

Probate & Trust Section, Tax Committee
Tax Updates – May 2015
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GUIDANCE FROM THE IRS

Revenue Ruling 2015-8, 2015-18 IRB (May 4, 2015), May 2015 Rates:

- Section 7520 Rate: 1.8%
- Annual Short Term AFR (0-3 years): .43%
- Annual Mid Term AFR (3-9 years): 1.53%
- Annual Long Term AFR (over 9 years): 2.30%

LEGISLATIVE ACTIVITY

H.R. 1105. On April 16, 2015, the House passed, by a vote of 240-179, H.R. 1105, the “Death Tax Repeal Act of 2015,” which would repeal the estate tax and the generation-skipping transfer tax.

The Obama Administration has issued a Statement of Administration Policy against H.R. 1105. Noting that well over 99% of taxpayers, including virtually all small businesses and family farms, do not pay any estate tax, the Statement of Administration Policy stated that H.R. 1105, which would add \$269 billion to the deficit over ten years and therefore was fiscally irresponsible. Accordingly, if the President were presented with the bill, his senior advisors would recommend that he veto it.

H.R. 529. The House has passed “a bill to amend the Internal Revenue Code of 1986 to improve 529 plans.”

The bill would: (1) allow payments from qualified tuition programs, such as 529 plans, for the purchase of computer or peripheral equipment, software, or Internet access and related services to be used primarily by the beneficiary while enrolled in an eligible educational institution; (2) eliminate the requirement that distributions from a 529 plan be aggregated for purposes of determining the amount includible in a taxpayer's income (i.e., where a beneficiary has received multiple distributions from a plan in the tax year, the portion of a distribution that represents earnings would be determined on a distribution-by-distribution basis, rather than an aggregate basis); and (3) allow a tax-free recontribution to a 529 plan of amounts refunded to a student by an eligible educational institution if the recontribution is made not later than 60 days after the date of such refund and doesn't exceed the refunded amount.

COURT GUIDANCE

Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue (12 CVS 8740). The North Carolina Superior Court Business Court Division has determined that NC G.S. § 105-160.2 (the “Statute”) is unconstitutional to the extent that it seeks to impose income tax

on an out of state trust (“Kaestner Trust”) whose only contact with North Carolina is the presence of a North Carolina resident beneficiary.

In Kaestner, the Court determined that the Statute violates both the due process and commerce clauses of the U.S. Constitution when applied to the Kaestner Trust, as taxpayer. The Court reasoned that there must be nexus and voluntary connectivity between the taxing state and the taxpayer, which it correctly emphasized was the Kaestner Trust not its beneficiaries.

The Kaestner Trust urged the Court to determine that the Statute was unconstitutional on its face, but the Court declined to do so and limited its holding to the application of the Statute to the Kaestner Trust facts.

Notable Kaestner Trust facts include that:

- The trustee did not travel to North Carolina.
- The custodian of the investments of the Trust was out of state.
- The tax returns for the Trust were prepared out of state.
- All records of the Trust were maintained out of state
- The trustee did not make any distributions to the beneficiary .
- Pursuant to the terms of the Trust, the beneficiary was not able to compel the trustee to make a distribution from the Trust.

At least two other state courts had previously allowed taxation of non-resident trusts with similar circumstances under similar statutes, McCulloch v. Franchise Tax Board, 390 P.2d 412 (Cal. 1964), and Chase Manhattan Bank v. Gavin, 733 A.2d 782 (Conn. 1999).

The Court in Kaestner, first distinguishes the Kaestner Trust facts from those in McCulloch and Gavin, noting that in McCulloch the beneficiary who resided in California was also a trustee and in Gavin the Settlor was a Connecticut domiciliary, but the Kaestner Court also noted that regardless of such distinguishing facts it found the reasoning in McCulloch and Gavin to be unpersuasive.

The Kaestner Court relied upon McNeil v. Commonwealth, in its Commerce Clause analysis and noted factual similarities. 67 A.3d at 187.

Some commentators believe it is likely that the North Carolina Department of Revenue will appeal.