

TIME IS TICKING FOR DEATHBED TAX PLANNING: AN ANALYSIS OF ITS EFFECTIVENESS

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I. INTRODUCTION

Death—no matter who it happens to—always results in a tumultuous and awful situation. One minute, an individual could be laughing with a loved one, and the next, they are gone. In addition to the costs of funeral or similar arrangements and other associated costs, such as caskets and tombstones, in recent years, deathbed taxes have become more prominent.¹ A person’s estate is still subject to taxation, even when the person passes.²

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1. See *Funeral Costs: How Much Does an Average Funeral Cost?*, PARTING BLOG, (Sep. 14, 2017), <https://www.parting.com/blog/funeral-costs-how-much-does-an-average-funeral-cost/> (breaking down the average cost of a funeral and listing the various expenses), archived at <https://perma.cc/69Y7-2VH3>.

2. See I.R.C. § 641 (2017) (giving statutory authority for the imposition of tax on a decedent’s estate).

Ordinarily, deathbed taxation should be a relatively smooth process.³ However, complications may arise when there are many different players and interested parties involved, such as children from other marriages.⁴

This Article will address what constitutes deathbed planning in light of recent court decisions, such as *Estate of Powell*.⁵ Additionally, it will provide the reader with the estate planning steps one might want to follow at the end of his or her life, had the person not previously planned for the future of his or her heirs.⁶ The following is an insight into deathbed tax planning and what the process entails.⁷

II. EXPLANATION OF IMPORTANT TERMS

To understand deathbed tax planning in greater detail, it is critical to becoming familiar with the relevant terminology.⁸ Since the process can be quite difficult, understanding the following definitions is essential to ensure a smooth affair and to be aware of what one will have to deal with along the way.⁹

A. Definitions

Dead Bed Tax Planning is a last-minute attempt to ensure that after one passes, their family will be financially secure.¹⁰ Usually, part of this plan involves trying to minimize estate taxes and any other taxes that arise following one's passing.¹¹

A "deathbed" is a place where a person dies or lies during their last few hours before death.¹²

"Deathbed gifts" are gifts given to a loved one or family member while one is on their deathbed.¹³ Deathbed gifts are a known and effective way to

3. See William Baldwin, *Deathbed Tax Dodges: Take These Steps Now to Save Later*, FORBES (Aug. 27, 2012, 11:15 AM), <https://www.forbes.com/sites/baldwin/2012/08/27/deathbed-tax-dodges-take-these-steps-now-to-save-later/#329f44425321> (discussing techniques to make deathbed taxation less complicated and providing an example of why deathbed taxation may become more complicated), archived at <https://perma.cc/3LNK-9BJJ>.

4. *Id.*

5. See *infra* Section II.C.

6. See *infra* Section IV.

7. See *infra* Section II.

8. Baldwin, *supra* note 3.

9. *Id.*

10. *Id.*

11. *Id.*

12. *Deathbed*, MERRIAM-WEBSTER, www.merriam-webster.com/dictionary/deathbedlast visited Feb. 5, 2018), archived at <https://perma.cc/LRD5-9XC6>.

13. See Kevin A. Pollock, *Federal Estate and Gift Taxation of Deathbed Gifts*, KEVIN A. POLLOCK BLAWG, (May 27, 2011), willtrustsestates.blogspot.com/2011/05/federal-estate-and-gift-taxation-of.html, archived at <https://perma.cc/C576-Q5LC>.

reduce, and potentially eliminate, the taxable value of the estate belonging to the decedent in question.¹⁴

Estate taxes are the taxes levied on the transfer of an estate from a decedent to his or her beneficiaries prior to the transfer itself.¹⁵

In addition to estate taxes, the transfer of a decedent's property to the beneficiaries may incur an inheritance tax.¹⁶

A limited partnership (LP) consists of two or more partners who are liable only for the amount of money they have invested.¹⁷

A charitable lead annuity trust is a charitable lead trust (CLT) in which charity receives a guaranteed annuity payment during the term of the trust.¹⁸ A CLT is not tax exempt.¹⁹

A spousal lifetime access trust (SLAT) is a trust that benefits the donor's spouse and children.²⁰ A SLAT can reduce a spouse's estate tax burden at death through the gift tax exemption.²¹

A gross estate consists of all property owned by a decedent at the time of death.²² Generally, assets are valued at their fair market value at the date of death.²³

An individual retirement account (IRA) is a type of "individual retirement plan," which provides tax advantages for retirement savings.²⁴ There are several types of IRAs as of 2016: Traditional IRAs, Roth IRAs, SIMPLE IRAs and SEP IRAs.²⁵ Sometimes referred to as individual retirement arrangements, IRAs can consist of a range of financial products such as stocks, bonds or mutual funds.²⁶

14. *Id.*

15. See 42 AM. JUR. 2d *Estate Taxes* § 3 (2018) (defining estate tax as tax levied upon the entire estate and payable as an expense of administration); *c.f.* 42 AM. JUR. 2d *Estate Taxes* § 3 (2018) (defining estate tax as a tax that is independent of the receipt of the property by a beneficiary).

16. See 42 AM. JUR. 2d *Inheritance or Succession Taxes* § 5 (2018) (defining inheritance taxes as a tax imposed on the transfer of the property to the beneficiary and not a tax on the decedent).

17. See *Limited Partnership*, INVESTOPEDIA, <https://www.investopedia.com/terms/l/limited-partnership.asp> (last visited Feb. 3, 2018), archived at <https://perma.cc/6Q9E-YLLJ>.

18. See *Charitable Lead Trust*, THE FREE DICTIONARY BY FARLEX, <https://financial-dictionary.thefreedictionary.com/charitable+lead+trust> (last visited Feb. 3, 2018), archived at <https://perma.cc/34W3-PG3K>.

19. Daniel L. Daniels & David T. Leibel, *Charitable Lead Trusts: A Primer*, PLANNED GIVING DESIGN CENTER (Sep. 16, 2012), <http://www.pgdc.com/pgdc/charitable-lead-trusts-primer>, archived at <https://perma.cc/LY9E-TNGA>.

