**Philadelphia Estate Planning Council**

**Current Developments – February 2020**

February 2020 Rates:

* Section 7520 Rate: 2.2%
* Short Term AFR (0-3 years): 1.59%
* Mid Term AFR (3-9 years): 1.75%
* Long Term AFR (over 9 years): 2.15%

On January 17, 2020, the Estate Tax Reduction Act was introduced in the House by Rep. Joey C. Arrington (R-Tex.). The bill would cut the estate, gift and GST tax rates to a flat 20%. If enacted, the bill would apply to estates of those dying and gifts and generation skipping transfers made after December 31, 2019.

Notice 2020-6 provides guidance to financial institutions on reporting required minimum distributions (RMDs) for 2020 after the amendment of Internal Revenue Code § 401(a)(9) by the Setting Every Community Up for Retirement Enforcement Act (SECURE Act). If an IRA owner has an RMD due for 2020, the IRA trustee, custodian or issuer maintaining the IRA must file Form 5498 by June 1, 2020. In addition, for an IRA owner with an RMD due in 2020, the financial institution must furnish a statement to the IRA owner by January 31, 2020 that informs the owner of the date by which the RMD must be distributed and either provides the amount of the RMD or offers to calculate the amount upon request. This statement should not be sent to IRA owners who will attain age 70 ½ in 2020. However, in recognition of the short amount of time after the SECURE Act was enacted that financial institutions have had to change their systems, if a financial institution provides an RMD statement to an IRA owner who will attain age 70 ½ in 2020, the Internal Revenue Service will not consider such statement to have been provided incorrectly, but only if the institution notifies the IRA owner by April 15, 2020 that no RMD is required for 2020. Finally, since the SECURE Act did not change the required beginning date for IRA owners who attained age 70 ½ prior to January 1, 2020, the IRS encouraged all financial institutions to remind IRA owners who attained age 70 ½ in 2019 and have not yet taken their 2019 RMDs that they are required to do so by April 1, 2020.

In Rev. Proc. 2020-3, the Internal Revenue Service updated its list of issues that the IRS’s Associate Chief Counsels will not issue letter rulings or determination letters. Among the additions to the list are (a) whether any portion of income, deduction and credit against the tax of a trust will be included in computing the taxable income, deductions and credits of grantors under Internal Revenue Code § 671 when distributions of income or principal are made either (1) at the direction of a committee, with or without the grantor’s participation, and a (A) majority or unanimous agreement of the committee members is not required, (B) the committee has fewer than two persons other than the grantor and the grantor’s spouse, or (C) all of the committee members are not beneficiaries or (2) at the direction of, or with the consent of, adverse parties, whether named or not named in the trust document, and (b) whether a trust that is not exempt from tax under Internal Revenue Code § 501(a) is described in Internal Revenue Code § 4947(a)(2) where the parties to the trust represent that they have not taken nor plan to take any charitable income tax deduction.

In Chief Counsel Advice 202002011 (Jan. 10, 2020), the Internal Revenue Service concluded that a constructive denial clause in a conservation easement deed, under which the easement holder is considered to have denied a request for a proposed use if the holder does not respond within a specified number of days, is not inconsistent with the perpetuity requirements of Internal Revenue Code § 170(h).

In *Merrell v. Commissioner*, TC Summary Opinion 2020-5 (Jan. 16, 2020), an IRA owner under age 59 ½ and not disabled received a distribution from his IRA. The owner did not pay an additional tax of 10% pursuant to Internal Revenue Code § 72(t)(1) because his wife, with whom he filed a joint income tax return, was disabled. The Internal Revenue Service issued a notice of deficiency noting that the distribution should be subject to the 10% additional tax. The Tax Court noted that the exception to the additional 10% tax under Internal Revenue Code § 72(t)(2)(A)(iii) applies when an employee is disabled, and that the term “employee” under Internal Revenue Code § 72(t)(5) is defined as “the individual for whose benefit such plan was established.” Since the owner was not disabled, the Tax Court held that the exception to the 10% additional tax under Internal Revenue Code § 72(t)(2)(A)(iii) did not apply.

In *U.S. v. Kohls*, 125 AFTR 2d 2020-322 (DC OH, Jan. 2, 2020), the Form 706 for an estate was filed in December 2002. In January 2003, the Internal Revenue Service opened an audit of the tax return. In November 2004, the estate, through the executor, transferred estate property to the executor in his individual capacity and received no money for the transfer. The IRS completed its audit and, on or about May 27, 2005, the executor signed a Form 890 assessment waiver to consent to the immediate assessment and collection of a tax deficiency of about $200,000. On the same date, the executor signed an application for extension (Form 4768), and the IRS granted a one-year extension for payment. On July 4, 2005, the IRS made an assessment against the estate of the tax deficiency pursuant to Internal Revenue Code § 6203. Later in 2005, the estate, through the executor, transferred two additional properties for no consideration. The IRS granted the estate two more extensions to pay the estate tax. As a result, the payment was due on May 27, 2008. The executor did not pay the estate tax. On July 2, 2018, the IRS filed a complaint to collect the estate tax. In its complaint, the IRS asserted liability against the executor individually and in his capacity as executor. The executor asserted that the IRS’s claim was time-barred under Internal Revenue Code § 6502. Both parties agreed that the time limit for filing the complaint was 13 years after the assessment, which is the sum of 10 year claim period under Internal Revenue Code § 6502(a)(1) plus three years due to the extensions (Internal Revenue Code § 6161(b)(2)). The executor claimed that the period began on May 27, 2005, the date the executor signed the assessment waiver. The IRS contended that the assessment waiver was not an assessment, and that an assessment is made when the liability is recorded by the IRS. Therefore, the IRS claimed that the period began on July 4, 2005. The District Court held that an assessment begins when the IRS assesses the tax liability and not when a waiver of assessment is filed. As a result, the IRS’s complaint was not time-barred. The District Court found that the executor was legally required to pay the estate tax for which he received notice of the tax liability and demand for payment. The Court also found that the executor was personally liable as a fiduciary under 31 U.S.C. § 3173. The executor transferred estate assets to himself and family members, rendering the estate insolvent, while knowing that the estate tax return was undergoing an audit and he advised the probate court that no distributions could be made.

