Probate & Trust Section, Tax Committee
Tax Updates – March 2014
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GUIDANCE FROM THE IRS

Revenue Ruling 2014-12, IRB Bulletin 2014-15, April 2014 Rates:

- Section 7520 Rate: 2.2%
- Short Term AFR (0-3 years): 0.28 %
- Mid Term AFR (3-9 years): 1.81%
- Long Term AFR (over 9 years): 3.32%

2013 Form 1041, U.S. Income Tax Return for Estates and Trusts: the IRS has released a final version of 2013 Form 1041 and draft instructions with it.
Form found here: http://www.irs.gov/pub/irs-pdf/i1041.pdf
Instructions found here: http://www.irs.gov/pub/irs-pdf/i1041.pdf

2013 Form 8960 Instructions for the Net Investment Income Tax for Individuals, Estates, and Trusts. The IRS has issued draft instructions for Form 8960 (a draft of the form itself was released in August 2013). Besides providing detailed instructions for completing the form, the instructions shed additional light on the net investment income tax rules themselves, including but not limited to the net operating loss deduction.
Instructions found here: http://www.irs.gov/pub/irs-pdf/i8960.pdf

CASES

Estate of Richmond v. Commissioner, T.C. Memo, 2014-26 (Feb 11. 2014): The Tax Court rejected the estate's lower value of a decedent's interest in a closely-held C corporation, which was valued using a capitalization-of-dividends method, rather than a net asset value method and applying various discount, as the IRS did. Helen Richmond, the decedent, owned a 23.44% interest in Pearson Holding Co. at the time of her death. The estate reported the value of this interest at $3,149,767. However, before the Tax Court, representatives asserted the value was $5,046,500, which was still lower than the IRS's claim of a value of $7,330,000. Through the date of the decedent's death, the company followed its stated philosophy of maximizing dividend income, which provided a steady stream of income to the interest holders, while minimizing taxes and preserving capital. The estate retained an accounting firm to value the stock for estate tax purposes. He used a capitalization-of-dividends method. The IRS' expert valued the decedent's interest by using a discounted net asset method and applied an overall discount of 40% taking into consideration the minority interest, lack of marketability and the built-in capital gain tax. The Tax Court said that while the dividend capitalization method is a way of valuing businesses, it's more appropriate when the company's assets are difficult to value. Here, the company's portfolio consisted primarily of securities whose values could have been computed without controversy. As such the court determined that the NAV method had to be used to determine the value of the company and thus the decedent's interest.

Close v. Commissioner, T.C. Memo, 2014-25 (Feb. 10, 2014): The Tax Court held that the IRS failed to prove that two trusts were shams and that a couple had unreported income from logging activities on property held by the trusts under the analysis set forth in *Markosian v. Commissioner*, 73 T.C. 1235 (1980) . The Court first

determined that the IRS bore the burden of proof with respect to the sham trust claim because there was a new theory which altered the original deficiency or required the presentation of different evidence as a new matter. Under IRC section 7522, a notice of deficiency must "describe the basis for" any tax deficiency included in the notice and where it fails to describe the basis and there is a need for new evidence, then the Commissioner bears the burden of proof regarding the new basis. The Tax Court found that the IRS failed to carry this burden as to either trust, including failing to call the trustees of either trust to testify.

Black v. Commissioner, T.C. Memo 2014-27 (Feb. 12, 2014): The Tax Court upheld an IRS deficiency determination and accuracy-related penalty against an individual who borrowed against a life insurance policy and whose debt was extinguished with policy proceeds, finding that the capitalized interest that had accrued was includible in the gross distribution and taxable amount realized on policy termination. The taxpayer borrowed against a life insurance policy, but failed to repay the loans. The policy was terminated, and the loans were then satisfied by the insurance policy proceeds. The IRS issued a notice of deficiency to the taxpayer, contending that the amount of income realized upon termination of the insurance policy included both: (1) the policy loan principal; and (2) capitalized interest on the policy loan. The taxpayer countered that the amount realized included only the loan principal. The Tax Court agreed with the IRS.

PRIVATE LETTER RULINGS

PLRS 20141001- 20141010 (March 7, 2014): The IRS published multiple private letter rulings addressing ownership of a trust when an ownership committee is in place. They address whether the transfers of property from the grantor to the same trust and then from the trust to beneficiaries will be treated as completed gifts. The IRS found, based upon the facts submitted, that each Grantor would not be treated as owner of the trust, but that the final decision would be deferred until examination of income tax returns. Further, the contribution of property by the grantor was not a completed gift, and thus includible in the grantor's estate. However, any transfer of property from the trust to a beneficiary, other than the grantor, would be a completed gift by the grantor.

LEGISLATIVE

Obama Administration's 2014 Green Book: Recently released, the Green Book mentions potential major reforms including:

- Reverting the estate, gift, and generation-skipping transfer tax exclusions and rates back to 2009 levels. Estate and GST tax exemptions would be reduced to $3.5 million, while the gift tax exemption would be reduced to $1 million. There would also be no indexing these numbers for inflation. The top tax rate would be increased to 45%.
- Exposing sales, exchanges, and "comparable transactions" with intentionally defective grantor trusts (IDGT) to tax consequences.
- Placing additional restrictions on grantor retained annuity trusts (GRAT). These restrictions include requiring a minimum term of 10 years, preventing the ability to front-load the GRAT annuity, and imposing a minimum taxable gift.
- Changing the annual gift tax exclusion limit to $50,000 per donor on the donor's transfers of property, even if the gifts did not exceed $14,000 per individual.