

**Philadelphia Bar Association
Probate & Trust Section, Tax Committee
Tax Update – September 2012
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GUIDANCE FROM THE IRS

Revenue Ruling 2012-28, October 2012 Rates:

Section 7520 Rate: 1.2%
Short Term AFR (0-3 years): .23%
Mid Term AFR (3-9 years): .93%
Long Term AFR (over 9 years): 2.36%

Proposed Reg. 138367-06. The IRS released proposed regulations to Circular 230, CFR 31 part 10, to eliminate the complex rules governing covered opinions. The proposed regulations expand the requirements for written advice under Circular 230, Section 10.37, in addition to making several other changes to Circular 230. The IRS has asked for comments on the proposed changes and has scheduled a public hearing in Washington for Dec. 7, 2012. The proposed changes will take effect when they are published as final regulations.

Draft Form 706 United States Estate (and Generation-Skipping Transfer) Tax Return for estates of decedents dying after December 31, 2011 and before January 1, 2013. This draft form includes a new Part 6, Portability of Deceased Spousal Unused Exclusion, which has 4 sections: Section A. Portability Election; Section B. QDOT; Section C. DSUE Amount Portable to the Surviving Spouse; Section D. DSUE Amount Received from Predeceased Spouse(s). The draft also includes new Schedule PC, Protective Claim for Refund. In October 2011, the IRS issued Rev Proc 2011-48, 2011-42 IRB, which provided guidance on the filing and subsequent resolution of a protective claim for an estate tax refund based on a deduction for a claim or expense under IRC section 2053 and accompanying regulations. The guidance explained one way to do this was to file what had been an unreleased Schedule PC.

Notice 2012-21, 2012-10IRB: Guidance on portability of the Unified Credit between spouses under Internal Revenue Code (IRC) Section 2010(c).

Temporary Reg. §20.2010-2T: Portability Regulations: The IRS issued temporary and proposed regulations that provide guidance on electing portability of a deceased spousal unused exclusion amount (DSUEA) to the surviving spouse as well as the rules governing the surviving spouse's use of DSUEA. The IRS stated that the regulations cover the entirety of sections 2010 and 2505, as there are no existing regulations under those sections. The IRS confirmed that the term "basic exclusion amount" means the basic exclusion amount in effect in the year of the death of the decedent whose DSUEA is being computed. The regulations also clarify the section 2010(c)(4)(B)(i) provision regarding the "last deceased spouse" limitation.

CASES

Wandry v. Commissioner: On August 28th, the IRS appealed the decision by the Tax Court to the Tenth Circuit Court of Appeal. The Tax Court upheld a defined formula clause to fix the value of the donor's gift of LLC interests.

Neff v. Commissioner, TC Memo. 2012-244 (Aug. 27, 2012): Two employees had split-dollar arrangements with their employer. Upon the termination of this arrangement, the employees paid their employer an amount less than the amount that the employer had paid in premiums. As a result, the Tax Court found that the employees had taxable income under IRC section 61 and section 83 in the amount of the difference of the premiums paid and the amount the employees paid back to the employer upon termination.

Estate of Wimmer v. Comm’r, TC Memo 2012-157, (June 4, 2012): The Tax Court allowed an annual exclusion for gifts of interests in a family limited partnership (FLP). To qualify for the annual gift tax exclusion, the gift must be a present interest. The court determined that a present interest exists if: 1- the FLP will generate income; 2- Some portion of that income would flow steadily to the recipients of the gifts; and 3- That portion of the income could be readily ascertained. The assets of the Wimmer FLP consisted of publicly traded and dividend paying stock and the partnership agreement allocated partnership profits proportionally to partnership interests. Therefore, all three requirements were met in this case, and therefore the gift tax exclusion was available for the present interest in income given.

PRIVATE LETTER RULINGS

IRS Private Letter Ruling 201233008: The IRS ruled that a proposed partial termination and modification of a trust will not cause the trust to be included in the grantor’s estate under IRC section 2036 or section 2038, that it will not trigger a deemed gift under IRC section 2501, and that it will not affect the trust’s status as exempt from the generation-skipping transfer tax. The trust was exempt from GST tax because, on its creation, the grantor had allocated a sufficient amount of his GST exemption to the trust to result in the trust having an inclusion ratio of zero. The IRS did not explain how a partial termination or modification of such a trust would affect its status as exempt from GST, but rather applied the guidance from the scenario of a grandfathered GST trust, when the status is not affected by the same proposed changes.

IRS Private Letter Ruling 201228012: A father was a sole owner of corporation, which has one class of voting common stock. He and his children are directors of the company. The father was ready to retire and cede management to them. To accomplish this, the father proposed giving each child a certain number of shares. Immediately after the transfer, the corporation would redeem the father’s remaining shares for cash and a promissory note, which would provide monthly installments of principal and interest. The IRS ruled this strategy would result in favorable tax consequences for all of the parties. The IRS concluded the father’s gain on the redemption will be capital gain reportable on an installment basis. The IRS also stated the redemption won’t cause any dividend income to be constructively received by the children.

LEGISLATIVE NEWS

Senator Orrin Hatch (R-Utah) introduced the “Tax Hike Prevention Act of 2012,” S. 3143, 112nd Cong., 2d Sess. , on July 19, 2012. The Act proposes extending the current 35% top estate and gift tax rate and the flat 35% GST rate, as well as the \$5.12 million estate and gift tax exemption and GST exemption through 2013. The Act has been placed on the Senate calendar.