**Philadelphia Estate Planning Council**

**Current Developments – October 2019**

October 2019 Rates:

* Section 7520 Rate: 1.8%
* Short Term AFR (0-3 years): 1.69%
* Mid Term AFR (3-9 years): 1.51%
* Long Term AFR (over 9 years): 1.86%

Thomson Reuters Checkpoint released their projected inflation-adjusted exclusion amounts for 2020. The unified estate and gift tax exclusion amount will increase to $11,580,000 (up from $11,400,000 in 2019), the generation skipping transfer tax exemption will also increase to $11,580,000 from $11,400,000 in 2019, the annual exclusion amount for gifts made in 2020 will remain at the current amount of $15,000, and the annual exclusion for gifts made to noncitizen spouses will increase to $157,000 (up from $155,000 in 2019).

On September 24, 2019, the IRS issued Revenue Procedure 2019-38. The procedure was issued to expand the safe harbor for treating interest in rental real estate, including interest in mixed use property, as a trade or business for purposes of the qualified business income deduction under IRC § 199A. If all of the safe harbor requirements are met, an interest in real estate will be treated as a single trade or business for purposes of the § 199A deduction. To qualify for this safe harbor, separate books and records are maintained to reflect income and expenses for each rental real estate enterprise, 250 or more hours of rental services are performed each year for rental real estate enterprises that have been in existence for less than four years or, for other rental real estate enterprises, 250 or more hours of rental services are performed in at least three of the past five years, the taxpayer maintains contemporaneous records, including time reports, logs, or similar documents, regarding hours of all services performed, description of all services performed, dates on which services were performed and who performed the services, and the taxpayer or relevant passthrough entity attaches a statement to the return filed for the tax years the safe harbor is relied upon.

The IRS issued final regulations that amend the rules for hardship distributions from a 401(k) plan. In general, a retirement plan can make hardship distributions only if the plan permits such distributions, because of an immediate and heavy need of the employee and in an amount necessary to meet the financial need. The final regulations modify the safe harbor list of expenses in Reg. § 1.401(k)-1(d)(3)(iii)(B) and distributions for such safe harbor expenses are deemed to be made for an immediate and heavy financial need. In addition, the final regulations eliminate the rules in existing Reg. § 1.401(k)-1(d)(3)(iv)(B) (under which the determination of whether a distribution is necessary to satisfy a financial need is based on all relevant facts and circumstances) and provide one general standard for determining whether a distribution is necessary. Under this general standard, a hardship distribution may not exceed the amount of an employee’s financial needs (including taxes and penalties reasonably anticipated to result from the distribution), the employee must have taken other available, non-hardship distributions under the employer’s plans, and the employee must provide a representation that he or she has insufficient cash or other liquid assets to satisfy the financial need.

In Private Letter Ruling 201936009, the taxpayer’s husband was a participant in a 457(b) plan. Prior to his death, he named his estate as the sole beneficiary in the plan. The taxpayer is the executrix and sole beneficiary of the residual estate. The taxpayer sought to roll over her husband’s account in the plan to an IRA in the taxpayer’s name. However, the recordkeeper for the plan disallowed the transfer because the estate, not the taxpayer, was the named beneficiary. The IRS determined that under these circumstances, the husband’s account may be treated as paid from the plan to the taxpayer for purposes of IRC § 402(c). As a result, the taxpayer may roll over the distribution from her husband’s plan to her IRA and exclude the roll over amount from her gross income.

In Private Letter Ruling 201938002, the personal representative of an estate retained a law firm to prepare the federal estate tax return. The personal representative timely filed the estate tax return, but the law firm did not advise the personal representative to elect alternate valuation under IRC § 2032 on the return. In preparation of the accounting for the decedent’s estate, the law firm determined that the election for alternate valuation should have been filed. Within one year after the due date of the estate tax return, the personal representative filed a supplemental estate tax return making the alternate valuation election. Subsequently, the personal representative submitted a request for an extension of time to make the election. Under §§ 301.9100-1 and 301.9100-3 of the Procedure and Administrative Regulations, an extension of time may be granted if it is determined that the taxpayer acted reasonably and in good faith and granting relief will not prejudice the interests of the government. In addition, § 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advised the taxpayer to make, the election. The IRS concluded that the standards of §§ 301.9100-1 and 301.9100-3 were satisfied and grated the personal representative an extension.