20. *Spousal Lifetime Access Trust (SLAT)*, JUX LAW FIRM, <https://jux.law/spousal-lifetime-access-trust-slat/> (last visited Feb. 3, 2018), archived at <https://perma.cc/7WTH-CVWN>.

21. *Id.*

22. See *The Gross Estate*, LAW SHELF EDUCATIONAL MEDIA, <https://lawshelf.com/courseware/entry/the-gross-estate> (last visited Feb. 3, 2018), archived at <https://perma.cc/5663-BXJL>.

23. *Id.*

24. See Sheyna Steiner, *IRA Accounts for Beginners: Everything You Need to Know*, BANKRATE (Sep. 7, 2017) <https://www.bankrate.com/investing/ira/all-about-ira-accounts-for-novices/>, archived at <https://perma.cc/MG4D-XT5W>.

25. *Id.*

26. *Id.*

A Deathbed Roth Conversion is a conversion strategy that in most cases is unnecessary, thanks to the “IRD” (Income in Respect of a Decedent) tax, that provides IRA beneficiaries a deduction for the estate taxes paid by the IRA owner.²⁷

An individual’s modified adjusted gross income is the sum of said individual’s household adjusted gross income and any tax-exempt interest income they may have (these are the amounts on lines 37 and 8b of IRS form 1040).²⁸

The required minimum distribution is the least amount one must withdraw from their IRA account each year.²⁹ One generally has to begin withdrawing from their accounts six months after their seventieth birthday.³⁰ However, withdrawals are not required for Roth IRAs until the owner’s death.³¹

A Simplified Employee Pension Individual Retirement Arrangement (SEP IRA) is an IRA variation.³² SEP IRA’s are used to provide retirement benefits for business owners and their employees.³³ A SEP plan provides business owners with a simplified method to contribute toward their employees’ retirement as well as their own retirement savings.³⁴ Contributions are made to an Individual Retirement Account, or Annuity (IRA) set up for each plan participant (a SEP-IRA).³⁵

A Savings Incentive Match Plan for Employees Individual Retirement Account (SIMPLE IRA) is a type of tax-deferred employer-provided retirement plan in the United States that allows employees to set aside money and invest it to grow for retirement.³⁶

27. Michael Kitces, *How The 691(c) IRD Deduction Can Eliminate The Need For Deathbed Roth Conversions To Avoid (Federal) Estate Taxes*, KITCES (July 15, 2015, 7:01 AM), <https://www.kitces.com/blog/how-the-691c-ird-deduction-can-eliminate-the-need-for-deathbed-roth-conversions-to-avoid-federal-estate-taxes/>, archived at <https://perma.cc/4ZQL-PVY4>.

28. See Zane Benefits, *How to Calculate Modified Adjusted Gross Income (MAGI)*, ZANE BENEFITS (Feb. 4, 2016), <https://www.zanebenefits.com/blog/how-to-calculate-modified-adjusted-gross-income-magi>, archived at <https://perma.cc/TRW8-FQ5X>.

29. *Retirement Plan and IRA Required Minimum Distributions FAQs*, IRS, <https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-required-minimum-distributions> (last visited Feb. 3, 2018), archived at <https://perma.cc/X298-6R23>.

30. *Id.*

31. See *Retirement Topics Required Minimum Distributions RMDs*, IRS, <https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds> (last visited Feb. 3, 2018), archived at <https://perma.cc/M86N-XAVG>.

32. See Sheyna Steiner, *IRA Accounts for Beginners: Everything You Need to Know*, BANKRATE (Sep. 7, 2017) <https://www.bankrate.com/investing/ira/all-about-ira-accounts-for-novices/>, archived at <https://perma.cc/ZH4A-3FZF>.

33. *Id.*

34. *Id.*

35. *Id.*; see also SEP IRA, THE FREE DICTIONARY BY FARLEX, <http://financial-dictionary.thefreedictionary.com/SEP+IRA>.

36. See *SIMPLE IRA Plan*, IRS, <https://www.irs.gov/retirement-plans/plan-sponsor/simple-ira-plan> (last updated Jan. 25, 2018), archived at <https://perma.cc/RJL3-YQT7>.

Social Security taxes are usually collected in the form of payroll tax or self-employment tax.³⁷ The Social Security tax—also known as Old Age, Survivors, and Disability Insurance (OASDI)—pays for the retirement, disability, and survivorship benefits received by millions of Americans each year.³⁸

Income in Respect of a Decedent (IRD) is income owed to the decedent at the time he or she died. Examples of IRD include retirement plan assets, IRA distributions, unpaid interest and dividends, salary, wages, and sales commissions.³⁹

B. Deathbed Planning v. Post-Deathbed Tax Planning

While deathbed tax planning occurs in the three months before an anticipated death, post-deathbed tax planning is a critical period following the death with a window of up to nine months.⁴⁰ During this time frame, one must file all of the necessary estate taxes, because after this period no further adjustments can be made.⁴¹

C. Background and Current Status

The case of *Estate of Powell v. Commissioner* highlights common mistakes and should serve as a reminder of how not to go about asset protection and estate planning.⁴²

In the summer of 2008, when Nancy Powell passed away, the decedent, her son Mr. Powell, began his incapacitated mother's estate planning just nine days before her passing.⁴³

Mr. Powell began the aggressive plan by claiming the title of general partner.⁴⁴ After creating NHP Enterprises, a limited partnership, he went on to obtain a 99% limited partnership interest by transferring over \$10 million of his mother's assets to NHP from her revocable trust.⁴⁵ A day later, Mr.

37. *What Do Social Security Taxes Pay For?*, IN CHARGE INSTITUTE OF AMERICA, <https://www.incharge.org/financial-literacy/where-do-my-social-security-tax-dollars-go/>, archived at <https://perma.cc/74P9-EEEE>.

38. *Id.* See *Must I Pay Taxes on Social Security Benefits?*, SOCIAL SECURITY ADMINISTRATION (Jan. 5, 2018), <https://faq.ssa.gov/link/portal/34011/34019/article/3831/must-i-pay-taxes-on-social-security-benefits>, archived at <https://perma.cc/P2XB-E2C2>.

