**Philadelphia Estate Planning Council**

**Current Developments – November 2019**

November 2019 Rates:

* Section 7520 Rate: 2.0%
* Short Term AFR (0-3 years): 1.68%
* Mid Term AFR (3-9 years): 1.59%
* Long Term AFR (over 9 years): 1.94%

The Internal Revenue Service released Rev. Proc. 2019-44, which s inflation-adjusted numbers for 2020. For gifts made and estates of decedents dying in 2020, the exclusion amount will be $11,580,000 (up from $11,400,000 in 2019). The exemption from generation skipping transfer tax exemption will also increase to $11,580,000 from $11,400,000. The annual exclusion amount for gifts made in 2020 will remain at $15,000.

The IRS released proposed regulations that would update the life expectancy and distribution period tables used to calculate required minimum distributions from qualified retirement plans, individual retirement accounts and annuities and certain other tax-favored employer-provided retirement arrangements (Prop. Reg. § 1.401(a)(9)-9). The tables provided in the proposed regulations reflect longer life expectancies than those in the existing regulations. The result of these changes would be reduced required minimum distributions, which would allow participants to retain more in their retirement plans for later years. The life expectancy tables would apply for distribution calendar years beginning on or after January 1, 2021. The preamble to the proposed regulation states that after the final regulations are issued, if a taxpayer began receiving substantially equal periodic payments before January 1, 2021 using the method described in section 2.01(a) of Rev. Rul. 2002-62, then the application of the final regulations will not be treated as a modification to a series of substantially equal periodic payments under IRC § 72(t)(4)(A)(ii). Additionally, if a taxpayer begins receiving substantially equal periodic payments on or after January 1, 2021 and uses either the fixed amortization method under section 2.01(b) or the fixed annuitization method under section 2.01(c) of Rev. Rul. 2002-62, then the method will be applied by applying the tables in final regulations in lieu of the tables in formerly applicable Reg. § 1.401(a)(9)-9, which are referenced in Rev. Rul. 2002-62.

The IRS issued final regulations on the new information reporting obligations for certain life insurance contract transactions under IRC § 6050Y. The reporting requirements are designed to help people who sell life insurance contracts properly report gains from any sales. The final regulations also offer guidance on new reporting requirements applicable to each person who makes a payment of reportable death benefits and how to calculate the amount of death benefits excluded from gross income. The final regulations generally apply to reportable policy sales and payments of death benefits occurring after December 31, 2018 (Reg. § 1.101-1, Reg. § 1.6050Y-1, Reg. § 1.6050Y-2, Reg. § 1.6050Y-3, Reg. § 1650Y-4).

Chief Counsel Advice Memorandum CCA 201939002 addressed the issue of whether a hypothetical willing buyer and seller of shares in a publicly traded corporation would consider a pending merger when valuing stock for gift tax purposes. Under the facts at issue, the donor was co-founder and chairman of the board of Corporation A, a publicly-traded corporation. On Date 1, the grantor transferred shares of Corporation A to a grantor retained annuity trust. On Date 2, after the market closed, Corporation A announced a merger with Corporation B. The merger was the culmination of negotiations with multiple parties, and before the transfer on Date 1, exclusive negotiations with Corporation B. On the X day of trading after the merger was announced, the value of Corporation A stock increased significantly. Treas. Reg. § 25.2512-2(a) provides that the value of stocks and bonds is the fair market value per share or bond on the date of the gift. Treas. Reg. § 25.2512-2(e) provides that in cases in which it is established that the value per bond or share of a security determined based on the selling or bid and asked prices provided under Treas. Reg. § 25.2512-2(b) does not represent fair market value, then some reasonable modification of the value determined on that basis or other relevant facts and elements of value shall be considered in determining fair market value. Fair market value is the price a hypothetical willing buyer would pay a hypothetical willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts (Treas. Reg. § 25.2512-1). The IRS notes that reasonable knowledge includes those facts that a reasonable buyer or seller would uncover during the course of negotiations over the purchase price of the property. Furthermore, a hypothetical willing buyer is presumed to be reasonably informed and prudent and to have asked the hypothetical willing seller for information that is not publicly available. Generally, a valuation of property for federal transfer tax purposes is made as of the valuation date without regard to events happening after that date. However, a post-valuation date event may be considered if the event was reasonably foreseeable as of the valuation date. Furthermore, a post-valuation event, even if unforeseeable as of the valuation date, also may be probative of the earlier valuation to the extent that it is relevant to establishing the amount that a hypothetical willing buyer would have paid a hypothetical willing seller for the property as of the valuation date. In this case, the IRS concluded that market value of the stock should take into consideration the likelihood of the merger as of the date the shares were transferred to the trust, and that the hypothetical willing buyer and willing seller would have knowledge of all relevant facts, including the pending merger.

