ORANGE Bank&Trust COMPANY

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ESTATE PLANNING REPORT

Orange Bank & Trust Company • Trust Services Division

Year-end 2022

PLANNING THOUGHTS

Federal estate tax filings jump 79%

In October, the IRS released data from the federal estate tax returns filed in 2021. Most of those filings were for deaths in 2020, when the amount excluded from federal estate tax was $11.58 million. According to the CDC, some 3.4 million Americans died that year, and the IRS figures imply that just 6,158 of the resulting estates filed an estate tax return. The number of returns was a 79% increase over the number in 2020, but the average reported estate fell 13% to $30.8 million, according to a Tax Notes analysis.

Of those 6,158 estate tax returns, a majority—3,574 estates worth a total of just over $91 billion—were nontaxable, including 237 estates worth $50 million or more. A combination of the unlimited marital deduction, unlimited charitable deduction, and the federal estate tax credit (plus smaller deductions for administration expenses and state death taxes) was responsible for bringing the tax liability down to zero.

Some 43% of the taxable estates were worth between $10 million and $20 million. Only 14% were worth more than $50 million, but they provided over 60% of the net federal estate tax revenue.

About 1,000 estate tax returns were filed by estates below the tax filing threshold ($11.58 million for 2020 deaths). Such filings were likely made in order to claim the Deceased Spousal Unused Exclusion (DSUE). Over $2.7 billion of DSUEs were claimed on 2021 estate tax returns, with 75% found on the nontaxable returns.

Decedent estates in just five states paid 56.8% of the total federal estate taxes in 2021. The honors go to the states in this table:

Top five states for remitting federal estate taxes in 2021

State	Number of taxable returns	Estate taxes paid
California	519	$3,615,363,000
Florida	349	$2,515,345,000
New York	221	$2,344,495,000
Texas	194	$1,077,662,000
Pennsylvania	79	$907,120,000

Source: https://www.irs.gov/statistics/soi-tax-stats-estate-tax-filing-year-tables

The ranking of states for charitable giving from estates is similar, as one would expect, although the variation in the percentage of the gross estate going to charity is wide.

Top five states for charitable gifts from estates in 2021

State	Gross charitable bequests	As a percentage of the gross estate
California	$6,039,148,000	47.4%
Florida	$3,261,234,000	33.3%
Texas	$2,198,647,000	46.6%
Virginia	$2,096,120,000	70.5%
New York	$1,397,284,000	17.2%

Source: https://www.irs.gov/statistics/soi-tax-stats-estate-tax-filing-year-tables

Because women live longer than men, one would expect that the estates of women would pay more estate taxes than the estates of men, because men's estates usually can rely on the marital deduction to eliminate the tax. The IRS statistics bear this out. The aggregate value of men's estates was $117 billion, which generated $8.9 billion in estate taxes. Women's estates were worth $64 billion, and they paid $9.4 billion in estate taxes.

The IRS also categorized the occupations of the 2021 decedents wealthy enough to file an

estate tax return. The top ten categories are listed in the table below. Note that "Retired" means that no specific occupation was listed; most of the decedents were, in fact, retired.

Decedent occupations from 2021 federal estate tax returns

	Men		Women	
Occupation	Number	Net worth	Number	Net worth
Business and financial operations	1,743	$63,323,396	393	$12,645,053
Management	410	$14,760,553	94	$2,548,014
Health care practitioners	240	$4,689,697	65	$1,291,620
Arts, design, entertainment, sports, and media	105	$3,231,169	107	$3,296,623
Legal	238	$4,833,525	35	$857,264
Education, training, and library	69	$1,457,025	136	$2,814,048
Office and administrative support	13	$567,703	80	$2,560,951
Farming, fishing, and forestry	211	$4,091,785	52	$2,480,021
Sales and sales related	177	$5,622,567	49	$924,926
Retired, no occupation listed	113	$2,678,349	652	$15,569,647

Source: https://www.irs.gov/statistics/soi-tax-stats-estate-tax-filing-year-tables

Total estate tax collections, according to the report, came to $18.4 billion in 2021, an amount that is scarcely a rounding error in the multitrillion-dollar federal budget. But to the families required to come up with that tax payment, it was a very big deal indeed. That's why estate planning remains very important, and estate planners can look forward to more work in the coming year.

The amount exempt from federal estate tax is $12.92 million in 2023, which may seem like plenty of tax shelter. However, the exemption amount falls in half in 2026, and so estate taxes then will come due from many more estates.

CASES AND RULINGS

Email correspondence may be sufficient to amend a trust.