39. Raymond A. Zimmermann, *The Importance of IRD*, JOURNAL OF ACCOUNTANCY (Mar. 31, 2004), <https://www.journalofaccountancy.com/issues/2004/apr/theimportanceofird.html>, archived at <https://perma.cc/ASL3-H6MX>.

40. See *Simplifying Estate and Gift Tax Planning*, WOLTERS KLUWER (Jan. 2017), <https://www.cchgroup.com/news-and-insights/wbot2017/estate-gift-taxes>.

41. *Id.*

42. *Estate of Powell v. Comm'r*, 148 T.C. No. 18 (T.C. 2017).

43. *Id.*

44. *Id.*

45. *Id.*

Powell got ahold of a doctor's note which gave him the ability to act under his mother's durable power of attorney.⁴⁶ This allowed him to create a CLAT in which to place his mother's assets.⁴⁷ Upon her death, Mr. Powell and his brother were named remainder beneficiaries.⁴⁸ This, along with the power of attorney Mr. Powell had, allowed him "[t]o grant, convey, sell, transfer, mortgage deed in trust, pledge and otherwise deal in all property real and personal, which the principal may own."⁴⁹ In addition, he became authorized to:

[M]ake gifts on the principal's behalf, including, but not limited to, forgiveness of loans, to a class composed of the principal's children, any of such children's issue, or any or all to the full extent of the federal annual gift tax exclusion under Internal Revenue Code Section 2503(b) or any successor statute.⁵⁰

Mr. Powell misused his power of attorney by filing for a gift tax return which he transferred into the CLAT.⁵¹ A gift of more than \$1.6 million was granted to him and his brother after he determined a 25% discount made \$7.5 million the value of the 99% limited partnership interest.⁵² The tax court reviewed this case and all assets gifted to the CLAT were deemed includable in the decedent's estate under IRC Section 2033 (property in which decedent had an interest) or IRC Section 2038 (revocable transfers).⁵³ The IRS issued deficiency notices on both the estate and gift tax returns, as well.⁵⁴

The power of attorney Mr. Powell had did not provide him sufficient coverage to go about his mother's estate planning in the manner that he did.⁵⁵ The misuse of family limited partnerships can result in the tax court invalidating any and all gifts made to the CLAT and result in further consequences such as revocation of power of attorney as well as the title of the remainder beneficiary.⁵⁶ The Powell brothers misused their jurisdiction to avoid taxes and make unlawful gifts while their incapacitated mother lay on her deathbed.⁵⁷ After the IRS denied the gifts made to the CLAT, the tax court placed the assets into a temporary hold, at which time they could not be further touched by any surviving family members.⁵⁸

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.* at 2.

51. *Id.*

52. *Id.*

53. *Id.* at 12.

54. *See id.* at 3.

55. *See id.* at 14-15.

56. *See id.*

57. *See id.*

58. *See id.*

Essentially, under his mother's durable power of attorney, Mr. Powell made deathbed transfers of his mother's assets which were found to be unlawful.⁵⁹ Ultimately, the tax court found that Mr. Powell's power of attorney did not allow him to make the deathbed transfers he did.⁶⁰ It concluded that under IRC Section 2036(a)(2), anything transferred to NHP Enterprises was includable because Nancy had the right to dissolve it, but did not do so.⁶¹ The tax court also determined that the IRC Section 2036 exemption did not apply in this situation because the decedent's son had no non-tax reason to legitimize the transfer.⁶² Furthermore, under IRC Section 2035, it was established that all assets transferred were not includable.⁶³ Lastly, the tax court found that under IRC Section 2043(a), the transfers made to NHP fell under the estate tax return, which prevented Mr. Powell from facing double taxation.⁶⁴ *Estate of Powell v. Commissioner* is a case to learn from and one that has helped shape the current status of what constitutes as deathbed planning.⁶⁵

D. Strangi v. Commissioner of Internal Revenue

While *Estate of Powell* serves as a landmark case in the field of deathbed planning, the decision was based in large part on a previous court decision: *Strangi v. Commissioner of Internal Revenue*.⁶⁶ In the case of *Strangi v. Commissioner of Internal Revenue*, Albert Strangi placed assets valued at about \$10 million into a family limited partnership shortly before he died.⁶⁷ In 1965, Strangi married his second wife, Delores Seymour, who had two children of her own from a previous marriage.⁶⁸ In 1987, they each prepared wills in which they designated their children as residual beneficiaries and themselves as the primary beneficiaries.⁶⁹ Shortly after, Seymour became ill, causing the couple to move and select Michael Gulig as an attorney-in-fact under a general power of attorney.⁷⁰ In 1990, Strangi had a new will drawn up in which he excluded his step-children and only named his children by blood as beneficiaries.⁷¹ Seymour passed away six months after Strangi named his daughter from his first marriage, Rosalie, and a bank as the

59. *See id.*

60. *See id.*

61. *See id.* at 7.

62. *See id.* at 9.

63. *See id.* at 7.

64. *See id.* at 8.

65. *See id.* (imposing a new limit on the power of attorney).

66. *See id.*

67. *See Strangi v. Comm'r*, 417 F.3d 468, 472–74 (5th Cir. 2005), reh'g granted, 429 F.3d 1154 (5th Cir. 2005).

68. *Id.* at 472.

