

Philadelphia Bar Association, Probate and Trust Section
Tax Committee's Tax Update – May 2013
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GUIDANCE FROM THE IRS

Revenue Ruling 2013-15 –July 2013 Rates:

Section 7520 Rate: 1.40%
Short Term AFR (0-3 years): 0.23 %
Mid-Term AFR (3-9 years): 1.22 %
Long-Term AFR (over 9 yrs): 2.80 %

Revenue Ruling 2013-14, 2013-26 IRB (June 24, 2013): The IRS ruled that a Mexican land trust is not treated as a trust for U.S. tax purposes. The IRS explained the reasoning is the different in the role and responsibility of the trustee. A trustee for a U.S. trust must take title to property for the purpose of protecting or conserving it for the beneficiaries, whereas, a trustee for a Mexican land trust's sole responsibility is to hold and transfer title at the direction of the taxpayer.

CASES

McNeil v. Commonwealth of Pennsylvania, Nos. 651 F.R. 2010, (Pa. Commonwealth, May 24, 2013):

The court concluded that the imposition of the Pennsylvania Income Tax on the interest on all of the income of two inter vivos trusts that are located in, administered in, and governed by the laws of Delaware, with no Pennsylvania income or assets, violates the Commerce Clause of the U.S. Constitution. The U.S. Supreme Court established a four prong test to determine whether a state tax withstands constitutional scrutiny. The imposition does not satisfy the following three prongs: 1) the taxpayer must have a substantial nexus to the taxing jurisdiction, 2) the tax being imposed upon the taxpayer must be fairly related to the benefits being conferred by the taxing jurisdiction, and 3) the tax may not discriminate against interstate commerce.

In re Huber v. Huber, 201 BR 685, 2013 WL 2154218 (Bankr. W.D. Wash, May 17, 2013):

A federal bankruptcy judge allowed the creditors of a Washington resident to reach the assets inside a self-settled Alaska spendthrift trust. The judge did so by applying Washington's creditors' rights laws, instead of Alaska's laws. The court voided the transfer on three grounds. First, the trust's contacts with Alaska were found to be less significant than those with Washington. Second, the court found that Section 548 of the Bankruptcy Code applied because it was a transfer by a debtor to a self-settled trust made within 10 years before the bankruptcy petition, to a trust of which the debtor was a beneficiary and the debtor made the transfer with the intent to hinder, delay or defraud creditors. Third, the court found that Section 544 of the Bankruptcy Code applied, which gives the bankruptcy trustee the authority to void fraudulent transfers under state law. Here, Washington has the Uniform Fraudulent Transfer Act (UFTA),

which classifies a transfer as a fraudulent if the debtor acts with actual intent to hinder, delay, or defraud a creditor, or transfer without receiving a reasonably equivalent value in exchange for the transfer or obligation.

Steven E. Vlach and Nancy Vlach, TC Memo 2013-116:

The Tax Court has held that trusts established for asset protection by a doctor were shams and, therefore, should be disregarded. As a result, the doctor and his professional corporations owed taxes and penalties. The court held that avoidance of tax alone is not sufficient grounds for disregarding the trusts, but there are four factors to be considered: 1) the grantor-taxpayer's relationship to the trust property materially changed after the trust was created, 2) the trust had an independent trustee, 3) an economic interest in the trust passed to other beneficiaries, and 4) the taxpayer felt bound by restrictions imposed by the trust or the law of trusts. The Vlachs conceded that the trusts did not have an independent trustee. The court found there was no material change, as the Vlachs conducted their business and personal lives in the same manner irrespective of the trusts. The court also found that the trusts had no economic substance and there were no meaningful restrictions placed on the Vlachs by the trust documents. As such, the court held the trusts were shams.

PRIVATE LETTER RULINGS:

PLR 201320009: The IRS ruled that the conversion of two trusts into unitrusts will not cause the trusts to lose their grandfathered status from generation skipping transfer tax. As a result, the change will not result in any beneficiaries being charged with making gifts, nor will it trigger any gain or loss to the trusts or their beneficiaries.

PLR 201320004: The IRS ruled that the modification of an irrevocable trust to convert a mandatory income distribution into principal distribution for the beneficiary's support and maintenance did not constitute a taxable gift, recognition of gain, or change of the trust's zero inclusion ratio for generation-skipping transfer tax purposes.

LEGISLATIVE NEWS

Senate Finance Committee "Economic Security: Health, Retirement, life Insurance, Fringe Benefits and Executive Compensation" 113th Cong., 1st Sess. (May 23, 2013): The Committee released a summary of some of the tax reform proposals that would be considered by the Committee. The following are among the items being considered:

- Requiring inherited IRAs to be distributed within five years (with certain exceptions)
- Currently taxing the annual increase in the inside build-up on life insurance contracts
- Denying exclusion for death benefit payments above a specified amount
- Increasing the \$50,000 limit for employer-provided group term life insurance.