In re the Omega Trust, 2022 WL 1498499 (N.H. May 12, 2022)

Mark Douglas created the Omega Trust in December 2005. He amended the trust in June 2015 and again in September 2015. The Omega Trust had a trust protector. In July 2016, Mark informed the trust protector that he would be making a third amendment to the trust, that his health was deteriorating, and that he would contact his attorney with the changes. Mark sent an email to his attorney in August outlining the changes, including the addition of four beneficiaries. On August 12, the attorney responded to the email with some questions, and on August 16 the attorney sent a summary of the actions the firm would take to implement the amendment. Mark replied to that summary: "Very nice job, there are just a few suggested changes as noted below." Unfortunately, Mark died on August 18 without having signed the third trust amendment.

A year later, the executor of the estate asked the court to declare that this series of emails constituted a valid amendment of the trust. The trustee objected because of the absence of formalities in executing the amendment, and the court dismissed the suit.

The appellate court reversed, holding that Mark had the right to amend the trust at any time, and that the terms of the trust did not expressly forbid the use of email correspondence to effectuate an amendment. "Thus, the petitioner has sufficiently pled his case to survive a motion to dismiss." However, that may not be the last word, as the matter must return to the lower court for additional fact finding.

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Gift checks delivered shortly before death only avoid federal estate tax if they have been paid by the drawee bank. IRS is not allowed to withdraw a concession.

Estate of DeMuth v. Comm'r, T.C. Memo. 2022-72

William DeMuth executed a power of attorney appointing his son, Donald, as agent in 2007. From that year through 2014, Donald gave annual gifts to his brothers and other family members, relying upon the annual gift tax exclusion to avoid transfer taxes. In the summer of 2015, as William's health began to fail, Donald wrote an additional 11 checks for an aggregate of $464,000 from his father's brokerage account. (Some checks were for more than one person, so all came within the annual gift tax exclusion.) Four of the donees deposited their gift checks before William died in September, but only one check had been paid by the drawee bank by the date of death.

The estate tax return for William did not include the value of the gift checks, which the IRS spotted upon audit. The Service argued that the ten checks that had not cleared before death were estate includible. However, in its opening brief, the IRS conceded that all four checks had been "credited by drawee banks."

The Tax Court holds that under state law (here, Pennsylvania) a

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gift of a check is not complete until it is no longer possible to issue a stop payment order. The Court noted that both the IRS and the taxpayer seemed to confuse the idea of a "depository bank," which accepts the check deposit, and the "drawee bank," which pays the funds. Under these facts, only the check that cleared should be excluded from the taxable estate.

However, that early concession made by the IRS, even though it was erroneous, may not now be withdrawn. All four of those checks avoid the estate tax, while the other seven will be taxed.

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Revocation of a will by divorce applies only to the ex-spouse, not to the ex-spouse's relatives.

Matter of Estate of Tomczik, 976 N.W.2d 143 (Minn. Ct. App. 2022)

Mathew and Sara married in 1992. The marriage lasted until 2019, when they divorced. They had no children, and neither remarried. Mathew died in 2021.

Mathew's 1995 will named Sara as the primary beneficiary of his estate. He never amended or revoked the will after the divorce. His will further provided that should Sara die first, his residuary estate would be divided "one half to my heirs at law and one half to my wife's heirs at law." Mathew's brother, Michael, as personal representative of the estate, identified to the probate court Mathew's siblings as heirs. Under Minnesota law, any will provision for a spouse is automatically revoked upon divorce, so Sara had no claim to the estate. However, Sara's parents objected, arguing that under a plain reading of the will, they should inherit half the estate!

The lower court dismissed the claims of the in-laws, but the Minnesota Court of Appeals reverses. The law negating a surviving spouse's inheritance rights upon divorce could have extended that revocation to the ex-spouse's relatives, but it did not. It is not up to the courts to supply the language that the legislature failed to include.

A vigorous dissent argues that that Sara's "heirs at law" cannot be known because she has not yet died. "The illogic of appellants' argument becomes even more apparent if, for example, Sara had remarried. Under that scenario, if we were to apply appellants' interpretation, Sara's new husband would be a beneficiary of a portion of Mathew's residual estate." The dissenter would have affirmed dismissal of the case.

WASHINGTON TALK

The effect of the COVID-19 pandemic upon the supply chains and prices has been much commented upon. Less well known is that the pandemic caused the development of a major backlog at the IRS. As of the end of August this year, some 8.2 million individual tax returns remained unprocessed.

But according to a November update, major progress has been made. The number of unprocessed returns has been cut to 4.2 million. "These include tax year 2021 returns and late filed prior year returns. Of these, 1.9 million returns require error correction or other special handling, and 2.3 million are paper returns waiting to be reviewed and processed."

