THE ROBINS KAPLAN SPOTLIGHT

A TRUSTS AND ESTATES NEWSLETTER | WINTER 2017 | VOL. 2 NO. 4

THE TAX ISSUE

ROBINS KAPLAN LLP

REWRITING THE ODDS

INSIDE THIS ISSUE

A PRACTICAL REVOLUTION: TAX CONSEQUENCES OF MARRIAGE EQUALITY

BY DENISE S. RAHNE AND KATHERINE S. BARRETT WIIK

Mundane and practical human realities often drive dramatic social change. Such is the case with the relationship between taxes and marriage equality. Disparate tax consequences led to the landmark Supreme Court decision in *U.S. v. Windsor*, 133 S. Ct. 2675 (2013), which struck down the Defense of Marriage Act's unequal tax treatment of same-sex couples. The case set the stage for the Court's recognition of a constitutional right to marriage equality two years later. The marriage equality decisions are now dramatically affecting the taxation landscape for some taxpayers, including through the IRS's recent **Notice 2017-15**.

Before *Windsor*, while various states were beginning to legalize same-sex marriages through court rulings or the popular vote, these same marriages were not recognized for federal tax purposes. Section 3 of the Defense of Marriage Act (DOMA), 110 Stat. 2419, represented the obstacle to such recognition. DOMA defined marriage to mean "only a legal union between one man and one woman as husband and wife." One consequence of this amendment disqualified estate transfers between same-sex spouses for the marital deduction, among other things.

The question of whether same-sex marriages should be recognized for federal tax purposes was the central focus of *Windsor*. While the Supreme Court's opinion is sweeping in its constitutional jurisprudence and marked by Justice Kennedy's stirring case for equality and rhetorical flourish, the practical issue that enabled the case to be brought was a stinging $363,053 tax bill. Basing its decision on the principles of due process and equal protection, the Supreme Court found such unequal tax treatment to be unconstitutional.
This brought the matter full circle. Tax realities having provided the impetus for federal recognition of same-sex marriages, *Windsor* then necessitated substantive revision to tax policies and regulations. As the IRS itself noted, more than 200 provisions in the Internal Revenue Code and Treasury regulations use the term "spouse" or, variously, "husband," "wife," or "marriage."

Within months following *Windsor*, the IRS published **Revenue Ruling 2013-17**, which determined that, in light of the *Windsor* decision, "husband" and "wife" would include married couples regardless of gender. This particular ruling was *prospective* as of September 16, 2013, which meant that only taxpayers for whom the statute of limitations had not run were in a position to file amended returns to recognize their spousal relationships.

Revenue Ruling 2013-17 also drew a distinction between "place of celebration" and "place of domicile," indicating that the IRS would rely on "place of celebration" to determine whether the marriage was recognized. This distinction became moot two years later when the Supreme Court issued its decision on

Obergefell v. Hodges, 135 S. Ct. 2584 (2015), which recognized a fundamental right to marry, requiring all states to grant same-sex marriages and recognize such marriages when granted in other states.

On September 2, 2016, in the wake of both *Windsor* and *Obergefell*, the Treasury Department and the IRS issued final regulations amending the regulations under Sec. 7701 to reflect that same-sex marriages are recognized for federal tax purposes.

Yet, the devil is in the details. Earlier this year the IRS issued Notice 2017-15. The notice provides special administrative procedures for allowing certain taxpayers and the executors of certain estates to address both the calculation of a generation-skipping transfer exemption, as well as the applicable exclusion amounts from estate or gift tax that did not qualify for the marital deduction at the time of the transfer. In addition, the notice sets forth procedures for seeking limited forms of relief related to applicable exclusion amounts, even where the statute of limitations for the return in question has expired.

Notice 2017-15 addresses situations within the statute of limitations differently from those where the statute has expired.

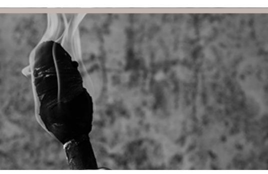
In applicable cases where the statute of limitations has not expired, impacted taxpayers may avail themselves of either an amendment or supplementation process pursuant to IRS forms 709 or 706, respectively. Typically, these procedures can be coupled with other amendments or supplementation that a taxpayer wishes or may be required to do in the context of his or her overall tax planning.

Notice 2017-15 provides some, albeit limited, remedies for taxpayers in same-sex marriages where the statute of limitations has expired. Specifically, a taxpayer in this situation may recalculate any current applicable exclusion amount that may be impacted from a change in the law. Pursuant to the notice, the taxpayer may not, however, adjust the value of a transferred interest or a position taken on any legal issue (except the recognition of the marriage) as the basis for any remedy. Taxpayers outside of the statute of limitations also may not alter split-gift elections or seek gift or estate tax refunds or credits.

