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TRUST & INVESTMENT
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Estate planning for married couples

Widowhood is hard enough; it should not be a financial catastrophe as well.

A fictionalized recent question we received:

"My wife and I are about to move into a senior living complex, where we expect to spend the rest of our lives. This may sound sexist today, but throughout our 60 years of a pretty happy marriage, she has handled the cooking and the housework, while I have handled the money. If she dies before I do, I know I'll be able to hire a cook and household help. But what happens if I die first? Who will handle the money? I don't mean the daily routine stuff like the groceries; she's fine with that. I mean managing our retirement portfolio and seeing to it that the taxes are paid—are my main concerns. Is there a service that can provide lifetime financial protection for my wife if she survives me?"

We're pleased to report that a thoughtfully designed trust should resolve the issues presented by this individual. A marital trust will provide the surviving spouse with income for life. If the trust contains life insurance policies, the trustee will see to claiming the proceeds. The investment portfolio

Choices for marital trusts

These are the most common types of trusts for surviving spouses

Trust type	Estate tax exposure at spouse's death	All income to spouse?	Spouse can direct remainder?	Comment
Traditional marital deduction trust	Yes	Yes	Yes	Best for larger estates, paired with a credit shelter trust
Qualified Terminable Interest Property (QTIP) Trust	Elective	Yes	No	Best for multiple-marriage, blended family situations
Credit shelter trust	No	Elective	No	Appropriate by itself for smaller estates, but may be paired with traditional or QTIP trust
Qualified Domestic Trust (QDOT)	Yes	Yes	Elective	For a spouse who is not a U.S. citizen

Source: Internal Revenue Code; M.A. Co.

will be managed prudently under the legal standards associated with "fiduciary duty"—that means the interests of the trust beneficiary are paramount.

There are a number of choices to review when designing a marital trust. See the table "Choices for marital trusts" on the previous page for a capsule review.

Tax considerations

Married couples have two privileges under the federal estate tax—privileges intended to treat them as a single economic unit. First, there is the unlimited marital deduction for property that passes to a surviving spouse. Second, if one spouse doesn't use up his or her federal estate tax exemption ($12,920,000 for 2023), the surviving spouse will inherit the unused portion. In layman's terms, the estate tax exemption itself has become "portable" and is inheritable. In IRS lingo, it is a Deceased Spousal Unused Exemption Amount (DSUEA). Together, a married couple may protect nearly $26 million from the federal estate tax (provided they both die before 2026, when the amount exempt is scheduled to be cut in half).

For example, say that Husband dies in 2023, leaving his entire estate to Wife in a marital deduction trust. Whether the estate is $1 million or $50 million, there will be no federal estate tax, thanks to the unlimited marital deduction. Husband's estate will not use any of his exemption, so Wife may also inherit a DSUEA of $12,920,000 to use at her future death, which will be combined with her own estate tax exempt amount.

However, as welcome as the portability of unused exemption amounts between spouses may sound, in many cases it may make estate administration somewhat more complicated. To preserve the unused exemption, the executor for the first spouse to die must file a federal estate tax return, even if no estate tax is due, even if the estate is well under the $12.92 million basic exclusion amount. Even if the surviving spouse doesn't appear to be a candidate for paying federal estate taxes, one cannot know how long the spouse will live and what other assets he or she might come into. Therefore, the number of estates filing federal estate tax returns will have to grow in the coming years to preserve this opportunity.

Another issue is that the statute of limitations for the estate of the first spouse to die will remain open until the death of the second spouse, when the DSUEA will be claimed. This could be decades later.

Finally, the DSUEA does not extend to the generation-skipping transfer tax. Relying on this approach "wastes" the exemption of the first spouse to die.

On the other hand, there is the income tax to consider, especially for estates that appear likely to dodge the federal estate tax bullet. The tax basis of inherited assets is "stepped up" to fair market value at the date of a decedent's death. Assets in a credit shelter trust enjoy no such step-up when the trust terminates, so the heirs could be facing a large tax on built-up capital gains.

The table "Portable exemptions versus credit shelter trusts" below sums up the pros and cons. There is no answer that will be best for everyone. Many experts suggest that portability is a good backup for those who fail to plan, but less than ideal as a first choice. In many cases, especially for smaller estates, the better course will be to rely on a bypass trust to consume the first spouse's exclusion. This allows for finality in that spouse's estate; it offers flexibility in providing for other heirs; and appreciation in bypass trust assets will not be subject to estate tax at the second spouse's death.

Portable exemptions versus credit shelter trusts

This table illustrates the pros and cons of credit shelter trusts and reliance on the estate tax portability provisions for married couples.

	Portable exemption	Credit shelter trust
Inflation protection	None	Growth in trust asset values (including inflationary growth) avoids future estate taxation (an "asset freeze")
Basis step-up at surviving spouse's death	Yes	No
Estate planning simplicity	Easily understood, meets most couples' expectations, but will require estate tax filings by nontaxable estates	Somewhat more complicated; harder for couples to understand, but existing estate plans do not require redrafting
Asset protection upon future remarriage and divorce	No	Yes
Preservation of inheritance for children	No	Yes
Generation-skipping transfer tax exemption	Lost	Preserved

Source: Internal Revenue Code; M.A.Co.

Has your estate been planned?

Estate planning today is highly personalized. Don't expect to buy a plan "off the shelf." With dozens of planning approaches to choose from, you and your advisors will need to do some careful analysis of your estate, your family situation, and your goals.