There are also an estimated 900,000 unprocessed amended tax returns in November, filed on Form 1040-X. They are processed in the order received, and processing can take up to 20 weeks, the IRS reports. Taxpayers may get status reports on their amended returns by going to "Where's My Amended Return?" at the IRS website [https://www.irs.gov/filing/wheres-my-amended-return].

DOL greenlights ESG investing. The "socially responsible investing" movement of the 1990s has been reincarnated and refined in recent years. Three categories of factors are involved: environmental, social, and governance (ESG). An environmental focus may look at carbon emissions, water stress, renewable energy, or pollution. Social factors might be diversity, inclusion, labor, employee welfare, or data security. Governance issues might touch upon independent directors, audit standards, women in leadership, and executive compensation.

Companies may be scored for their ESG performance. They may self-report, or data may be gathered by third parties who then sell the data.

Mutual funds employing ESG criteria are widely available, but the use of such criteria in retirement plans has been somewhat controversial. The Trump Administration's Department of Labor issued regulations permitting the consideration of ESG factors by retirement plans, but demanding that the positive pecuniary benefits of such factors needed to be shown. The ESG promoters considered the weak endorsement to be chilling.

The Biden Administration suspended those rules and issued new ones, finalized in November. The new rules don't mandate using ESG factors, but plans won't be subject to criticism if they do so. The DOL explained their new thinking in a blog post: https://blog.dol.gov/2022/11/22/allowing-esg-factors-in-retirement-plan-investments.

Cryptocurrency and retirement plans. Earlier this year, Fidelity Investments made news with the announcement that they would make investing in the digital currency Bitcoin one of the investment choices available to 401(k) plan participants. Bitcoin has been classified as property, not money, by the IRS. As such, there is no legal restriction on investing retirement funds in it.

At least, that is true at the moment. Three U.S. Senators wrote to Fidelity's President last July, asking that the offering be rescinded, because such an investment was thought to be too risky. They followed up with a November letter renewing the request.

The most important recent development causing concern was the collapse of FTX, a digital currency exchange, with losses to millions of clients that may reach billions of dollars. The Senators

also noted in their letter that the value of Bitcoin had fallen from $21,239, when the first letter was written, to a two-year low of $16,884.

The letter concluded: "In light of these risks and continuous warning signs, we again strongly urge Fidelity Investments to do what is best for plan sponsors and plan participants—seriously reconsider its decision to allow plan sponsors to offer Bitcoin exposure to plan participants. By many measures, we are already in a retirement security crisis, and it should not be made worse by exposing retirement savings to unnecessary risk. Any investment strategy based on catching lightning in a bottle, or motivated by the fear of missing out, is doomed to fail."

Donor-advised funds continue to prosper. Taxpayers generally welcomed the rough doubling of the standard deduction in the 2017 tax reform legislation. One group that was worried about unintended side effects of the change was the nonprofit sector. The larger standard deduction, coupled with the cap on the deduction for state and local taxes, meant that most taxpayers would no longer get any tax benefit for their charitable gifts.

The worries turned out to be unfounded, as total charitable giving has not declined. Most people give to charity for philanthropic reasons, not to get tax benefits. However, there was a related side effect, and that has been a boom in donor-advised funds.

The idea behind a donor-advised fund is that money is permanently set aside for charity in the fund, but the charity may not yet be specified. A full tax deduction may be allowed in the year of the contribution to the fund, while the disbursements to charity take place over the subsequent years. Note that the advice that the donor makes to the fund about the charitable beneficiary in subsequent years is not binding, but the fund will typically follow the wishes of the donor.

The tax strategy that this suggests is to bunch charitable deductions. One year, the taxpayer doubles up on charitable gifts and itemizes deductions, while the next year, no such gifts are made and the standard deduction is taken instead. When the large gift is made to a donor-advised fund, the receipt of the money by the charity is deferred.

A recent report from the National Philanthropic Trust documents the success of donor-advised funds [https://www.nptrust.org/reports/daf-report/]. Key metrics:

- The number of accounts in donor-advised funds rose from 1,007,745 in 2020 to 1,285,801 in 2021, an increase of 27.6%.
- Assets held in these funds grew 39.5% from 2020 to 2021, from $167 billion to $234 billion.
- Total transfers to charities by the funds in 2021 were $45.74 billion, a 27.3% payout rate. This was a 12.7% increase over the 2020 payout rate.
- Private foundations hold some $1.3 trillion in assets, about five times larger than the donor-advised funds. Yet the total grants by private foundations came to only $96.27 billion, about double the total grants from the donor-advised funds. (Private foundations are only required to distribute 5% of their assets annually to charity.)

The report concluded with a prediction of slower growth for donor-advised funds, in part as a response to financial market volatility in 2022.

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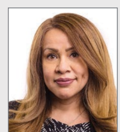

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