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House advances two HSA measures; What's the impact on estate planning?

The House Committee on Ways and Means has advanced two bills that would expand Health Savings Accounts (HSAs) and help make out-of-pocket healthcare expenses more affordable.

HSAs allow individuals to pay for eligible medical expenses with funds put aside on a pre-tax basis. The Bipartisan HSA Improvement Act and the HSA Modernization Act would both expand eligibility for those wishing to use these tax advantaged accounts.

The Bipartisan HSA Improvement Act focuses on making HSAs more accessible. The measure:

- Allows individuals who utilize health services such as direct primary care arrangements and worksite health clinics to use their own resources to contribute to HSAs.
- Eliminates a prohibition against an individual establishing an HSA if their spouse has an existing flexible spending account (FSA) – a similar savings vehicle for health expenses.
- Allows individuals to convert certain amounts of their FSA or health reimbursement arrangement (HRA) dollars into an HSA.

The HSA Modernization Act would also expand access. Most significantly, however, it would increase contribution limits to better align with what an individual might owe in total out-of-pocket expenses and deductibles.

The new contribution limit, proposed for 2025, would be equal to the annual deductible and out-of-pocket limitation permitted for high-deductible health plans. (For example, had this legislation been law in 2023, the HSA annual contribution limit would have been $7,500 for self-only coverage and

$15,000 for family coverage, instead of $3,850 and $7,750, respectively.)

The plan would expand HSA eligibility to the following:

- Veterans receiving care through the Veterans Administration
- Working seniors enrolled in Medicare Part A
- Persons enrolled in Catastrophic and Bronze plans on the healthcare exchange
- Native Americans

The bill would also:

- Allow the use of an individual's HSA funds to cover health care services that occurred up to 60 days prior to the establishment of an HSA.
- Allow spouses to contribute "catch-up" funds into the same health sav-

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IRS ruling on irrevocable grantor trusts: What you need to know

The IRS has issued Revenue Ruling 2023-2, which clarifies the tax treatment of assets held in an irrevocable grantor trust (IGT). Under the ruling, assets held in an IGT are not eligible for step-up in basis treatment upon the grantor's death.

That means that the beneficiaries of the trust will have to pay capital gains tax on the appreciation of the assets that occurred during the grantor's lifetime, even if they did not receive the assets until after the grantor's death.

Notably, some advisors were already working under this assumption and will have advised clients that assets in the trust would not receive the step-up. However, it's worth revisiting your plan to ensure that your current arrangements are still the most tax-efficient way to transfer assets to your heirs. The ruling could result in higher taxes for many beneficiaries.

It's also worth noting that Revenue Rulings are not binding in federal court, including the Tax Court. Taxpayers may challenge the IRS ruling, so the issue may not be final. In the meantime, however, it is probably safest to plan your estate as if the ruling will be upheld.

Next steps

This ruling impacts a variety of irrevocable grantor trusts, including asset protection trusts, charitable trusts, life insurance trusts, qualified personal residence trusts, and others.

If you have a settled irrevocable trust that now holds highly appreciated assets, consider substituting high-basis assets (such as cash), so the low-basis assets are owned by you personally, and therefore eligible for step-up upon your death. That may be possible through a "power of substitution" provision or a purchase from the trust.

Alternately, in select cases you could grant a third party (such as an elderly parent) testamentary general power of appointment over the IGT. That would give the "power holder" control over the trust to cause those assets to be included in the power holder's estate for estate tax purposes.

Talk to your estate planning attorney about the risks. And be aware that, as a tax minimization strategy, this only works if the power holder's estate isn't likely to exceed the estate tax exemption.

The estate planning landscape is ever evolving, so it is important to regularly review your estate plan to ensure that it is still meeting your needs and goals. If you have an IGT, consult with an attorney to determine how the IRS's ruling will impact you.

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IRS and DOJ crack down on abusive trust arrangements

The Internal Revenue Service is cautioning the public about tax schemes that create "sham" or "abusive" trusts to evade federal taxes. The IRS has detected a recent surge in these schemes.

These trusts, which may be marketed by national promoters, promise taxpayers significant tax reduction and asset protection. In reality, these promotions are complex tax evasion schemes that can be costly for taxpayers, both in terms of financial penalties and potential criminal prosecution.

Specifically, in August, the IRS Chief Counsel issued a memorandum on a trust arrangement known as a "section 643(b) trust." In it, the Chief Counsel urged IRS examiners to aggressively challenge these arrangements.

Giving the warnings, taxpayers should make sure their trusts comply with federal income tax laws.

Two promoters charged

In September, the DOJ indicted two individuals for conspiracy to defraud the United States and aiding and assisting in the preparation of false income tax returns in a nationwide scheme.

According to the indictment, Timothy McPhee of Colorado and Larry Conner of Texas, along with others, promoted and sold an abusive-trust tax shelter to clients nationwide for fees ranging from approximately $25,000 to $50,000.

The indictment alleges that McPhee and Conner instructed clients to assign their income to a series of sham trusts to make it appear as if that income was no longer owned or controlled by the client. However, this paper trail was allegedly false as the clients continued to benefit from and control the income assigned to the sham trusts.

Analysts say that copycat trust promoters are still active in the market.

Beware of abusive promoters

The IRS is aware that promoters are selling abusive trust schemes. In some cases, the individual may not fully understand the illegal or fraudulent nature of the trust arrangement and may be deceived into believing it is a legitimate financial or tax strategy.

However, ignorance of the law is generally not considered a valid defense, and individuals who unknowingly participate in abusive trust schemes may still face legal consequences.