69. *Id.*

70. *Id.*

71. *Id.*

co-executors of the Estate.⁷² Strangi started to develop health problems of his own over the following three years, at which point attorney Michael J. Gulig, Rosalie Gulig's husband, stepped in to handle his daily affairs.⁷³ The actions Gulig took in this capacity included the transfer of 98% of Strangi's assets into a limited partnership in exchange for a 99% limited partner interest.⁷⁴ Gulig claimed that he did so to protect the estate from the Seymour children, who he expected to contest the will.⁷⁵

Ultimately decided on July 15, 2005, the court found Gulig's actions to be violations of 26 C.F.R. Section 20.2031-1(b), *United States v. Byrum*, and other provisions; a result of the fact that Strangi transferred millions of dollars in, inter alia, brokerage accounts, annuities, houses, life insurances policies, and limited partnership interests.⁷⁶ Such actions, because of the nature in which they were taken, were found to be riddled with deathbed tax planning mistakes.⁷⁷

The IRS wished to void family limited partnerships of tax benefits and, in *Estate of Strangi vs. Commissioner*, the court did not account for the limited partnership as part of the estate taxes.⁷⁸ The court was to include any of the decedent's assets in their gross estate, including any deathbed gifts the decedent made.⁷⁹ Therefore, this omission in the case of Strangi's estate went against the Internal Revenue Code Section 2036(a)(1).⁸⁰

To avoid these mistakes, lawyers should keep family and business affairs separate, file income tax returns, and monitor the records of all activity.⁸¹ A family limited partnership is an entity that should avoid commingling assets.⁸² Furthermore, the assistance of an estate planning attorney is recommended to help meet one's tax-planning goals and to decide whether or not it is best for one to maintain the family entity.⁸³ Terminating the limited partnership would mean tax consequences will be assessed.⁸⁴ However, continuing it will require the transference of a voting interest to be completed through a sale or gift.⁸⁵

72. *Id.* at 473.

73. *Id.*

74. *Id.* at 474.

75. *Id.*

76. *Id.* at 474–82.

77. *See id.*

78. *Compare id.*, with I.R.C. § 2036(a)(1) (2018).

79. *Compare Strangi v. Comm'r*, 417 F.3d 468, 472–74 (5th Cir. 2005), reh'g granted, 429 F.3d 1154 (5th Cir. 2005), with I.R.C. § 2036(a)(1) (2018).

80. *See supra* Section II.D.

81. *See supra* Section II.D.

82. *See supra* Section II.D.

83. *See supra* Section II.D.

84. Milton Childs, *Using Family Limited Partnerships for Estate Planning*, 5 MARQ. ELDER'S ADVISOR 193, 193–99 (2004) (discussing requirements to continue the limited partnership).

85. *See supra* Section II.D.

Deathbed transactions, transfers, and taxes are part of a complicated process that can require multiple levels of court involvement, especially when disputes arise.⁸⁶ The *Estate of Strangi vs. Commissioner* is a case from which one can learn the possible mistakes when dealing with family limited partnerships.⁸⁷

III. THE DEATHBED PLANNING PROCESS

Fortunately, as long as an individual on the verge of death is still alive and cogent, it is not too late to plan for death taxes.⁸⁸ Death can come at any moment, and it is always best to be prepared.⁸⁹ The best time for an individual to begin the estate planning process is when they are healthy. Measures may be taken to ensure family members will be financially secure in the aftermath of death.⁹⁰ Deathbed tax planning can be successfully done at any moment in the three-months prior to one's death.⁹¹

In some states, a testator may execute a deathbed will in oral form with witnesses instead of written down and signed.⁹² Some restrictions may be included when a will is conducted orally, such as one which limits the number of assets one is allowed to transfer.⁹³ Oral dictations leave room for contention regarding the amount that was heard; in contrast, written wills, by nature, provide more clarity.⁹⁴

If at the time of death, the net value of one's estate is more than the federal estate tax exemption amount, their beneficiaries will be subject to taxes.⁹⁵ Additionally, death and inheritance taxes may vary by state.⁹⁶ In New York residents must file an estate tax return upon death if the combined amount of one's federal gross estate and includible gifts total more than the basic exclusion amount.⁹⁷

86. See *supra* note 68.

87. See Natalie Jackson, *The Critical Year*, TEAHAN & CONSTANTINO (Apr. 25, 2016), tcnylaw.com/the-critical-year/, archived at <https://perma.cc/6WD7-KV72>.

88. See *id.*

89. See *id.*

90. See *id.*

91. See E. Campion, Annotation, *What Amounts to "Last Sickness" or the like Within Requirement that Nuncupative Will be Made During Last Sickness*, 8 A.L.R. 3d 952 (1966).

92. See *id.*

93. See Jose Rivera, *What Is a Deathbed Will?*, LEGALMATCH (Oct. 10, 2013), www.legalmatch.com/law-library/article/deathbed-wills-lawyers.html, archived at <https://perma.cc/S78P-UUW>.

94. Jonathan G. Blattmachr & Dan Hastings, *New York Estate Tax Deduction for Principal Residences: Complications Abound*, 68 OCT. N.Y. ST. B.J. 10, 12 (1996).

95. See *id.*

96. See *id.*

97. See Cynthia Myers, *How to Give Assets to Your Children Before Your Death*, ZACKS, <https://finance.zacks.com/give-assets-children-before-death-1624.html>, (last visited Apr. 10, 2018) archived at <https://perma.cc/BBU7-MLG5>.

Fortunately, these payments can be avoided or mitigated through the use of a living trust.⁹⁸ For example, married couples can add a provision to their living trust that will allow each to use exemptions, thus saving money for their beneficiaries to enjoy.⁹⁹

A. *Deathbed Gifts*

Before death, a soon-to-be decedent may choose to gift some of his or her assets to intended beneficiaries.¹⁰⁰ If done properly, deathbed gifts can help mitigate inheritance taxes on behalf of the beneficiary.¹⁰¹ Typically, such a gift will be granted tax-free, as long as the value falls below the \$28,000.00 threshold required for it to be covered by the gift exemption.¹⁰²

This raises the question, however, of how someone who is dying can make such a rash decision about a large sum of money.¹⁰³ California estate law notes that it is common for clients to be unable to make gifts due to their mental or physical states.¹⁰⁴ In such a situation, the individual with the future decedent's power of attorney will typically oversee the gifting process as an authorized representative.¹⁰⁵

B. *Pros and Cons of Deathbed Tax Planning*

When considering the pros and cons of deathbed tax planning, it is important to first consider estate tax planning as a whole since the processes are quite similar.¹⁰⁶ In most cases, deathbed taxes do not take effect until the person of interest passes and has to pay taxes on the estate.¹⁰⁷ A few ways to get around these taxes are by preemptively placing the assets in trusts and gifting them away.¹⁰⁸

A specific method which may come in handy when doing deathbed tax planning is the Spousal Lifetime Access Trust (SLAT).¹⁰⁹ As an irrevocable trust, the SLAT helps a spouse on his or her deathbed reduce assets, so that

98. *Id.*

99. *Id.*

100. *Id.*

101. 2009-10 I.R.B. 648.