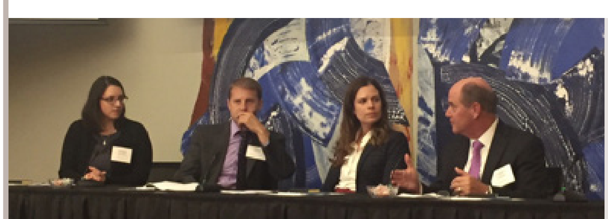
While not explicitly stating so as the rationale behind the entire ruling, the IRS does note concerns over "the interest of proving certainty and to ease the administrative burden on both taxpayers and the IRS."

At the end of the day, two unavoidable platitudes apply for impacted taxpayers: *Change is coming,* and *time is of the essence*. Impacted taxpayers should seek guidance sooner rather than later, given the critical intersection between the jurisprudence of social changes and the realities of tax code policy.

PASSING THE TORCH



This past September, Robins Kaplan was proud to present the Trusts and Estates Seminar — Passing the Torch — at our Minneapolis office. This half-day seminar covered various topics related to how the current multi-generational transfer of wealth raises a number of issues for estate planning and litigation. Thank you to all who attended! Stay tuned for more presentations and events from our Trusts and Estates Group.



Panelists, starting second from left: Referee Joel Olson (Ramsey County), Sarah Sonday (TrustPoint), and Larry Farese (Robins Kaplan) discuss generational issues in trusts and estates litigation and controversies.

ESTATE OF THE LAW: AN UPDATE ON MINNESOTA'S ESTATE TAX & THE FEDERAL ESTATE TAX EXEMPTION

BY STEVE K. ORLOFF AND SARAH J. KHOURY

As Benjamin Franklin shrewdly stated, "...in this world nothing can be said to be certain, except death and taxes." Nonetheless, it is *uncertain* what the future holds for the ever-changing discussion on the Minnesota estate tax and the controversial topic of repealing the federal estate tax.

WHAT IS ESTATE TAX?

Minnesota, along with 13 other states and the District of Columbia, imposes an estate tax upon death. This is separate from any federal estate taxes that may be required. This means, if a decedent's estate is above a particular threshold value, the state will collect an estate tax before the decedent's estate can be distributed to any beneficiaries. Bequests to charities and surviving spouses are typically exempt from estate taxes. Minnesota does not impose an inheritance tax on an estate's beneficiaries.

MINNESOTA ESTATE TAX EXEMPTION LIMITS

Legislation in 2014 increased the individual estate tax exemption amount by $200,000 per year, to reach $2 million by 2018. However, during the 2017 legislative session, prior to these increases taking full effect, Minnesota Governor Mark Dayton signed a tax bill further increasing the individual exemption amount of taxable estates in Minnesota. The exemption amount will rise by $300,000 per year, to reach $3 million by 2020. This increase will apply retroactively to 2017 decedents, meaning the preexisting $1.8 million individual exemption will increase to $2.1 million this year. The top tax rate will remain at 16 percent, and the lowest tax rate will increase from 12 to 13 percent.

Changes in the qualified small business property and farm property deductions have also occurred with the rise in the Minnesota individual estate tax exemption, but the combined exclusion (estate tax exemption plus the qualified deduction) remained unchanged at $5 million.[1]

CONCERNS WITH INCREASED EXEMPTION LIMITS

Before signing the tax bill in Minnesota, Governor Dayton expressed serious concerns relating to the negative implications it would cause on the state budget, saying the increased exemption stood to benefit only Minnesota's wealthiest residents. Currently, approximately 1,100 Minnesota estates are required to pay the estate tax. With the tax exemption rising to $3 million starting in 2020, it is estimated the law will require 200 to 250 estates to pay an estate tax. The Minnesota Department of Revenue expects the decrease in the number of estates required to pay estate taxes would reduce estate-tax-generated revenue by 25 percent.

FEDERAL ESTATE TAX EXEMPTION

The Minnesota exemption amount still remains lower than the 2017 federal estate tax exemption. This means that even if a decedent's estate does not trigger the federal estate tax, it still may owe the Minnesota estate tax. The 2017 individual exemption for federal estate taxes is $5.49 million but will increase to $5.6 million for 2018 decedents.[2] The top federal tax rate of 40 percent is applied to any amount distributed beyond the exemption.

