Philadelphia Estate Planning Council
Current Developments – September 2019

September 2019 Rates:

- Section 7520 Rate: 2.2%
- Short Term AFR (0-3 years): 1.85%
- Mid Term AFR (3-9 years): 1.78%
- Long Term AFR (over 9 years): 2.21%

On May 15, 2019, the Charities Helping Americans Regularly Throughout the Year Act of 2019 was introduced. The Act would make several changes to the contribution rules, including allowing qualified charitable distributions from an IRA to a donor advised fund.

On June 25, 2019, the Strengthen Social Security by Taxing Dynastic Wealth Act was introduced in the Senate. The changes proposed in the Act include a return to 2009 estate and gift tax rates, returning the estate tax exclusion amount and GST exemption to $3.5 million, limiting the gift tax applicable exclusion amount to $1 million, and limiting the DSUE amount of a surviving spouse to reflect the reduced gift tax exemption levels. The revenue increase would be set aside to bolster the Social Security Trust Fund.

On June 28, 2019, PA House Bill 262 of 2019 was signed into law. HB 262 amended 72 P.S. § 9116 to add a new section that applies a tax rate of zero percent to transfers to a child 21 years of age or younger from a natural or adoptive parent or a stepparent who dies after December 31, 2019. In addition, HB 262 amends 72 P.S. § 7331 to recognize IRC § 645 elections for tax years beginning after December 31, 2019.

In Private Letter Rulings 201920001 through 201920003, three irrevocable trusts were reformed by court order to convert a general power of appointment to a limited power of appointment due to a scrivener's error. The IRS stated that the judicial reformations did not result in any adverse estate, gift or GST tax consequences. The Service noted that the trust instruments, affidavits and representations indicated that the grantor did not intend for the beneficiaries to have powers of appointment, and the reformations were supported by clear and convincing evidence of the scrivener's errors.

In Private Letter Ruling 201928005, the foundation beneficiary of a charitable lead trust acquired both the annuity interest and remainder interest. The trust proposed to seek a state court order to terminate the trust and transfer the trust property to the foundation. The IRS noted Rev. Rul. 83-75, which holds that the distribution of appreciated securities by a trust to pay a fixed annuity to a charitable organization results in a taxable gain to the trust, as well as *Kenan v. Commissioner*, 114 F.2d 217 (2d Cir. 1940), which held that the distribution of appreciated property to satisfy a pecuniary obligation causes gain recognition. However, since in this case the charity held both the annuity and remainder interests, the distribution does not discharge an annuity obligation and does not result in gain recognition.

In Private Letter Ruling 201931006, the IRA of a deceased owner had no designated beneficiary. The custodian provides that if there is on beneficiary designation, the IRA is payable to the owner's estate. The owner also died intestate. Under state law, the owner's surviving spouse is sole heir to the owner's estate. The IRS determined that because the spouse is the administrator and sole heir to the owner's estate, for purposes of applying Section 408(d)(3)(A), the surviving spouse is effectively the individual for whom the IRA is maintained and is eligible to roll over the proceeds into an IRA maintained in his own name.

In Private Letter Rulings 201932001 through 201932010, the settlor created an irrevocable trust prior to September 25, 1985 for the benefit of his son. The trust's material purpose was to ensure that the son receive an income stream for his support. Upon the son's death, the trust was to be distributed to his issue. As allowable under state law, the son and the remainder beneficiaries entered into an agreement to terminate the trust because the continuance of the trust was no longer necessary to achieve the material purpose of the trust because the son's net worth had grown significantly. The agreement further provided for the trust's termination and distribution among the son and the remaindermen in accordance with their actuarial interests. The IRS concluded that as long as the actuarial values of the trust accurately represent the actuarial value of each beneficiary's interest, the termination and distribution of the trust will not result in GST or gift tax. However, the amounts received by the beneficiaries are considered amounts received from the sale or exchange of a capital asset, which result in gain recognition.

In Private Letter Ruling 201935005, decedent was married at the time of his death but named a person other than his spouse as beneficiary. Subsequently, the custodian of the IRA retitled the IRA pursuant to a court order, naming the spouse as the sole beneficiary. The IRS determined that the spouse met the requirements to be treated as the individual for whose benefit the account was maintained and was able to roll over distributions from the decedent's IRA into one or more IRAs established and maintained in her own name.

In Private Letter Ruling 201936001, the taxpayer created an irrevocable trust for the benefit of the taxpayer's spouse and descendants. The taxpayer elected out of the automatic allocation rules with respect to the transfer to the trust. The taxpayer also allocated GST exemption to the transfer. However, a Notice of Allocation was not attached. The IRS looked to the taxpayer's intent to determine that the taxpayer substantially complied with the requirements for a valid allocation of GST exemption. Specifically, the IRS noted the proper reporting of the GST allocation on the Form 709 and the terms of the trust instrument, which was attached to the tax return.

In Rev. Rul. 2019-19, a required distribution is made from a qualified retirement plan to a taxpayer in 2019. Although the taxpayer could cash the check, the taxpayer did not do so. The failure to cash the check does not permit the taxpayer to exclude the amount of the distribution from gross income in that tax year. Whether the taxpayer retains the check, returns it, destroys it or cashes it in a subsequent tax year is irrelevant. Additionally, the failure to cash the check does not alter the employer's withholding or reporting obligations.