102. *Webb v. Saunders*, 181 P.2d 43, 47-48 (Cal. Ct. App. 1971).

103. *Id.*

104. *Id.*

105. *Estate of Erickson v. Comm'r*, 93 T.C.M. (CCH) 1775 (T.C. 2007).

106. See William Baldwin, *Deathbed Tax Dodges: Take These Steps Now to Save Later*, FORBES (Aug. 27, 2012), <https://www.forbes.com/sites/baldwin/2012/08/27/deathbed-tax-dodges-take-these-steps-now-to-save-later/#1d17414d5321>, archived at <https://perma.cc/CS72-Y2HV>.

107. *Id.*

108. *Id.*

109. Rebecca S. Manicone, *Spousal Lifetime Access Trusts (SLATs)*, GREENBURG TRAURIG (Aug. 3, 2016), <http://www.gtlaw-legacyadvisors.com/2016/08/spousal-lifetime-access-trusts-slats/>, archived at <https://perma.cc/QR2T-LUSJ>.

he or she pays a smaller amount in taxes while ensuring that the spouse and children will have access to the assets in the trust.¹¹⁰ Though the SLAT has many benefits, there are also some drawbacks.¹¹¹ One downfall is if one gets divorced, one may lose all assets.¹¹² Death, another ominous topic, also plays a role in the SLAT.¹¹³ If the donor's partner dies, access to the assets in the trust may end up foregone.¹¹⁴ When set up as part of the deathbed tax planning process, the donor is close to death, so the risk of both of these situations is mitigated.¹¹⁵ As with any trust, it is important to weigh this cost against the amount of tax savings in which this course of action will result.¹¹⁶

Aside from the issues listed above, another obstacle that may arise is the Reciprocal Trust Doctrine.¹¹⁷ Working against the benefits of the SLAT, "[t]he Reciprocal Trust Doctrine is a judicially-created doctrine developed in response to the perceived tax-avoidance where two parties create trusts for each other which, in effect, leave each other lifetime enjoyment over property while avoiding inclusion in the gross estates."¹¹⁸ This can cause conflict because the Doctrine states that if two people create similar trusts for one another, the courts can "uncross" the trusts and treat the situation as if each person created a trust for his or her own benefit.¹¹⁹ As a result, if both spouses set up SLAT's for one another, the IRS may void both of them and thus the assets involved may no longer be exempt from taxation.¹²⁰

C. The Role of Taxes and How to Avoid Them

A person has a few options to lessen the amount of taxes loved ones will face after he or she passes.¹²¹ For instance, spending one's assets can be an easy way to lower the value of the estate.¹²² This is only a viable option for people who have an extensive amount of savings and are not in danger of running out of resources before they die.¹²³ Additionally, giving away assets prior to death is a way to reduce death taxes, although this option is only

110. *Id.*

111. William S. Forberg, *Select Transfer Tax Planning Issues, Including Trust Ownership of Business Interests, Equalizing Transfers, GST Planning, Spousal Access Trusts*, CU005 ALI-CLE 633 (Am. Law Inst., July 18–20, 2012).

112. *See* Baldwin, *supra* note 106.

113. *See id.*

114. *See id.*

115. *See id.*

116. *See id.*

117. *See* Manicone, *supra* note 109.

118. *See id.*

119. *See id.*; *see also* Estate of Bischoff v. Comm'r, 69 T.C. 32 (T.C. 1977).

120. *See* Manicone, *supra* note 109.

121. *Understanding Estate Taxes*, ESTATEPLANNING.COM—POWERED BY WEALTH COUNSEL, <http://www.estateplanning.com/understanding-estate-taxes/>, archived at <https://perma.cc/2HCG-2LN8> (last visited Mar. 14, 2018).

122. *Id.*

123. *See id.*

recommended for people with enough assets to take care of themselves before death.¹²⁴ A person can gift assets to family while still alive, but giving to friends or charities is an equally viable option.¹²⁵ Doing so will help reduce the value of the estate and thus lessen the amount of taxes that will be due later.¹²⁶ By using advanced estate planning methods such as opening up a SLAT, people will have significantly increased access to their lifetime gift tax exemptions and annual exclusion gifts.¹²⁷ Furthermore, family limited liability companies can help people gift assets in a way that allows for asset protection and reductions for estate taxes.¹²⁸ After a person passes away, charitable income tax reductions can be given if the person opened a charitable trust.¹²⁹

Marriage is another way to avoid taxes.¹³⁰ For instance, married couples benefit in the situation where one spouse dies without using up the entirety of his or her federal estate tax exemption.¹³¹ This allows the surviving spouse to add the untouched amount to their annual exemption, allowing them to have up to \$10 million completely exempt from federal estate tax.¹³² Married couples can also reduce or eliminate estate taxes by setting up an AB Trust in their estate plans.¹³³ An AB Trust is a joint account that names a beneficiary who is not the other spouse.¹³⁴ If a person lives in a state which collects both inheritance tax and state estate tax, then another option is to move to a different state that will exempt the decedent and beneficiaries from one of these taxes.¹³⁵ As long as the person who moves declares legal residence in the new state, he or she can ensure that more money stays within the family instead of going to the government towards death taxes.¹³⁶

It is also important to note that if funds are removed from a bank account immediately before death, this does not mean the beneficiaries will dodge paying inheritance taxes.¹³⁷ Likewise, if a beneficiary removes funds directly following the death, this does not mean that the beneficiary will be exempt from gift taxes.¹³⁸

124. *See id.*

125. *See id.*

126. *Id.*

127. *See id.*; *see supra* notes 20, 21.

128. *See Understanding Estate Taxes, supra* note 121.

