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STATEMENTS OF POLICY

Title 61—REVENUE

DEPARTMENT OF REVENUE

[61 PA. CODE CH. 94]

Taxation of Trusts

[41 Pa.B. 5994]

[Saturday, November 5, 2011]

The Department of Revenue (Department) has adopted a statement of policy under § 3.2 (relating to statements of policy). The statement of policy in § 94.3 (relating to taxation of trusts terminated under 20 Pa.C.S. § 7710.1) is new and takes effect upon publication in the *Pennsylvania Bulletin*.

This statement of policy is promulgated by the Department to implement a consent requirement for termination of noncharitable irrevocable trusts made without court approval or notice to the Department.

Specific questions regarding this statement of policy may be directed to the Department of Revenue, Office of Chief Counsel, P. O. Box 281061, Harrisburg, PA 17128-1061.

DANIEL MEUSER,
Secretary

(*Editor's Note:* Title 61 of the *Pennsylvania Code* is amended by adding a statement of policy in § 94.3 to read as set forth in Annex A.)

Fiscal Note: 15-455. No fiscal impact; (8) recommends adoption.

Annex A

TITLE 61. REVENUE

PART I. DEPARTMENT OF REVENUE

Subpart B. GENERAL FUND REVENUES

ARTICLE IV. COUNTY COLLECTIONS**CHAPTER 94. INHERITANCE TAX PRONOUNCEMENTS—STATEMENTS OF POLICY****§ 94.3. Taxation of trusts terminated under 20 Pa.C.S. § 7710.1.**

(a) Effective for Resident and Non-Resident Pennsylvania Inheritance Tax Returns filed on or after July 1, 2012, wherein the person responsible for filing the return has not made an election to prepay tax under section 2113(a) of the Inheritance and Estate Tax Act (act) (72 P. S. § 9113(a)) concerning trust assets reported on the return as part of a qualified spousal trust under section 2113 of the act, the Department will reserve the right to assess Pennsylvania Inheritance Tax at the highest applicable rate in effect at the time the Department issues its initial Notice of Inheritance Tax Appraisal, Allowance or Disallowance of Deductions and Assessment of Tax, unless the person responsible for filing the return requests a Future Interest Compromise from the Department in conjunction with the filing and in the manner prescribed by the Department.

(b) If a Future Interest Compromise is not requested in accordance with subsection (a), the person responsible for filing the return shall acknowledge in writing, in the form and manner provided by the Department, the person's assumption of liability for inheritance tax consequences that result from the termination of a trust under 20 Pa.C.S. § 7710.1 (relating to nonjudicial settlement agreements—UTC 111) that occurs after the return has been filed. This assumption of liability applies to a termination made without court approval or notice to the Department. This liability does not apply to a termination made under a specified termination date as contained within the trust instrument provided to the Department.

(c) If a trust has been terminated under 20 Pa.C.S. § 7710.1, without request for a Future Interest Compromise in accordance with subsection (a), the assets of the trust will be valued for Pennsylvania Inheritance Tax purposes as of the date of termination and tax will be due and owing as of the date of termination. Interest will accrue on an inheritance tax liability as of the termination date and in accordance with section 806 of The Fiscal Code (72 P. S. § 806).

[Pa.B. Doc. No. 11-1877. Filed for public inspection November 4, 2011, 9:00 a.m.]

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**Philadelphia Bar Association
Probate & Trust Section's Tax Committee
Tax Update – October 2012
Prepared by Marguerite Weese, J.D., LL.M. (Tax), Wilmington Trust N.A.**

GUIDANCE FROM THE IRS

Revenue Ruling 2012-30, November 2012 Rates:

Section 7520 Rate: 1.0%
Short Term AFR (0-3 years): 0.22%
Mid Term AFR (3-9 years): 0.89%
Long Term AFR (over 9 years): 2.40%

IR-2012-78, Various Tax Benefits Increase Due to Inflation Adjustments

Annual Exclusion for Gifts in 2013: \$14,000
Amount reducing children's net unearned income subject to "kiddie tax": \$1,000
Foreign earned income exclusion: \$97,600

**Details on these inflation adjustments and others will be found in Revenue Procedure 2012-41, which will be published in the Internal Revenue Bulletin 2012-45 on November 5, 2012.*

