

Philadelphia Bar Association
Probate & Trust Section Tax Committee
Tax Update – September 2013
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GUIDANCE FROM THE IRS

Revenue Ruling 2013-18, October 2013 Rates:

Section 7520 Rate: 2.4%
Short Term AFR (0-3 years): 0.32%
Mid Term AFR (3-9 years): 1.93 %
Long Term AFR (over 9 years): 3.50 %

Chief Counsel Advice 201330033 (July 26, 2013): The IRS Office of Chief Counsel examined the estate and gift tax treatment of sales of stock to grantor trusts in exchange for self-cancelling promissory notes. The IRS concluded that 1) if the fair market value of the notes is less than the fair market value of the property transferred to the grantor trusts, then the difference in value is deemed a gift; 2) the notes should be valued based upon a method that takes into account the willing-buyer, willing-seller standard, and should also account for the decedent's medical history on the date of the gift; and 3) there is no estate tax consequence associated with the cancellation of the notes with the self-cancelling feature upon the decedent's death.

Chief Counsel Advice 201328030 (July 12, 2013): The IRS decided that a decedent's right to receive life insurance dividends is not an incident of ownership for purposes of determining whether the proceeds of the insurance are includible in the decedent's taxable estate. Under the terms of the taxpayer's divorce agreement, the taxpayer/decedent was to maintain life insurance policies on his life for the sole benefit of his former spouse. Under the terms, the Decedent was to pay all premiums, but could not borrow against or pledge the policies. The Decedent was, however, entitled to the dividends. The IRS stated that although the dividends from the policies technically belonged to the decedent, the mere right to the dividends, by itself, is not an incident of ownership that would cause the value of the insurance proceeds to be included in the decedent's gross estate under Internal Revenue Code section 2042(2).

CASES

United States v. Windsor, 570 U.S. __ (2013): The Supreme Court held that the Defense of Marriage Act (DOMA) section 3 was an unconstitutional deprivation of equal protection. Section 3 of DOMA defines marriage for purposes of administering federal law as the legal union between one man and one woman as husband and wife. It further defines spouse as a person of the opposite sex who is a husband or wife. Edie Windsor and Thea Spyer were in a committed relationship for three decades prior to registering as domestic partners in New York City in 1993 and then marrying in Canada in 2007. Spyer died in February 2009, leaving her estate to Windsor, but because of DOMA, the estate did not qualify for the unlimited marital deduction under Internal Revenue Code section 2056(a). As a result, Spyer's estate had to pay \$363,053 in federal estate tax. Windsor paid this amount and then sued for refund. As a result of the Supreme Court finding DOMA section 3 unconstitutional, it also determined that Windsor was entitled to a refund.

Cozen O'Connor, P.C. v. Jennifer J. Tobits, 2013 WL 3878688 (E.D. Pa.) July 29, 2013: The U.S. District Court for the Eastern District of Pennsylvania held that a profit-sharing plan of a Pennsylvania company must treat as surviving spouse, a person who was legally married under the law of Canada to someone of the same-sex spouse who was a participant of the plan. Sarah Farley, an employee of the Pennsylvania law firm married Jennifer Tobits, in Canada in 2006. In 2010, Farley died. Under the relevant plan language, death benefits would be paid first to the participant's surviving "spouse." The term "spouse" was not defined by the plan, except to the extent that the plan required that the couple had to be married for at least a year before a "spouse" could receive

benefits. In deciding whether Tobits was a “spouse”, the court looked to *U.S. v. Windsor*, 570 US, 133 S.Ct. 267 (2013), in which the U.S. Supreme Court struck down section 3 of the Defense of Marriage Act. In light of the holding in *Windsor*, the U.S. District Court states that when a state recognizes a party as a “surviving spouse,” the federal government must do the same with respect to ERISA benefits. Here, the Canadian marriage was deemed valid, and Illinois, the state of the couple’s domicile, recognized a same-sex marriage that was performed in another jurisdiction, including the jurisdiction of Canada. Because Illinois considered Tobits to be Farley’s surviving spouse, the court found that she was Farley’s surviving spouse under the plan and, therefore, the proper death benefit recipient.

United States v. Mangiardi, 2013 WL 3810658 (S.D. Fla.) July 22, 2013: A U.S. District Court applied the 10-year statute of limitations to the collection of unpaid estate taxes from the transferee of a decedent’s estate, under Internal Revenue Code Section 6324, rather than the 4-year statute under Internal Revenue Code Section 6901. The court stated that the statute of limitations that is supposed to apply to the decedent’s estate should also apply to the transferee because the liability of the transferee is derivative.

PRIVATE LETTER RULINGS

IRS Letter Ruling 201327010 (July 5, 2013): In the fact pattern provided in this PLR, the taxpayer was the trustee, the trust protector, as well as a discretionary beneficiary of a trust, which held an insurance policy on the life of the taxpayer. The taxpayer divided the trust into two separate trusts, and resigned as trustee of the trust that held the insurance policy. By resigning as trustee, the taxpayer relinquished his powers over the policies or their proceeds and thus his incidents of ownership. Assuming the taxpayer survives the three years after ceasing to be trustee, the policy proceeds will no longer be includible in the taxpayer’s gross estate.

IRS Letter Ruling 201326011 (June 28, 2013): The IRS stated that a grantor who was the income beneficiary of an irrevocable trust and who held a testamentary limited power to appoint the remainder of the trust was deemed to own both income and principal under the grantor trust rules. The determination of the ownership of the trust income stemmed from the finding that the income was required to be distributed to the grantor. The determination of the ownership of the principal stemmed from her ownership over the income allocable to the principal because she had a testamentary power to appointment the corpus, as well as any accumulated income allocable to corpus, and the capital gains were added to corpus.

IRS Letter Ruling 201330016 (July 26, 2013): The IRS stated that a taxpayer who was the beneficiary of death benefits payable on annuities that were owned by her mother at her mother’s death, did not cause a taxable event when she elected to receive the death benefits over her life expectancy because the exchange qualified under Internal Revenue Code Section 1035(a)(3) for tax-free exchange treatment.

PA LEGISLATION

Act 52 (L. 2013, H465 (Act 52)): Act 52 was signed into legislation by Pennsylvania Governor Tom Corbett to be generally effective on July 9, 2013. The Act provides for new credits and exemptions as well as clarifications of certain income tax provisions.

- **Family-Owned Business Exemption:** Pennsylvania now provides an exemption from its inheritance tax for a qualified family-owned business, so long as the business is transferred to one or more qualified transferees. A qualified family owned business is defined for this purpose as having fewer than 50 full-time employees, a net book value of assets less than \$5,000,000, and must have been in existence for at least five years prior to the owner’s death.
- **Income Tax Withholdings:** The withholding requirements have been amended to now require withholdings from distributions made by an estate or trust that receives income from Pennsylvania sources to nonresident beneficiaries.