129. *See id.*

130. *See id.*

131. *See id.*

132. *See id.*

133. *See id.*

134. *See id.*

135. *See* Jeff Bukhari, *These Are the 14 States with the Worst 'Death Taxes'*, FORTUNE.COM (Apr. 24, 2017), fortune.com/2017/04/24/states-worst-death-taxes/, archived at <https://perma.cc/ASMX-A5CG>.

136. *See id.*

137. *See Understanding Estate Taxes, supra* note 121.

138. *See id.*

D. State Comparison

With death, one can expect federal government death taxes, which are unaffected by the state of residences.¹³⁹ However, some states impose estate taxes on top of the federal tax.¹⁴⁰ For instance, the District of Columbia, New York, New Jersey, Vermont, Maryland, Delaware, Illinois, and Hawaii all tax the estate.¹⁴¹ Maine and Connecticut impose estate taxes as well, though theirs are lower than the other states' rates, with a \$5.49 million exemption and 12% tax rate and \$2 million exemption and 12% tax rate, respectively.¹⁴² For federal estate taxes, 40% is the maximum tax rate and the federal exemption is \$5.49 million.¹⁴³ In other words, the IRS can only tax an estate's value if it is higher than the above amount.¹⁴⁴ This is good news because the high standards mean that many people can avoid these taxes.¹⁴⁵ A recent congressional report found that of the 2.6 million deaths reported in 2013, only 0.2% were liable for estate taxes.¹⁴⁶ Fortunately, the value of the taxable estate is deducted from state taxes, and the difference is what determines one's liability for federal taxes.¹⁴⁷

Some places with the highest tax rates and the lowest exemptions include the District of Columbia, Massachusetts, and Oregon because they have only a \$1 million exemption and a tax rate of 16%.¹⁴⁸ Rhode Island and Minnesota have the same tax rate, although their exemptions are \$1.15 million and \$1.8 million, respectively.¹⁴⁹ Washington, however, taxes death most heavily; its exemption is \$2.13 million, but the tax rate is a whopping 20%.¹⁵⁰

139. I.R.C. § 2001 (West 2017).

140. Julie Garber, *State-Level Estate Taxes and Exemptions*, THE BALANCE (Nov. 23, 2017), <https://www.thebalance.com/state-estate-tax-and-exemption-chart-3505462>, archived at <https://perma.cc/VFNR-MHQD>.

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. *See id.*

146. Joint Committee on Taxation, *History, Present Law, and Analysis of the Federal Wealth Transfer Tax System (JCX-52-15)*, at 1 (Mar. 16, 2015).

147. See Michael B. Sauter, et al., *States with The Highest and Lowest Taxes*, USA TODAY (Oct. 28, 2012), <https://www.usatoday.com/story/money/personalfinance/2012/10/28/state-taxes-states-highest-lowest/1654071/>, archived at <https://perma.cc/5KFK-2XTJ>.

148. *2017 Tax Rate Guide*, MERRILL LYNCH (Apr. 2017), <https://mlaem.fs.ml.com/content/dam/ML/articles/pdf/2017-tax-rate-guide.pdf>, archived at <https://perma.cc/42PY-X74N>.

149. *Id.*

150. *Id.* at 78.

E. Inheritance Taxes

As mentioned, the inheritance tax applies to anyone who inherits an estate, property, or money from a relative or family member.¹⁵¹ This plays a role in deathbed tax planning because most people who wish to pass down an estate or large sum of money have a will which executes post-mortem.¹⁵² Inheritances, as opposed to pre-mortem transfers, can save a lot of money in terms of taxes.¹⁵³ As of October 2017, only six states currently collect inheritance taxes: Iowa, Kentucky, Maryland, Nebraska, New Jersey, and Pennsylvania.¹⁵⁴ As of 2018, there is a \$11.2 million exclusion on inheritance, so the inheritance is only subject to the maximum 40% rate.¹⁵⁵ If one inherits money, one also does not have to pay income taxes on it.¹⁵⁶ Additionally, in the states listed above, inheritance taxes are exempt if the inheritance is going toward a surviving spouse.¹⁵⁷

IV. GOOD TIPS IN DEATHBED TAX PLANNING

A. Deathbed Roth Conversion

The Deathbed Roth Conversion aids in preserving wealth and saving income related to taxes.¹⁵⁸ The Deathbed Roth Conversion allows one to convert a traditional Individual Retirement Account (IRA) to a Roth IRA.¹⁵⁹ Typically, traditional IRA accounts have income limits.¹⁶⁰ For single individuals, the MAGI must be less than \$133,000.00.¹⁶¹ For married couples who wish to file jointly, the income must be less than \$196,000.00, and for

151. See Julie Garber, *How Taxes May Affect Your Inheritance*, THE BALANCE (Oct. 9, 2017), www.thebalance.com/will-you-have-to-pay-taxes-on-your-inheritance-3505056, archived at <https://perma.cc/D48Z-AKYD>.

152. *Id.*

153. *Id.*

154. *Id.*; see Scott Drenkard & Richard Borean, *Does Your State Have an Estate or Inheritance Tax?*, TAX FOUNDATION, (Jan. 16, 2017), <http://taxfoundation.org/does-your-state-have-estate-or-inheritance-tax/>, archived at <https://perma.cc/VUF3-BDHT>.

155. See I.R.C. § 2001 (West 2017).

156. Scott Drenkard & Richard Borean, *Does Your State Have an Estate or Inheritance Tax?*, TAX FOUNDATION (Jan. 16, 2017), <http://taxfoundation.org/does-your-state-have-estate-or-inheritance-tax/>.

157. Jared Walczak, *Facts & Figures 2015: How Does Your State Compare?*, TAX FOUNDATION (Mar. 10, 2015), https://files.taxfoundation.org/legacy/docs/fact%26figures_15_wep_9_2.pdf, archived at <https://perma.cc/8C62-LYVY>.

158. Dawn Doeblen, *3 Ways a Roth IRA Can Build and Preserve Wealth*, WTOP (Aug. 30, 2017), <https://wtop.com/business-finance/2017/08/3-ways-a-roth-ira-conversion-can-build-and-preserve-wealth/>, archived at <https://perma.cc/67UJ-65X6>.