In Minnesota there is no gift tax liability. However, the federal transfer tax system and the applicable exemption apply to both transfers during life and at death. Gifts that do not exceed the annual exclusion for the calendar year will not have a gift tax nor count against the estate tax exemption. The 2017 annual exclusion amount for gifts is $14,000 but will increase to $15,000 in 2018. Any gifts above this amount to a single recipient will require filing a gift tax return and will count against a decedent's lifetime federal estate tax exemption amount.

Enactment of the 2012 American Taxpayer Relief Act permanently allowed what is known as the "portability election." This allows for the surviving spouse to claim the unused portion of the federal estate tax exemption not utilized by one's deceased spouse and add it to the balance of one's own exemption.[3]

TRUMP ADMINISTRATION AND THE ESTATE TAX

President Donald Trump's tax plan outline calls for eliminating the federal estate tax. President Trump has described the enforcement of the rules proposed under the Obama administration surrounding the federal estate and gift tax as overly burdensome. Yet, repealing the estate tax will benefit only the United States' wealthiest families.

President Trump's plan does not repeal the gift tax, which applies to amounts transferred while living. Further, the plan does not indicate whether the stepped-up basis, which allows assets to be revalued by an heir so that the capital gains taxes are essentially bypassed, would be maintained. If the stepped-up basis is discontinued, this can amount to a new tax burden on the middle class.

Repealing the federal estate tax may also have negative implications for those states, like Minnesota, that levy an estate tax. States would no longer have the ability to rely on the IRS to conduct estate audits or issue regulations and guidance. The financial, administrative, and time burdens of these procedures will fall back to these states.

APPLICATION TO ESTATE PLANNING

While there is still much debate surrounding the complexities and modifications of the estate tax at both the state and federal level, estate planners can provide options to their wealthy clients who may be affected by the tax. Using advanced planning techniques can assist clients to minimize or eliminate the impact of taxes on their estates. Specifically, to reduce estate taxes, wealthier clients can spend down their assets, gift up to the annual exclusion amounts, or legally shield assets in trust vehicles.

With the use of trust vehicles, a client can give an independent trustee the power to amend the allocation of trust assets in response to changes in the Minnesota and federal estate tax. This additional authority can allow a client to avoid an unfavorable tax outcome if rules governing the tax basis of assets transferred are changed. Additionally, granting powers of appointment can be beneficial in allowing for changes in beneficiary designations or trust terms to be made.

Due to the shifting landscape of Minnesota's estate tax and the federal estate tax, individuals should take care in planning around these complex uncertainties when formulating an estate plan.

---

1. C. Robert Holcomb & Gary A. Hachfeld, *Ag Income Tax Update for Farm Families*, AGRIC. BUS. MGMT., 1, 12-14 (2016).
2. I.R.S. Rev. Proc. 2017-58, 1, 19-22 (2017).
3. *See* I.R.S. Pub. 559, 1, 26 (2016).

PRIVILEGED TAXES? THE GRAY AREA FOR PROTECTING TAX ADVICE IN ESTATE PLANNING

BY STEVE A. BRAND AND TIMOTHY BILLION

It is no question that the current tax code is complex. Taxpayers—including settlors or trustees of a trust, individuals, and businesses—therefore frequently obtain legal and financial advice regarding how to structure businesses or transactions to minimize tax liability. But what happens when the IRS demands to see that advice?

THE IRS'S POWER TO DEMAND INFORMATION

The IRS has broad summons powers it can use to examine any documents or compel testimony from a taxpayer.[1] That power extends to the taxpayer's representative or a third party with potentially relevant information. The IRS routinely directs summonses to attorneys, accountants, and trustees, in addition to the taxpayers themselves. Those summonses often seek "all documents" relating to a particular transaction or filing. If the subject of a summons refuses to turn over the documents or testify as requested, the IRS can file a petition in federal court to enforce the summons.

Courts generally impose a minimal burden on the IRS, only requiring the IRS to show (1) the investigation will be conducted for a legitimate purpose, (2) the inquiry is relevant to the investigation's purpose, (3) the IRS does not already possess the information, and (4) all administrative steps required by the IRS Code have been followed.[2] If the IRS meets that burden, then the taxpayer must establish a reason why the IRS is not entitled to the information it seeks.

THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK PRODUCT DOCTRINE

One reason the IRS may not be entitled to information sought in a summons is if an evidentiary privilege applies. The courts widely recognize two evidentiary privileges: the work product doctrine and the attorney-client privilege. The work product doctrine—which generally prevents the disclosure of one side's legal theory, mental impressions, and strategy—is broad, but it only applies once litigation is reasonably anticipated. Usually, taxpayers seek tax advice before anticipating litigation, so the work product doctrine does not apply.