In Private Letter Rulings 201941008 through 201941023, a settlor created irrevocable trusts for the benefit of his children and their descendants. A provision in the trust instruments contained a drafting error that did not limit a beneficiary’s withdrawal right over contributed assets to the greater of $5,000 or five percent of the value of the trust assets. Any lapse of the withdrawal right would be treated as a taxable transfer by the beneficiary and prevent effective deemed allocations of GST exemption by the transferors. In addition, the portion of the trust relating to the lapsed withdrawal right in excess of $5,000 or five percent of the value of the trust assets would be included in the beneficiary’s gross estate for estate tax purposes. New estate planning counsel discovered the error and filed a petition for judicial reformation in state court. The court issued an order reforming the trust to eliminate the error retroactive to the creation of the trusts. But the order was contingent upon the issuance of a favorable private letter ruling by the Internal Revenue Service. The IRS noted that the purpose of the reformation was to correct the scrivener’s error, not to alter or modify the instrument. The IRS concluded that the beneficiaries only possessed general powers of appointment to the extent of their withdrawal rights under the reformed trust instruments. Also, as a result of the reformation, the beneficiaries were not deemed to have released general powers of appointment within the meaning of IRC §§ 2514 and 2041 by reason of lapse of any withdrawal right.

In Private Letter Ruling 201943006, the decedent’s estate was not required to file a federal estate tax return. While there was an unused portion of the decedent’s applicable exclusion amount, for various reasons an estate tax return was not timely filed and a portability election was not made. The IRS determined that the information and representations submitted on behalf of the decedent’s estate explained the circumstances that resulted in the failure to timely file the portability election and granted an extension for the decedent’s estate to elect portability pursuant to § 301.9100-3.

In Private Letter Ruling 201944008, the taxpayer created two irrevocable trusts, one for the benefit of his children and one for the benefit of his wife and children. In addition, the taxpayer and his wife created an irrevocable trust for the benefit of their children. All three trusts have generation skipping transfer tax potential. The taxpayer transferred property to the three trusts but did not intend for GST exemption to be allocated to the transfers. The taxpayer retained an accountant to provide advice with regard to the tax consequences of the transfers and to file any necessary tax returns. The accountant failed to advise the taxpayer of the automatic allocation rules under IRC § 2632(c) and the ability to elect out of the automatic allocation. As a result, GST exemption was automatically allocated to the transfers. The taxpayer requested an extension to elect out of the automatic allocation for all of the transfers. The IRS concluded that based on the facts and representations made, the taxpayer acted reasonably and in good faith, thereby satisfying the requirements of § 301.9100-3, and granted an extension.