159. *Id.*

160. See generally *id.* (explaining that these income limits do not apply to Roth conversions).

161. See generally *Roth IRA Limits*, <https://www.rothira.com/roth-ira-limits> (providing a quick summary for required modified adjusted gross income for different individuals), archived at <https://perma.cc/UR72-UBQM>.

married couples filing separately, the income must be less than \$10,000.00.¹⁶² In terms of deathbed tax planning, one benefit of the Roth Conversion is it provides the ability to stretch retirement income.¹⁶³ Roth IRA accounts are exempt from the required minimum distribution (RMD) rules.¹⁶⁴ The rule states that one must withdraw from all retirement accounts starting six months after the person's seventieth birthday.¹⁶⁵ With the Roth IRA, on the other hand, one is not forced to take distributions, which allows assets to grow tax-free.¹⁶⁶

Inheritance is an issue that can become problematic in IRAs.¹⁶⁷ With Roth IRAs, although the original owners are not subject to the RMD rules, inheritors have RMD rules that they must follow.¹⁶⁸ The inheritor RMD rules state:¹⁶⁹

- Generally, you must take distributions during your lifetime or within five years after the original account holder passed away.
- With an Inherited Traditional IRA, you'll pay taxes on any distributions you take.
- Rollover, SEP, and SIMPLE IRAs become Inherited Traditional IRAs.
- With an Inherited Roth IRA, you don't pay taxes on distributions.

With inherited IRAs, however, a complication can occur if the inheritor is disabled or has special needs.¹⁷⁰ If an inheritor is disabled or has special needs, inheriting an IRA can cause the loss of need-based assistance.¹⁷¹ Social Security Disability Insurance (SSDI) allows disabled individuals who qualify for Social Security to receive benefits for themselves and certain family members.¹⁷² A good way to avoid this problem, or mitigate the issues which may arise because of it, is to consider establishing a special needs

162. *Id.*

163. Doeblen, *supra* note 158.

164. *Roth IRA Required Minimum Distribution (RMD)*, ROTH IRA, <https://www.rothira.com/roth-ira-required-minimum-distribution-rmd>, archived at <https://perma.cc/8CF4-EZXJ>.

165. See Jpod, comment to *Death Bed Roth Conversion*, BENEFITSLINK, (July 2017), <https://benefitslink.com/boards/index.php?%2Ftopic%2F61042-death-bed-roth-conversion%2F>, archived at <https://perma.cc/P6XL-FPKR>.

166. *Roth IRA Required Minimum Distribution (RMD)*, ROTH IRA, <https://www.rothira.com/roth-ira-required-minimum-distribution-rmd> (last visited Mar. 14, 2018), archived at <http://perma.cc/8CF4-EZXJ>.

167. *Inherited IRA Withdrawal Rules*, CHARLES SCHWAB, https://www.schwab.com/public/schwab/investing/retirement_and_planning/understanding_iras/inherited_ira/withdrawalrules (last visited Mar. 14, 2018), archived at <https://perma.cc/GA5C-DNMH>.

168. *Id.*

169. *Id.*

170. *Id.*

171. See Ed Slott, *Taking Special Care with Inherited IRAs*, FINANCIAL PLANNING (Sept. 1, 2011), www.financial-planning.com/news/taking-special-care-with-inherited-iras, archived at <https://perma.cc/7E67-ZYAV>.

172. *Benefits for People with Disabilities*, SOCIAL SECURITY, <https://www.ssa.gov/disability> (last visited Mar. 14, 2018), archived at <https://perma.cc/2JHC-GU2T>.

trust.¹⁷³ With a special needs trust, the inheritor can receive their share of the IRA without jeopardizing his or her assistance.¹⁷⁴

IRAs also link well with estates.¹⁷⁵ When planning estates, some families, typically those belonging to older generations, want to pay taxes on their IRA balances as an extra benefit to their beneficiaries.¹⁷⁶ If one expects his or her total estate to fall below the federal estate individual exemption amount of \$5.49 million, it is then time to decide who has the lower tax rate, the eventual beneficiary or the owner of the estate.¹⁷⁷ With the owner of the estate paying taxes on the estate, the amount of taxes that the family will have to pay in the long run decreases and thus benefits the beneficiary the most.¹⁷⁸

B. IRA

An Individual Retirement Account (IRA) is another strategy used in deathbed tax planning.¹⁷⁹ A traditional individual retirement account provides deductions for contributions and allows an individual to defer taxes on investment earnings until the funds are withdrawn, typically during retirement.¹⁸⁰ The difference between a traditional IRA and a Roth IRA is that there are no deductions for contributions to a Roth IRA.¹⁸¹ However, if one follows all of the rules, one's investment earnings will be distributed tax and penalty free in retirement.¹⁸² It is typical in deathbed tax planning to use the Roth IRA.¹⁸³ An important factor when it comes to opening an IRA

173. See *Taking Special Care with Inherited IRAs*, *supra* note 171.

174. See *id.*

175. See *Smart Ways of Leaving Your IRA to Your Heirs*, MERRILL EDGE, <https://merrilledge.com/article/3-smart-ways-pass-ira-assets-your-heirs> (last visited Mar. 14, 2018, archived at <https://perma.cc/BG8N-9252>).

176. See *id.*

177. See generally Robert S. Barnett & Elizabeth Forspan, *Avoiding the Squeeze: Trusts, Estates, and the New ATRA Tax Regime*, JOURNAL OF ACCOUNTING, <https://www.journalofaccountancy.com/issues/2014/apr/trusts-estate-planning-20138750.html> (last visited Mar. 14, 2018) (taking advantage of beneficiary's tax bracket), archived at <https://perma.cc/QR4S-CJSH>.

178. See MERRILL EDGE, *supra* note 175.

179. See William Baldwin, *Deathbed Tax Dodges: Take These Steps Now to Save Later*, FORBES (Sept. 10, 2012), <https://www.forbes.com/sites/baldwin/2012/08/27/deathbed-tax-dodges-take-these-steps-now-to-save-later/#3a16d6b05321>, archived at <https://perma.cc/4K5F-BBCV>.

