Philadelphia Estate Planning Council
Tax Updates – January 2017
Prepared by Barbara E. Little, Obermayer Rebmann Maxwell & Hippel LLP

Rev Rul 2017-02, 2017-3 IRB January 2017 Rates:

- Section 7520 Rate: 2.4%
- Annual Short Term AFR (0-3 years): 0.96%
- Annual Mid Term AFR (3-9 years): 1.97%
- Annual Long Term AFR (over 9 years): 2.75%

IRS Regulatory Agenda IRS Notice, 81 Fed. Reg. 81242, 81243, 11/17/2016

The IRS is currently soliciting comments concerning three items of interest related to estate administration:

1. Form 8855. Form 8855 is used to make the Code Section 645 election that allows a qualified revocable trust to be treated and taxed (for income tax purposes) as part of the related estate during the election period.

2. TD 7941. This regulation relates to the Code Section 6324A election. The purpose of the proposed regulation is to clarify the procedure for making an election to place a lien on Code Section 6166 property (closely held business) as an alternative to a bond or the personal liability of the personal representative.

3. Form 4952. Form 4952 is used to figure the deduction carry forward amounts of investment interest expense (interest paid on loans allocable to investment property).

Proposed Code Selection 2704 Regulations Work to Minimize Valuation Discounts

The Proposed Code Section 2704 remains controversial. These proposed regulations concern the treatment of certain lapsing rights and liquidation in determining the value of transferred equity interests in relation to the valuation of interests in corporations and partnerships for estate, gift, and generation-skipping transfer (GST) tax purposes. The IRS is focused on trying to prevent the undervaluation of such transferred interests. Under the proposed regulation, the use of discounts for lack of control and lack of marketability is significantly limited, if not eliminated. Opponents of the proposed regulations state these are a camouflaged means of imposing a significant tax increase without direct congressional authorization.

Earliest Inheritance Property Basis Reporting Deadline was June 30, 2016

The final regulations for consistent basis reporting have been issued. The earliest due date for providing statements to the IRS and to beneficiaries was June 30, 2016. In accordance with such regulations, if an executor or administrator of a decedent's estate must file an estate tax return, then such fiduciary must file consistent basis statements in accordance with Code Sections 6018(a) and 6035. Specifically, Code Section 6035(a)(3)(A) provides that each statement required to be furnished under Code Section 6035(a)(1) or Code Section 6035(a)(2) must be furnished at such time as the IRS may prescribe, but in no case at a time later than the earlier of: (i) the date which is 30 days after the date on which the return under Code Section 6018 was required to be filed (including extensions, if any); or (ii) the date which is 30 days after the date such return is filed. The basis of any reportable property to which Code Section 1014(a) applies can't exceed:

(A) in the case of property, the final value of which has been determined for purposes of the estate tax on the estate of the decedent, such value.

(B) in the case of property not described in (A), above, and with respect to which a statement has been furnished under new Code Section 6035(a) (see below) identifying the value of such property, such value.

No Deduction for Trust's Charitable Contributions Made Under State Court's Modifications

In Chief Counsel Advice 201651013, the IRS concluded that a trust was not entitled to a Code Section 642(c)(1) charitable deduction for income tax purposes where the contributions to the charitable organizations were possible only because of modifications to the trust pursuant to a state court order. Further, the Code Section 661 distribution deduction was disallowed to the extent of the trust's distributable net income for the payments to the charities.

The Trust was created for the benefit of Child 1 and Child 2 during their respective lifetimes and then for the benefit of their respective descendants, subject to testamentary powers of appointment granted to Child 1 and Child 2 to appoint the income among Grantor's descendants, the spouses of those descendants, and charities. Child 1 died in Year 1, having exercised his power of appointment over half of the income of Parent Trust in favor of his descendants.

The trustees and beneficiaries of the Trust entered into a settlement agreement dividing Parent Trust into two trusts, Trust A and Trust B, for the respective benefit of Child 1's descendants and Child 2. The trustees of Trust B subsequently filed an additional petition with the state court requesting certain modifications including that Child 2 be allowed to immediately exercise an inter vivos power to appoint the trust's income and principal to private foundations, Foundation 1 and Foundation 2, and so cause Trust B to terminate. The state court approved the modification and termination, and the distribution of the trust assets to Foundations 1 and 2 was completed by the end of Year 2.

On its amended Form 1041, U.S. Income Tax Return for Estates and Trusts, Trust B claimed a charitable contribution deduction for the payments to Foundations 1 and 2. On an attachment to the amended return, Trust B claimed that the deduction was allowable under Code Section 646(c)(1) or Code Section 646(c)(2), or, alternatively, under Code Section 661.

In the CCA, the IRS concluded that any payments to Foundations 1 and 2 after the modification of Trust B would not be considered to be made pursuant to the governing instrument, and so Trust B was not entitled to a deduction for such payments under Code Section 642(c)(1). In addition, IRS determined that Trust B was not entitled to a deduction under Code Section 661 for the payments to Foundations 1 and 2 because Code Section 642(c)(1) was the exclusive income tax provision for deductibility of payments by a trust or estate to a charitable beneficiary.

Code Section 2010

The IRS granted several 120-day extensions for the respective personal representative to make Code Section 2010(c)(5) portability election to take into account DSUE amount where taxpayer acted reasonably and in good faith and granting relief wouldn't prejudice govt.'s interests. See PLR 201650004; 201650009; 201651006; 201651007; 201652007; 201652008; 201652009; 201652010; 201652016.