In *Gillette v. Commissioner*, 125 AFTR 2d 2020-518 (7th Cir., Jan. 15, 2020), a taxpayer was a compulsive gambler, which the taxpayers claimed was linked to prescription medication. To fuel her gambling, taxpayer made a withdrawal from her IRA prior to her attaining age 59 ½. The taxpayers argued that they qualified for an exception to the 10% penalty for an early IRA withdrawal because the taxpayer’s compulsive gambling qualified as a disability under Internal Revenue Code § 72(m)(7). The Tax Court concluded that the taxpayer was not disabled because her impairment could be remedied. The Circuit Court cited 26 C.F.R. § 1.72-17A(f)(4), which states that a person is not deemed disabled if, “with reasonable effort and safety to himself, the impairment can be diminished to the extent that the individual will not be prevented by the impairment from engaging in his customary or any comparable substantial gainful activity.” The Court noted that the taxpayer continued to operate a rental property business during the year in which the IRA withdrawal occurred, and received treatment for her gambling addiction in a reasonable and safe manner without interrupting her business. The Court affirmed the Tax Court’s finding that the 10% penalty applied.

In *Heiting v. United States*, 125 AFTR 2d 2020-645 (DC WI, Jan. 23, 2020), married taxpayers created a revocable trust in 2004. The terms of the trust granted broad investment powers to the trustee but prohibited the sale of stock of two companies. In October 2015, the trustee sold the stock of the two companies, which resulted in a capital gain of approximately $5.6 million. Since the trust was treated as a grantor trust under federal tax law, the taxpayers reported the gain on their 2015 tax return. In January 2016, the trustee realized the sale of the stock was prohibited by the trust agreement and subsequently repurchased the stock with trust assets. On their 2016 return, the taxpayers claimed a deduction for the taxes paid on the 2015 gain under the claim of right doctrine, which is codified in Internal Revenue Code § 1341. The taxpayers claimed that since the trustee did not have the right to sell the stock, it had a legal obligation to use the sale proceeds to repurchase the stock. Additionally, the taxpayers argued that the trustee’s legal obligation should be imputed to them since they are treated as owners of the trust assets for income tax purposes. The District Court found that neither the trustee nor the taxpayers were legally obligated to repurchase the stocks. The Court also noted that the taxpayers had the right to amend or revoke the trust at any time, and that a beneficiary can consent to a trustee’s action. The District Court concluded that the claim of right doctrine did not apply.

In *U.S. v. Marin*, 125 AFTR 2d 2020-380 (DC NY, Jan. 23, 2020), an estate elected to defer payment of estate tax principal pursuant to Internal Revenue Code § 6166. The estate agreed to make interest only payments and thereafter pay the remaining principal and interest in up to 10 annual installments. The election required the estate to provide the IRS a bond or consent to a special lien. While the estate made interest only payments, it failed to make any additional payments after the last of the interest payments and failed to provide a bond or lien to the IRS. The IRS sent numerous letters to the estate regarding its failure to make payments and provide a bond or consent lien. Ultimately, the IRS terminated the estate’s installment payment election and filed notices of federal tax liens. The estate informed the IRS that estate’s financial condition was poor and that it did not have sufficient assets to fully pay its tax liabilities. Interim accountings filed with the Surrogate’s Court showed that the estate received rental and other income over the years which, according to the IRS, was not reported on an income tax return. In addition, the estate paid debts described as administrative expenses, such as administrative costs, bank fees, property maintenance costs and taxes, and insurance, even though such debt did not take priority over the IRS’s tax liens. The District Court found that the IRS sufficiently pled its claim against the executor for liability under Internal Revenue Code § 3713(b), and that the proceedings in the Surrogate’s Court did not collaterally estop the claim because those proceedings addressed the issue of whether the executor had accounted for all of the estate’s monies and property and not the priority of the estate’s debts. The District Court also found that the IRS sufficiently stated a claim against the executor for breach of fiduciary duty by alleging the use of estate assets to pay non-priority debts prior to satisfaction of the estate’s outstanding federal tax obligation and the use of estate assets by the executor for her own personal benefit. The District Court denied the defendants’ motion to dismiss the IRS’s claim of transferee liability under Internal Revenue Code § 6324(a)(2). The defendants’ theory that the IRS was required to first make assessments directly against them under Internal Revenue Code § 6901 was contrary to case law, which established that the collection procedures under Internal Revenue Code § 6901 are not mandatory and that assessment need only be made timely against the estate in order for a claim under Internal Revenue Code § 6324 to be valid.