The attorney-client privilege protects all confidential communications between a client and an attorney for the purpose of providing legal advice. Unlike the work product doctrine, the attorney-client privilege applies regardless of whether litigation is imminent. Documents shared with third parties, such as other parties to a transaction, are unlikely to be privileged. An exception is that the attorney-client privilege can include third parties—such as accountants—when their expertise is necessary for effective consultation between the attorney and client.[3] Note, however, that lawyers retaining a third-party expert should carefully document the engagement and its purpose, particularly if the taxpayer has previously used the services of that third party.

TO WAIVE OR NOT TO WAIVE

Importantly, the attorney-client privilege can be waived, particularly if a taxpayer raises a defense that he or she relied on legal advice. For example, if the IRS assesses an accuracy-related penalty against a taxpayer, the taxpayer can avoid the penalty if he or she shows that there was reasonable cause for, and he or she acted in good faith with respect to, the alleged underpayment.[4]

Raising a "reasonable cause and good faith" defense based on a legal opinion permits the IRS to obtain otherwise privileged attorney-client communications relating to the defense.[5] The taxpayer can choose to waive the privilege and disclose the privileged communications, particularly if those communications firmly establish the taxpayer's reasonable belief and good faith. The IRS, however, may then be entitled to all communications relating to whether the taxpayer's belief was more than likely reasonable. A recent 2017 case in the Eastern District of Kentucky showed how, in some circumstances, the taxpayer can also choose to abandon the defense rather than waive the privilege.[6]

Applying the attorney-client privilege is fact-intensive and determined case by case. When responding to an assessment of an accuracy-based penalty, a taxpayer waiving the attorney-client privilege can facilitate cooperation and an amicable resolution with the IRS. Waiving the privilege can also help a taxpayer prove the intent behind a transaction or establish a "reasonable cause and good faith" defense. Conversely, improper assertion of this defense can inadvertently waive the attorney-client privilege. Even an intentional waiver of the privilege can lead to broader disclosure than originally intended.

Before waiving the privilege or raising a defense based on reliance on legal advice, a taxpayer should always consult an experienced litigation attorney knowledgeable about privilege issues.

---

1. I.R.C. § 7602(a).
2. *See U.S. v. Powell*, 379 U.S. 48, 57-58 (1964).
3. *See U.S. v. Kovel*, 296 F.2d 918, 922 (2d Cir. 1961).
4. I.R.C. § 664(c)(1).
5. *See Ad Investment 2000 Find, LLC v. C.I.R.*, 142 T.C. 248 (2014).
6. *U.S. v. Micro Cap KY Ins. Co.*, 2017 U.S. Dist. LEXIS 44261, at *8 (E.D. Ky. Mar. 27, 2017).

MEET OUR ISSUE EDITOR:

SHIRA SHAPIRO

Shira T. Shapiro is a litigation attorney and member of Robins Kaplan's Trusts and Estates Planning, Administration, and Litigation Group. She represents the entire spectrum of trust and estate clients, including individuals and families, beneficiaries, charitable organizations, closely held family enterprises and their members, corporate fiduciaries, conservators, guardians, nonprofits, and personal representatives. Shira understands that emotions can run high in inheritance and other trusts and estates disputes. Her goal is to help her clients lessen the burdens litigation creates and achieve meaningful results. Shira can be reached at SShapiro@RobinsKaplan.com.

BISMARCK
1207 West Divide Avenue
Suite 200
Bismarck, ND 58503
701 255 3000 TEL

LOS ANGELES
2049 Century Park East
Suite 3400
Los Angeles, CA 90067
310 552 0130 TEL

NAPLES
711 Fifth Avenue South
Suite 201
Naples, FL 34102
239 430 7070 TEL

SILICON VALLEY
2440 West El Camino Real
Suite 100
Mountain View, CA 94040
650 784 4040 TEL

BOSTON
800 Boylston Street
Suite 2500
Boston, MA 02199
617 267 2300 TEL

MINNEAPOLIS
800 LaSalle Avenue
Suite 2800
Minneapolis, MN 55402
612 349 8500 TEL

NEW YORK
399 Park Avenue
Suite 3600
New York, NY 10022
212 980 7400 TEL

SIOUX FALLS
101 South Main Avenue
Suite 100
Sioux Falls, SD 57104
605 335 1300 TEL

ROBINS KAPLAN LLP®

REWRITING THE ODDS