It is important to know that once the IRS has identified a promoter selling abusive trust schemes, the IRS can often obtain a list of the promoter's clients. From there, an IRS auditor can begin examining each tax return to look for fraud.

What if you have a questionable trust?

Taxpayers who have 643(b) trusts, and those who are questioning the legitimacy of other trust arrangements, should consult with a qualified estate planning attorney to determine whether the trust complies with federal tax law.

If not, taxpayers should explore IRS amnesty options. Be aware that amnesty options are generally not available after a fraudulent scheme has been discovered.

Court finds check written before decedent passed is part of estate

A federal appeals court has ruled that the value of checks written before a decedent's death but paid after are includable in the decedent's estate for tax purposes.

The decision in Estate of DeMuth v. Commissioner offers a valuable tax reminder for both deathbed and year-end gifts: A gift is not complete until it can't be revoked.

Checks not deposited

In 2007, William E. DeMuth Jr. of Pennsylvania granted power of attorney to his son Donald DeMuth. In that capacity, Donald made annual monetary gifts to family members from 2007 to 2014.

In early September 2015, William was diagnosed with an end-stage medical condition. On September 6, Donald wrote 11 checks to family members totaling $464,000 from his father's investment account. Some of those checks were mailed and others were hand delivered. The decedent died five days later, on Sept. 11.

Of the 11 checks, only one was deposited and paid prior to William's death. Three checks were deposited on the date of death and paid on Sept. 14. The remaining seven checks were deposited and paid post-death.

On the decedent's tax return, Donald, as executor, excluded the value of all 11 checks that were written on Sept. 6. The IRS subsequently issued a notice that the account was undervalued (by the amount of the 10 checks paid after death) and issued a $179,130 deficiency.

The estate petitioned the Tax Court for reconsideration and the IRS agreed to exclude the three checks deposited on the date of death from the total, reducing the deficiency to $131,774. The court held that the remaining seven checks were part of the estate because they were not completed gifts before the decedent's death.

The estate argued that the gifts were made in contemplation of death, under a Pennsylvania statute that allows deathbed gifts to be excluded from the estate. In the federal appeals court's opinion, however, the evidence did

not support that finding as the decedent himself had not provided such a directive to his son.

Takeaways for planning

A gift is not complete for tax purposes until the gift is no longer revocable. If you write someone a check, you can cancel that check until it clears the bank. In the above case, if the gift been made by bank check (cashier's check) or wire, it would have represented an immediate withdrawal from the decedent's account and reduced the value of his estate.

If you are considering making a deathbed gift, it is important to consult with an estate planning attorney to discuss your options and to ensure that the gift is made in a way that complies with the law and has the intended impact on your estate.

There's also a lesson here for families that make year-end gifts at or near the annual exclusion gift amount. If you are writing a check, make sure your beneficiaries deposit it in time to complete the transaction before year-end. Otherwise, the IRS may consider your gift to have been made in the following year. If you intend to make the same gift the next year, that could result in doubling your gift, requiring a gift tax return and reducing your lifetime exemption.

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ings account rather than having to establish separate accounts for such contributions.

Both bills have the support of select business groups and consumer advocates. However, they are still in the early stages of the legislative process, and it is unclear if or when they will be passed into law.

Benefits of HSAs as an investment planning vehicle

HSAs offer several benefits as an investment planning vehicle. Contributions are tax-deductible, funds grow tax-free, and withdrawals for qualified medical expenses are also tax-free. Additionally, HSAs can serve as a retirement savings tool, allowing for penalty-free non-medical withdrawals after age 65.

The combination of tax advantages and investment potential makes HSAs a powerful tool for long-term planning. Talk to an estate planning attorney about your specific situation.

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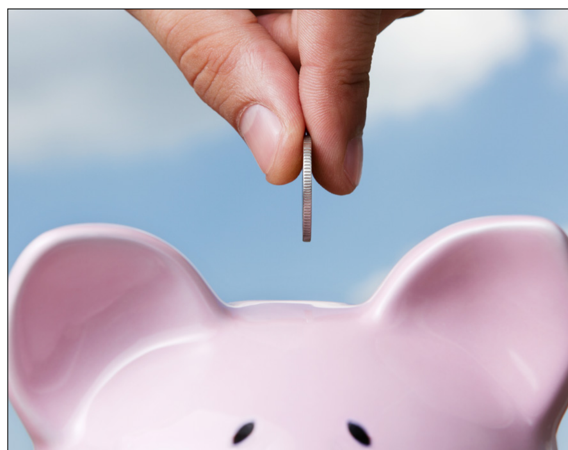
IRS extends deadline for Roth contributions by two years

The IRS has extended the deadline for Roth catch-up contributions by two years, to 2026. That means that employers have two more years to deal with a new provision of the Secure 2.0 Act, an update to retirement savings law that passed last year.

Employers have the option to allow employees age 50 and older to make catch-up contributions to their retirement plans. In 2023, older workers can save an extra $7,500 — on top of the standard contribution limit of $22,500 — to boost their accounts before retirement.

Currently, participants can choose to make those catch-ups on a pre-tax or a Roth (post-tax) basis. But beginning in 2024, Secure 2.0 would have required that employees making more than $145,000 per year make those contributions to a Roth account only.

The IRS extended the deadline in response to concerns from taxpayers and retirement plan sponsors.



The risk was that some employers would consider eliminating catch-up contributions altogether rather than deal with the administrative burden. Now employers and plan sponsors have two more years to administer the change.