

Using Taxes to Settle Estate and Trust Disputes

Legal Alert
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Almost every estate has some tax issues, whether federal or state estate taxes, real or personal property taxes or income taxes. Sometimes the tax tail can wag the settlement dog and it makes sense to ask how Uncle Sam, or the state and local taxing authorities, can contribute to settlement?

Taxes can move settlement forward particularly when one or more of the following situations apply:

1. The Decedent died while married to a second, third or fourth spouse;
2. The surviving spouse and the children from the decedent's earlier marriage(s) do not get along;
3. The parties are made aware that by using the "marital deduction" , or a spousal exemption, taxes will not be levied on assets passing to the surviving spouse, or a trust for the surviving spouse; and
4. The surviving spouse may be able to use his or her exemption to pass additional assets to the children or others tax-free at death.

Educating the surviving spouse and adverse parties (including the children) on estate taxes and the marital deduction is seldom easy and capital gains, real property and income taxes only further muddy the waters. For example, some states exempt from reassessment real property interests that pass to a surviving spouse or to children, but not to a caregiver or siblings or a non-relative.

I'm familiar with one case in which the ancestral home, but for the settlement, would have gone to the decedent's sister. As a result, the annual property taxes would have increased by thousands of dollars. The children were to receive a recently purchased warehouse that already was assessed high property

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taxes. By swapping inheritances with their aunt, the children got a property they were just as interested in, and the difference in value was more than made up for by property tax savings.

In another case, a surviving spouse, who had asserted numerous causes of action, found that a settlement which recognized her community property interests in the vacation home afforded her a step-up in basis to the date of death value and gave her the flexibility to sell the property without a significant capital gains hit.

Best Practices:

1. Employ tax professionals (accountants, attorneys, etc.) and use them during settlement discussions;
2. Educate clients about the applicable taxes and options for reducing the same through creative settlement; and
3. Consider not only the obvious (estate) taxes but assessments, exemptions, etc. at the state and local level.