CASES

Windsor v. United States (2nd Cir. October 18, 2012), aff'g 833 F. Supp. 2d 294 (S.D.N.Y.): Edith Windsor is a widow who sought an estate tax deduction after the death of her same-sex spouse. Not recognizing her same-sex marriage, the IRS levied a \$363,000 federal estate tax bill on her. Edith filed a constitutional challenge to the Defense of Marriage Act (DOMA) in the U.S. District Court for the Southern District of New York. The Court found section 3 of DOMA to be unconstitutional, stating that it violated Edith's rights under the Equal Protection Clause of the Fourteenth Amendment and ordered Edith to receive a tax refund. The 2nd Circuit Court of Appeals upheld the District Court's ruling.

Keller v. United States, _F.3d_, 2011W:9149592 (5th Cir. Sept. 25, 2012), aff'g 2009 WL 2601611 (S.D. Tex., 2009) and 2010 WL 3700841 (S.D. Tex., 2010): The decedent created a family limited partnership (FLP), but had not formally funded it prior to her unexpected death. Approximately a year after her death, the planners involved with the estate heard about the *Church* case, which stated that under Texas law, a partnership could be funded impliedly based upon the intent of the decedent prior to his/her death. Knowing that the decedent had planned to transfer a large bond portfolio to the partnership, the estate took the position that the FLP in fact owned the bonds at the time of the decedent's death. The estate, however, had sold the bonds to pay estate taxes and therefore, realizing that it had done so improperly, retroactively documented that it owed the FLP a loan of approximately \$114 million. The District Court upheld both actions, which were later affirmed by the Fifth Circuit Court of Appeals.

Brown v. Commissioner, _F.3d_,2012 WL 3932330 (7th Cir. Sept. 11, 2012), aff'g T.C. Memo 2011-83: The taxpayer purchased a life insurance contract in 1982. Throughout the years, the taxpayer borrowed against the policy's cash value and eventually his loan balance against his policy exceeded the policy's cash value. At that time, the insurance company terminated the contract using the policy's entire cash value of over \$37,000 to pay the policy-related debt. The taxpayer did not report any gain or loss on his federal return and the IRS subsequently determined that the taxpayer had approximately \$29,000 of unreported income resulting from the cash surrender value minus the investment in the contract. The Tax Court upheld the deficiency determination as well as the related penalty assessment and the Seventh Circuit affirmed the decision.

Foster v. Commissioner, T.C. Summ. Op. 2012-90 (Sept. 11, 2012): The Fosters contributed a façade easement to L'Enfant Trust, Inc. which is operated for the purpose of holding and enforcing conservation easements on historic designated properties in the Washington, D.C. region. The Fosters valued the easement by applying an 11% percentage reduction to the appraised value of the property prior to the easement. The percentage was decided upon after the appraiser had seen an article that suggested that this percentage was a safe harbor figure that was acceptable by the IRS. Accordingly, the Fosters claimed a \$98,500 charitable contribution deduction on their tax return. The Tax Court determined that the easement did not restrict the use of the property more than the local historic ordinances and therefore the 11% reduction was not substantiated by an actual decrease in value of the property.

Trout Ranch, LLC v. Commissioner, (2012, CA10) 110 AFTR 2d, 2012-5208 (Aug. 16, 2012): Trout Ranch, LLC purchased land with the goal of developing homes on a small portion of the property, while preserving the remainder. Trout Ranch used a conservation easement and subsequently claimed a charitable deduction of \$2.2 million. The IRS found that the easement did not significantly reduce the value of the property and, therefore, disallowed the deduction. The Tax Court rejected the use of the comparable-sales method, where the comparison properties had significantly more restrictive easements, and instead valued the easement at \$560,000. The Tenth Circuit affirmed the findings of the Tax Court.

PRIVATE LETTER RULINGS

IRS Private Letter Ruling 201238011, IRS Private Letter Ruling 201238012, and IRS Private Letter Ruling 201238016 (Sept. 21, 2012): The IRS permitted taxpayers to make late elections, with respect to 2010 decedents, to elect into carryover basis and out of the federal estate tax. In each of these scenarios, the decedent's executors had relied upon a qualified tax professional to prepare Form 8939, electing into carryover basis, and the professional had not done so.