At your request, one of our trust specialists will be glad to assist. Give us a call! ☐

This *really* happened

Telephone scams have been around for a long time, but the scammers have not given up trying. Here are two real cases we've become aware of, though the dialog is fictionalized.

CALLER: Hi Grandpa! It's me, your grandson.

GRANDPA: Well, hello. Which grandson are you?

CALLER: Your favorite grandson.

GRANDPA: No, I don't play favorites. Goodbye.

Had Grandpa fallen for the ploy, the scammer would probably have asked for some emergency money, and begged Grandpa not to tell his parents. The Grandchild Scam is distressingly common.

A more ominous example

From a colleague's email:

"Today at about 11:50 while working at the hospital ER, my daughter received a call on her cell phone, apparently from our home phone line according to caller ID. When she picked up, there was a woman hysterically screaming who sounded like my wife. My daughter thought something had happened to me and kept asking 'Mom what's wrong?' A male voice then got on the line and said, 'we are beating your parents and will kill them if you don't send us money.' My daughter said yes to everything, then put her phone on speaker so the hospital security guard could hear it, and he immediately called the Police Dept. The male demanded $1,200 be sent within 10 minutes or we would be killed. Five minutes later, my daughter called me, and I always pick up her calls. After she asked me where I was and I told her, she knew it was a scam. Still, she was really shaken by the story, as was my wife when she heard about it.

"In a twisted way I was initially disappointed that they only wanted $1,200, but it turns out that $1,200 is a small enough amount that some people could immediately send it. The callers provided an account number for transferring the funds. The police were very responsive and warned that scams like this occur frequently."

The scammers were hoping that by striking fear into the target of the call, the person would not be able to think clearly, and would panic and send them the money.

Monitoring by the Federal Trade Commission

The Federal Trade Commission suggests that there are four signs that a telephone solicitation is a scam. First, the caller pretends to be from a real organization, like the IRS or a utility company. Second, there may be an assertion of a problem with an account, or the offer of a prize. Third, there will be strong pressure to act immediately, either to avoid dire consequences or to secure the prize before it is "too late." Finally, these scammers are often looking to be paid in a specific strange way, such as in cryptocurrency or in gift cards.

To go along with those four red flags, the FTC offers five steps to avoid being the victim of a scam:

- ***Block unwanted calls and text messages.*** However, just registering your telephone number on the Do Not Call list is not sufficient. See https://consumer.ftc.gov/articles/how-block-unwanted-calls for more information.
- ***Don't give personal or financial information to strangers.*** Don't click on links in texts or emails, even if you think you recognize the sender. Instead, make contact through a website you know is trustworthy.
- ***Resist the pressure to act immediately.*** Honest businesses understand that time is required to make an informed decision.
- ***Refuse all strange payment demands.*** No honest organization wants to be paid in gift cards.
- ***Stop and talk to someone you trust.*** If you talk it over with a friend or family member before taking any action, you may come to realize that the call was a scam.

If you think that you have been scammed, the FTC wants to know about it! You may report the scam at https://reportfraud.ftc.gov/#/.

Remember, when it sounds too good to be true, it probably is.☐

Start the clock!

A long-standing axiom in estate planning is that when a taxable gift is made, the gift should be promptly reported to the IRS, even if no gift tax is due because of the available lifetime credits. The reason is that the filing of the gift tax return starts the statute of limitations running. Absent fraud, the IRS can't challenge the value of the gift after three years.

The importance of this rule was illustrated in a recent Tax Court case with highly unusual facts. A Taxpayer funded a life insurance policy in 2006 and assigned ownership of the policy to other family members in 2007. In 2012, the Taxpayer entered into the IRS voluntary offshore disclosure program, to restate his tax obligations from 2004 to 2009. Included in his submission was a gift tax return for 2006; for the purchase of the insurance policy. However, the IRS decided in 2016 that there was no gift in 2006, the gift happened in 2007. The Taxpayer disagreed, and withdrew from the program. The IRS issued a gift tax deficiency of $4.4 million for the 2007 gift in 2019.

Too late, the Tax Court ruled. The gift tax statute of limitations runs from the time that the IRS is put on notice of the transfer, even if the transfer is not completed until a later year. In this case, the IRS became aware of the transfer when the Taxpayer submitted his forms for the voluntary disclosure program in 2013, so the statute of limitations (including an extension) expired in 2017.

Beyoncé's tax troubles

According to a recent Tax Court filing, the IRS has asserted that pop icon Beyoncé owes $2.7 million in taxes and penalties for tax years 2018 and 2019. She is contesting the finding. Among the adjustments made by the IRS:

- disallowed $761,455 in other expenses reported on Schedule C, "Profit or Loss From Business";
- disallowed $473,738 in legal and professional services reported on Schedule C;
- disallowed an $868,766 deduction attributable to a charitable contribution carryover.

For entertainers, the line between personal and business expenses can be very blurry. Clothing, hair and makeup, even plastic surgery could be legitimate business expenses for an entertainer, but they must be carefully documented and show the business purpose. Similarly, the rules for substantiating large charitable contributions have become extremely strict. An error when the contribution is made can have disastrous tax consequences down the road.

Observers have speculated that filing the tax contest may just be a step toward negotiating a settlement with the IRS. The filing is short on the details justifying Beyoncé's tax positions, and a settlement would preserve her financial privacy. ☐