In Private Letter Rulings 201938004-6, petitions were filed to modify administrative and dispositive provisions and seek judicial construction for three trusts that were exempt from generation skipping transfer tax. In concluding that the modifications did not cause the trusts to lose their generation skipping transfer exempt status, the IRS cited Treas. Reg. § 26.2601-1(b)(4)(i)(C), which provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of a trust instrument or correct a scrivener’s error will not cause an exempt trust to be subject to generation skipping transfer tax if the judicial action involves a bona fide issue and the construction is consistent with applicable state law that would be applied by the highest court of the state. In addition, the IRS referenced Treas. Reg. § 26.2601-1(b)(4)(i)(D)(2), which states in part that a modification that is administrative in nature that only indirectly increases the amount transferred will not be considered to shift a beneficial interest in a trust to a lower generation beneficiary.

In T.C. Memo 2019-124, the taxpayer’s ex-wife transferred money from her retirement account to an IRA in the taxpayer’s name pursuant to a divorce property order. The taxpayer withdrew the funds within seven days of the transfer and closed the account. The taxpayer withdrew the funds prior to attaining age 59 ½. The taxpayer did not report the withdrawal despite receiving a Form 1099-R. The IRS notice of deficiency accounted for the withdrawal as well as the 10% penalty for early withdrawal. The taxpayer argued that the Tax Court should disregard his IRA and the intermediate steps of the transfer of funds from his wife’s retirement account to his IRA and his withdrawal and treat the transaction in substance as a cash payment by his spouse to him pursuant to the property order. The Tax Court determined that it would not use common law doctrines to create an equitable exception to the statutory scheme of IRC § 72. The court noted the transaction ultimately led to a withdrawal from the taxpayer’s IRA, which is included in income.

In *Stauffer v. IRS*, No. 18-2105 (1st Cir. Sept. 16, 2019), a taxpayer executed a durable power of attorney in October 2005, naming his son as his agent. Among the agent’s powers were the authority to prepare, execute and file the taxpayer’s income tax returns and represent the taxpayer before the Internal Revenue Service with respect to any claim or proceeding pertaining to the taxpayer’s tax liabilities. In March 2006, the taxpayer and his son had a falling out. Communication ceased between the two of them, and the son told his sister, the taxpayer’s accountant and attorney that he was no longer acting as agent. Taxpayer and his son reconciled approximately four years later. The taxpayer passed away in October 2012. As personal representative of the taxpayer’s estate, the son filed the taxpayer’s income tax returns for the years 2006 through 2012. The 2006 return reported an overpayment, of which the estate claimed a refund. The IRS denied the refund claim as untimely pursuant to IRC § 6511. The estate filed suit in federal district court, alleging the refund claim was timely because the taxpayer’s financial disability tolled the three-year statutory period to file the claim under § 6511(h)(1). The district court dismissed the complaint, finding that the taxpayer had capacity to execute the power of attorney, as of 2005, the son as agent was authorized under the power of attorney to act on the taxpayer’s behalf in financial matters for purposes of § 6511(h)(2)(B), and the power of attorney was neither revoked by the taxpayer or renounced by his son. As a result, the court held that the statutory period for filing a refund claim was not tolled. On appeal, the First Circuit held that a person may be considered authorized to act on behalf of a taxpayer who is financially disabled in financial matters for purposes of § 6511(h)(2)(B) even if he has no affirmative action to act on behalf of the taxpayer. Additionally, the court held that, for purposes of § 6511(h)(2)(B), a person authorized to act on behalf of a financially disabled taxpayer in financial matters is not required to have actual or constructive knowledge of the need to file tax returns for a specific year. Finally, the First Circuit found that the son did not provide enough evidence to prove that he renounced the power of attorney. The information provided did not demonstrate that the renunciation was made known to the taxpayer.

In *U.S. v. Estate of Elson*, 2019 U.S. Dist. LEXIS 175284 (D. NJ Oct. 9, 2019), the donor made gifts of real estate in 2004. The donor, who died in 2006, did not file gift tax returns. The executrix of the donor’s estate filed a gift tax return in 2009, and the estate made certain payments of its gift tax liability. However, a large balance of gift tax remained unpaid. The donees claimed that the government’s claims are subject to § 6324(b)’s 10-year limitation period for gift tax liens and are now time barred. The government argued that even if the 10-year lien has expired, the gift tax assessment against the estate is enforceable against the donees under the personal liability provision of § 6324(b). The court determined that since the government assessed additional gift tax liability against the donor’s estate in 2011, bringing an action to collect against the assessment in 2018 was within the 10 year limitations period. The court also stated that the individual assessments of the donees under § 6901 was not a prerequisite to the government’s § 6324(b) claim.