

**Philadelphia Bar Association Probate & Trust Section**  
**Tax Update – January 2014**  
**Prepared by Marguerite Weese, J.D., LL.M. (Tax), Wilmington Trust N.A.**

**GUIDANCE FROM THE IRS**

**Revenue Ruling 2014-1, IRB 2014-2, (Jan. 6, 2014) January 2014 Rates:**

- Section 7520 Rate: 2.2%
- Short Term AFR (0-3 years): 0.25%
- Mid Term AFR (3-9 years): 1.75%
- Long Term AFR (over 9 years): 3.49%

**Revenue Ruling 2014-6, February 2014 Rates:**

- Section 7520 Rate: 2.4%
- Short Term AFR (0-3 years): 0.3%
- Mid Term AFR (3-9 years): 1.97%
- Long Term AFR (over 9 years): 3.56%

**Finals Regulations issued (1.1411-1 through 1.1411-9 and 1.469-11):** The IRS has issued final regs that provide guidance on the 3.8% surtax on investment income and gains imposed by IRC section 1411. Except where noted, the final regs are effective for tax years beginning after December 31, 2013. Below are some highlights:

- **Individuals subject to IRC section 1411:** the final regs retain the proposed reg's definition of the term "individual" for IRC section 1411 purposes, but has clarified the treatment of a nonresident alien. With respect to dual-status individuals, who are residents for part of the year and nonresidents for the other part, the final regs clarify that such a dual status resident is subject to IRC section 1411, but only with respect to the portion of the year during which the individual is a U.S. resident.
- **Certain Trusts with "Special Computational Rules":** The final regs ultimately exclude cemetery perpetual care funds from IRC section 1411. However, the IRS declined to exclude qualified funeral trusts (QFT) from IRC section 1411, but it did clarify how the tax is to be calculated to the QFT; by treating each beneficiary's interest in that beneficiary's contract as a separate trust.
- **Charitable Purpose Estates:** The final regs clarify that charitable purpose estates are exempt from the application of IRC section 1411.
- **Electing Small Business Trusts (ESBTs):** The final regs retain the approach taken in the proposed regs, such that an ESBT is treated as two separate trusts for computational purposes, but consolidated into a single trust for the determining the AGI threshold under IRC section 1411(a)(2)(B)(ii).
- **Charitable Remainder Trusts (CRTs):** Under the final regs, net investment income is to be categorized and distributed based on the existing IRC section 664 category and class system. However, the final regs do retain the concept of "accumulated net investment income" which defined in the proposed regs.
- **Foreign Estate and Trusts:** The final regs retain the rule that the IRC section 1411 tax doesn't apply to foreign estates even with U.S. beneficiaries. However, the IRS clarified in TD 9644 that this rule does not exempt U.S. beneficiaries of foreign estates from the application of IRC section 1411 to distributions from foreign estates.

## CASES

**Miller v. Commonwealth of PA**, Docket No. 43 MAP 2011, (Dec. 17, 2013): The Miller Trust failed to meet the definition of a Living Trust or Will Substitute because the trust may end and the property pass before the settler dies. As such, the Miller Trust is not exempt from the PA Realty Transfer Tax. The Appellees transferred title to their house and farm to the irrevocable trust. Mrs. Miller was the only settler, claiming the trust was a will substitute. The Realty Transfer Tax Act imposes a tax on any real estate transaction evidenced by a document, but a "document" by definition does not include wills. A living trust, which is meant as a will substitute by the settler, becomes effective during the life of the settler, but distributions cannot be made to any beneficiaries other than the settler prior to the death of the settler. This was not the case with the Miller Trust, therefore failing the definition of a Living Trust and, thus, failing the exemption of the PA Realty Transfer Tax.

**Estate of Tanenblatt v. Commissioner, TC Memo 2013-263 (Nov. 18, 2013)**: The Tax Court ruled on various issues involving a decedent's LLC interest, including the character of the decedent's interest. Ms. Tanenblatt transferred her one-sixth interest in a limited liability company (LLC) to a trust, but retained the right to revoke the transfer. She later passed away. Membership of the LLC was divided among three family groups and transfers of membership interests outside of those groups was restricted, such that a nonfamily member could not become a member of the LLC without the unanimous consent of all of the members. A nonfamily member who received a membership interest, but did not become a member was still entitled to receive the distributions and allocations of profits and losses appurtenant to that membership interest, but had no right to participate in the management or control of the LLC.

The Tanenblatt estate valued the LLC interest based on discounts related to an assignee interest. The IRS's position was that while the valuation was accurate, the discounts applied were incorrect. The court held that a membership interest is in fact more valuable than an assignee interest of an equivalent percentage interest, because the member's interest can participate in the management and control of the LLC. The court went on to say that on the date of Tanenblatt's death, the decedent held a management interest.

**Clark, Brandon C. In re (2013, CA47), 714 F.3d 559, 2013 WL 1729600, cert granted (2013, S.Ct.) 2013 WL 4776520**: The Supreme Court has agreed to review In re Brandon Clark, which held that a debtor's inherited IRA may not qualify for a bankruptcy exemption under Bankruptcy Code section 522(b)(3)(C). The Seventh Circuit decision in this case conflicted with decisions of the Fifth and Eighth Circuits.

## PRIVATE LETTER RULINGS

**IRS Letting Ruling 201352001** (Dec. 27, 2013): The IRS determined that a direct skip transfer in trust by a decedent dying in 2010, where the decedent's executor elected out of the estate tax, was not subject to any GST tax. The IRS also determined that any future distributions from the trust would likely not be subject to GST tax. The decedent died in 2010 and directed a part of an annuity, which had been included in the decedent's gross estate, to be paid to three separate trusts for the decedent's grandchildren (one trust for each grandchild). If the grandchild survived the annuity term, the remaining funds would be distributed to the grandchild and the trust would terminate. Otherwise, the funds would be paid to the grandchild's descendants. The IRS stated that:

- 1) The trust was a skip-person under IRC section 2613(a) because the grandchild was the only permissible beneficiary of income and corpus from the trust and the only person with an interest under Reg 26.2612-1(d)(2),
- 2) The distribution of the annuity to the trust was a direct skip because the trust was a skip-person,
- 3) The disposition of the annuity was not subject to the GST tax, because the decedent's executor elected out of the estate tax for 2010,
- 4) The decedent remained the transferor of the trust because the annuity would have been included in the decedent's gross estate (had the executor not elected out of the estate tax),
- 5) The applicable fraction of the trust was 1, because no GST exemption was allocated to the trust, but under the Tax Act of 2010, the applicable rate of tax was zero and
- 6) Further distributions to the grandchild will not be subject to the GST tax.