (Distinguished), CGMA, Michelle L. Ward, JD, LLM, CSEP, Stephen J. Bigge, CPA, CSEP, and Peter J. Melcher, JD, LL.M., MBA.

Additionally, Keebler & Associates, LLP provides educational resources to the estate planning community including attorneys, financial advisors, trust officers, accountants and insurance professionals. For more information about the various educational programs available to professionals, click here.