Philadelphia Estate Planning Council
Current Developments – March 2018
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GUIDANCE FROM THE IRS

Revenue Ruling 2018-06, IRB Bulletin 2018-9 (March 5, 2018), March 2018 Rates:

- Section 7520 Rate: 3.0%
- Short Term AFR (0-3 years): 1.96%
- Mid Term AFR (3-9 years): 2.57%
- Long Term AFR (over 9 years): 2.88%

Rev. Proc 2018-18, IRB Bulletin 2018-10: Revised Inflation-Adjusted 2018 Figures for Estate and Trust Tax Brackets and Other Transfer Tax Items

The IRS recently released revised inflation-adjusted amounts for 2018 relating to the break points in the estate and trust income tax brackets.

Under the Tax Cuts and Jobs Act, for tax years beginning after December 31, 2017, dollar amounts that had been indexed using the Consumer Price Index for All Urban Consumers (CPI-U), including but not limited to the tax rate schedules for estates and trusts, unified credit against estate tax, reporting gifts and AMT exemption for a child subject to the kiddie tax, are now going to be indexed using the Chained Consumer Price Index for All Urban Consumers. The IRS has recalculated its previously released 2018 figures to take account of the new chained CPI indexing and to reflect other changes made by the Act.

For the unified credit against estate tax, the basic exclusion amount is $11,180,000 for 2018 decedents.

The estate and trust income tax brackets are as follows:

If taxable income is:	The tax is:
Not over $2,550	10% of taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	3,011.50 plus 37% of the excess over $12,500

In the case of foreign gifts from a nonresident alien individual or foreign estate for tax years beginning in 2018, the taxpayer is required only if the aggregate amount of gifts from that person exceeds $100,000 during the tax year. For gifts from foreign corporations and foreign partnerships for tax years beginning in 2018, the reporting threshold amount will be $16,076 (up from $15,797 for 2017).

The AMT exemption for 2018 for a child subject to the kiddie tax may not be higher than $7,600 (up from $7,500 for 2017) plus the child's earned income.

RECENT CASE

Green v. United States, No. 16-6371 (10th Cir. 2018): The Tenth Circuit, in a decision that reverses the lower court, held that Code Sec. 642(c)(1), the general rule of which is to allow trusts to take a deduction "without limitation" for any amount of gross income paid for a charitable purpose, does not allow a trust to take a charitable deduction for the excess of fair market value over adjusted basis of property contributed to a charity, in the situation in which such property was purchased by the trust with gross trust income.

The Trust in Green owned a single-member LLC, which was disregarded as an entity separate from the Trust for federal income tax purposes. In 2014, the LLC donated properties it had purchased to certain charities. In each case, the FMV of the donated property exceeded the property's adjusted basis. The funds for the three purchases came from a distribution to the Trust from an LP of which the Trust was a limited partner.

The trustee argued that the Trust should be able to take a charitable deduction under Code Sec. 642(c)(1) for donated real property purchased out of gross income and that the amount should be calculated based on the property's FMV. The trustee additionally argued that the FMV standard should apply to the charitable deduction because Congress did not specify a different valuation standard in Code Sec. 642(c)(1). The IRS, on the other hand, argued that: (1) Code Sec. 642(c)(1) limits a trust's deduction to the amount of gross income it contributed to charity; (2) gross income does not include unrealized appreciation; and (3) a liberal construction of the statute allowing fair market valuation would negate the requirement that the donation be traceable to gross income.

The Circuit Court held that the Trust could not take a deduction in excess of the adjusted basis of the donated properties. First, the court noted that the question of what amount of deduction is allowed under Code Sec. 642(c)(1) is unclear. It laid out several interpretations and noted that "considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer." Further, the court noted that "for a construction to be permissible...we look only to whether the implementing agency's construction is reasonable."

Ultimately, the court held that the regulatory construction of IRS of Code Sec. 642(c)(1) was reasonable and, therefore, permissible. The IRS construed the phrase "any amount of the gross income" to mean that charitable donations must be made out of a trust's gross income.

Under Code Sec. 61(a), "gross income" is defined to mean "all income from whatever source derived" and specifically includes "gains derived from dealings in property." The Code doesn't define "dealing," and does not specifically provide that gains and losses are disregarded until an act constituting "dealing" in property takes place. However, the court said that Reg. § 1.61-6(a) reasonably "albeit implicitly" construes "dealing" to mean that gains occur only upon "the sale or exchange" of property.

As the Trust never sold or exchanged the properties, the court said there the trust never realized the gains and therefore was never subject to being taxed on those gains. Allowing Code Sec. 642(c)(1)'s deduction to apply to unrealized gains would be inconsistent with the general treatment of gross income. Unless Congress clearly provides that the Code Sec. 642(c)(1) deduction should apply to unrealized gains associated with real property originally purchased with gross income, the court said that it could not apply the deduction in such a way.