In *Skeba v. U.S.,* 124 AFTR 2d 2019-6265 (D.C. N.J. Oct. 3, 2019), the decedent died on June 10, 2013. On or about March 6, 2014, the estate filed for an extension to file a return with a partial payment of the estate tax in the amount of $725,000 along with a cover letter explaining the reasons for the application. At that time, all of the estate’s liquid assets were used to pay state and federal estate taxes. The letter noted that the estate was in the process of securing a mortgage in order to pay the remaining tax liability. The estate made a second payment of $2,745,000 around March 18, 2014. On or about June 25, 2014, the IRS approved an extension to file the estate tax return from March 10, 2014 to September 10, 2014. A letter from the IRS noted that any extension of time was subject to the caveat that the extension was granted on a year by year basis only, and that in the event an extension request is denied, payment of tax is due upon receipt of the denied extension. On or about July 8, 2014, an extension to pay the estate tax was granted until September 10, 2014. The IRS letter pertaining to that extension noted that the extension of time did not relieve the estate from liability for the payment of interest during the period of extension. The estate continued to face filing delays due to litigation over the validity of the decedent’s will. The attorney representing the estate had been informed by IRS representatives that as long as the estate tax payment was made in full, the filing of the estate tax return after the filing extension deadline would not subject the estate to any penalty. In addition, an IRS representative advised one of the accountants for the estate that “if you’re paid in, you’re fine”. The federal estate tax return was filed on or around June 30, 2015. The return reported the net estate tax as $2,528,838 and the prior estimated payments of $3,470,000, resulting in an overpayment of $941,162. The IRS noted an overpayment before adjustment of $941,162 and assessed a failure to file penalty of $450,959.50, which was 25% of the unpaid amount of $1,803,838. In its analysis, the District Court noted that the terms of IRC §§ 6651(a)(1) and (a)(2) specify that the date prescribed to assess penalties for late filing and tax payment is to be determined with regard to any extension of time for filing. Since the IRS granted the estate an extension until September 10, 2014, and the estate tax was paid in full on March 18, 2014, there was no net amount due for which the IRS would assess a late filing penalty. The court also determined that the IRA should have conducted an investigation in order to determine whether there was reasonable cause for failure to file a timely return, and that their denial for abatement of the penalty was arbitrary and capricious.

In *Cavallaro v. Commissioner,* T.C. Memo 2019-144 (Oct. 24, 2019), a merger occurred between a company owned by the taxpayers and a company owned by their sons. The taxpayers’ accountants projected that as much as 85% of the shares of the merged company would go to the taxpayers. However, based on an incorrect assumption as to the ownership of intangible assets, the taxpayers only received 19% of the shares. The IRS determined that as a result of the merger, the taxpayers had each made a significant taxable gift to their sons. The Tax Court found that the taxpayers’ company owned the intangibles, that the allocation of the stock of the new company was not in accord with the actual relative values of the two companies, and that the transaction therefore resulted in disguised gifts to the sons. The taxpayers appealed to the First Circuit, who found that the Tax Court misstated the content of the taxpayers’ burden of proof. The case was remanded so that the Tax Court could evaluate whether the valuation provided by the IRS’ expert had methodological flaws that made it arbitrary and excessive, and if so, to determine the proper amount of tax liability. The Tax Court determined that the data the IRS expert used to place the sons’ company in the 90th percentile in industry profits would place the company in the 88th percentile. This represented a substantial difference in the valuation and therefore a substantial difference in the value of the disguised gift. As a result, the correction reduced the value of the gift by $6.9 million.

In *JPMorgan Chase Bank, N.A. v. Winget,* No. 18-2089 (6th Cir. Nov. 7, 2019), the grantor created a revocable and retained the power to revoke the trust at any time and to receive any income generated by the trust property. The grantor also served as trustee and held broad investment powers. The grantor’s company sought almost a half billion dollar loan from a group of lenders. The grantor guaranteed the loan both in his individual capacity and as trustee. The company defaulted on the loan, and an action was brought against the grantor and the trust. The court had decided that the grantor’s personal liability was limited to $50 million but did not limit the trust’s liability. The district court held that the lender could recover $750 million from the trust. On appeal, the Sixth Circuit held that a party who has a contract with a trust can recover from the property held by the trust. The court found that under state law and the terms of the trust agreement, the grantor had the power to enter into contracts on behalf of the trust and did so with the lender. Furthermore, the lender is allowed to collect on that contract and may do so from the trust property.