180. See *A Traditional IRA Lets You Postpone Taxes*, VANGUARD, <https://investor.vanguard.com/ira/traditional-ira> (last visited Feb. 22, 2018), archived at <https://perma.cc/5TTY-5YCB>.

181. *Traditional and Roth IRAs*, IRS, <https://www.irs.gov/retirement-plans/traditional-and-roth-iras> (last visited Mar. 14, 2018), archived at <https://perma.cc/56RL-3X95>.

182. See generally IRS Pub. 590-B (I.R.S.) (Jan. 4, 2016) (qualified distributions are tax free if requirements are met).

183. See Howard Vigderman, *Checklist of Tax and Non-Tax Considerations for Someone on His/Her Deathbed*, PRIVATE BUSINESS COUNCIL (Apr. 25, 2017), <https://corporateblog.mmwr.com/2017/04/25/checklist-tax-non-tax-considerations-someone-hisher-deathbed>, archived at <https://perma.cc/465A-MA8D>.

account is an individual's Modified Adjusted Gross Income (MAGI).¹⁸⁴ The MAGI is one's earned income tax with certain deductions and exclusions added back.¹⁸⁵ MAGI determines if an individual is able to collect certain tax benefits, such as IRA deductions or qualified Roth IRA contributions.¹⁸⁶ The Roth IRA Conversion tool is also useful when opening an IRA account.¹⁸⁷ This tool calculates all of one's earnings including IRA Investments, current and future tax rates, and time horizon and risk, meaning when one plans to withdraw funds.¹⁸⁸ IRAs are a sufficient tool in deathbed tax planning due to their ability to foreshadow future income, especially for taxes.¹⁸⁹

C. Estate Taxes with Roth Conversions

The Roth Conversion provides an extra benefit to those with over \$11.2 million in income.¹⁹⁰ The Roth Conversion triggers the tax rate early and reduces the size of both the estate and the taxes paid, which can amount to a rate of 40%.¹⁹¹ An IRA, in combination with an IRD, can also benefit estate taxes that amount to over \$5.45 million.¹⁹² An IRD is income payable after the death of the person entitled to it and which would have been taxable by the decedent if he or she had lived to receive it.¹⁹³ Because the income is not payable until after death, it cannot be included in the decedent's final tax return.¹⁹⁴ However, the income is taxable to the estate of the beneficiary.¹⁹⁵ IRD deductions effectively lower the amount of taxes one would have to pay.¹⁹⁶ IRDs comprise various forms of income, but the most common are unpaid compensation owed at death, retirement plan benefits, and commercial annuities.¹⁹⁷

184. See David Fisher, *How to Calculate Your Modified Adjusted Gross Income*, THE BALANCE (Aug. 31, 2017), <https://www.thebalance.com/how-to-calculate-your-modified-adjusted-gross-income-4047216>, archived at <https://perma.cc/FC9Y-FDF2>.

185. See *id.*

186. See *id.*

187. See *Roth IRA Conversion Calculator*, CHARLES SCHWAB CORP., https://www.schwab.com/public/schwab/investing/retirement_and_planning/understanding_iras/ira_calculators/roth_ira_conversion (last visited Mar. 14, 2018), archived at <https://perma.cc/CT89-QJR6>.

188. See *id.*

189. See Vigderman, *supra* note 183.

190. See Doeblér, *supra* note 158.

191. See *id.*

192. Ashlea Ebeling, *IRS Announces 2017 Estate and Gift Tax Limits: The \$11 Million Tax Break*, FORBES (Oct. 25, 2016), <https://www.forbes.com/sites/ashleaebeling/2016/10/25/irs-announces-2017-estate-and-gift-tax-limits-the-11-million-tax-break/#5a4dd37e3b70>.

193. See *Many Heirs Miss Out on a Valuable Tax Deduction*, PUTNAM INVESTMENTS, <https://www.putnam.com/literature/pdf/II786.pdf>. (last visited Feb. 22, 2018), archived at <https://perma.cc/G6J3-9L22>.

194. See IRS Pub. 559 (I.R.S.) (Jan. 31, 2018).

195. See *id.*

196. See *id.*

197. See *id.*

V. FINAL DEATHBED TAX PLANNING CONSIDERATIONS

Considering the current state of deathbed tax planning in the United States, it is crucial that elderly individuals properly account for their assets and plan for their distribution before they lose the mental capacity to do so.¹⁹⁸ Even those who have previously engaged in estate planning should confirm that all associated documents, accounts, and policies contain legally valid information designating chosen beneficiaries.¹⁹⁹ Individuals should also review their papers to be sure that their wishes regarding how their assets will be distributed have not changed.²⁰⁰ Additionally, individuals should be certain the power of attorney is set in place.²⁰¹ To avoid future court disputes, the grantor's wishes should be carefully prepared and recorded in a secure location and communicated to the beneficiaries.²⁰² In the short-term, individuals should diversify the tools they use to transfer their assets.²⁰³ Certain methods, such as charitable gifts or annual exclusion gifts, trusts, or IRAs, can provide additional tax benefits.²⁰⁴

Other important factors in deathbed tax planning include taking measures in one's best interest, such as altering one's cost basis by means of gifting or selling certain assets rather than having them distributed to heirs.²⁰⁵ Estate assets are subject to the fair market value, so individuals should hold on to anything that has depreciated in value.²⁰⁶

Although an individual may take measures to exempt oneself from certain death taxes, no one is exempt from death itself.²⁰⁷ Planning ahead, therefore, is critical.²⁰⁸ One should nevertheless be aware of the last-minute estate planning options which are available.²⁰⁹ When it comes to deathbed tax planning, it is best to explore one's options and begin acting sooner rather than later.²¹⁰

198. See Benjamin C. Sullivan, *Deathbed Financial Planning Tips*, PALISADES HUDSON FINANCIAL GROUP (Apr. 4, 2017), <http://www.palisadeshudson.com/2017/04/deathbed-financial-planning-tips/>, archived at <https://perma.cc/A5AT-C9LU>.

199. *Id.*

200. *Id.*

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.*

206. *Id.*

207. *Id.*

208. *Id.*

209. *Id.*

210. *Id.*