In *Burack v. Commissioner*, T.C. Memo 2019-83, an IRA owner received a distribution that was used to purchase a home while waiting for the sale of current home to close. It was the owner's intention to roll the distribution back into her IRA within 60 days of receipt. Upon the closing of the owner's former home, the owner received a check to redeposit back into the IRA. The check was sent via overnight mail to the IRA custodian and arrived 58 days after the owner received the IRA distribution. The check was deposited by the custodian into the owner's IRA 62 days after the IRA distribution. The owner argued that the rollover was not recorded as timely because of a bookkeeping error and that she is entitled to a hardship waiver under Section 408(d)(3)(I). The court determined that the facts showed that the late deposit was attributable to a bookkeeping error and that the distribution qualified for rollover treatment. Additionally, the court concluded that the owner met the requirements for a hardship waiver because the funds were deposited into an eligible retirement plan within one year from the beginning of the 60 day rollover period and if the custodian had deposited the funds as instructed, there would have been a valid rollover.

In *North Carolina Department of Revenue v. The Kimberly Rice Kaestner 1992 Family Trust*, 139 S. Ct. 2213, The Supreme Court affirmed the decision of the North Carolina Supreme Court holding unconstitutional the imposition of income tax from a trust based sole on the residence of trust beneficiaries. In *Kaestner*, the grantor, a New York resident, created a trust for the benefit of his children. The trustee was a Connecticut resident, the trust records and documents were maintained in New York, and the trust asset custodians were located in Massachusetts. The trust maintained no physical presence in North Carolina, made no direct investments there, and held no real property there. The terms of the trust provided the trustee with absolute discretion to distribute trust assets in such amounts and proportions as the trustee might from time to time decide. When the trust was created, no beneficiary lived in North Carolina. One of the beneficiaries moved to North Carolina several years after the trust's creation. A few years after that, the original trust was divided into subtrusts, one of which was formed for the benefit of the North Carolina resident and her children. The North Carolina Department of Revenue assessed a tax on the full proceeds that the trust had accumulated. The trustee sued in state court, arguing that the tax applied violates the Due Process Clause of the Fourteenth Amendment. The trial court found that the beneficiaries' residence alone was too tenuous a link between the state and the trust to impose a tax. The Supreme Court applied a two-step analysis to decide whether the tax abides by the Due Process Clause. First, there must be some minimum connection between the state and the person, property or transaction it seeks to tax. The minimum contacts analysis is flexible and focuses on the reasonableness of the state's action. Second, the income attributed to the state for tax purposes must be rationally related to values connected with the taxing state. The court determined that the residence of the beneficiaries alone did not provide the minimum contact necessary to support a tax on the trust income when the beneficiaries did not receive income from the trust or had the right to demand the income or otherwise control, possess or enjoy it either during the tax years in question or in the future.

The Supreme Court denied certiorari following the Minnesota Supreme Court's decision in *Fielding v. Commissioner*, 916 N.W. 2d 323 (Minn. 2018). In *Fielding*, a Minnesota grantor created four trusts. At the time the trusts became irrevocable, the grantor was domiciled in Minnesota. As a result, the trusts were classified as resident trusts under Minnesota law and subject to tax in the state. No trustee was a Minnesota resident, the trusts were not administered in Minnesota, the trust records were maintained outside of Minnesota, some of the trusts' income was derived from investments with no direct connection to Minnesota and three of the four beneficiaries reside outside of Minnesota. The trustee challenged the taxation of the trusts under the state and federal Due Process Clauses and the federal Commerce Clause. The Tax Court concluded that the only relevant contact was the grantor's residency at the time the trust became irrevocable, and that this factor did not establish a connection of sufficient substance to support taxation. The Minnesota Supreme noted that in the context of a due process challenge, the court "will examine all relevant contacts between the taxpayer and the State, including the relationship between the income attributed to the state and the benefits the taxpayer received from its connections with the state." The court noted that the relevant connections are Minnesota's connection to the trustee, not the connection to the grantor. The court also found that the trusts' ownership in stock of a Minnesota company was not a relevant or legally significant connection with the state because the stock is an intangible asset.

In *Estate of Kollsman v. Commissioner*, No. 18-70565 (9th Cir. 2019), the Ninth Circuit affirmed the Tax Court's decision to that two paintings had been undervalued by about $1.8 million for estate tax purposes. The court held that a hypothetical buyer and seller are presumed to have reasonable knowledge of the relevant facts affecting the property's value, and that a hypothetical buyer would know that cleaning one of the paintings was "a well advised and low-risk undertaking." The court also held that the Tax Court did not err in accepting the valuations provided by the IRS valuation expert because of his explanation of methodology, reliance on comparables and research on the paintings' conditions.

In *Carter v. United States*, 2019 WL 3767479 (N.D. Ala. Aug. 9, 2019), the personal representative of an estate valued the shares of stock, which represented about 45% of the estate, at $17.6 million. What was unknown at the time was that a customer defrauded the bank, which eventually led to the bank's closing. The shares' value dropped to $8.5 million. The personal representative asserted that she suffered from "severe mental and emotional maladies which rendered her incapable of managing the Estate's financial affairs." Five years after filing the estate tax return, the estate filed a claim for refund. Although the executor acknowledge that the refund suit was untimely, she claimed that the lateness should be excused due to financial disability under Section 6511(h). That section suspends the statute of limitations for a refund claim when an individual is unable to manage her financial affairs because of a "medically determinable physical or mental impairment." The court found that financial disability claims apply only to claims for individual taxpayers and not estates.