Philadelphia Bar Association Probate & Trust Section
Tax Update – October 2013

GUIDANCE FROM THE IRS

Revenue Ruling 2013-22, November 2013 Rates:

- Section 7520 Rate: 2.0%
- Short Term AFR (0-3 years): 0.27%
- Mid Term AFR (3-9 years): 1.73 %
- Long Term AFR (over 9 years): 3.37 %

Inflation-Adjusted 2014 Figures for Estate and Trust Tax Brackets and other Transfer Tax Items

- Unified estate and gift tax exclusion for decedent's dying in 2014: $5,340,000
- Generation-skipping transfer (GST) tax exemption for transfers made in 2014: $5,340,000
- Gift tax annual exclusion for gifts made in 2014: $14,000

2014 Tax Rate Brackets for Estates & Trusts	
If taxable income is:	**The tax is:**
Not over $2,500	15% of taxable income
Over $2,500, but not over $5,800	$375.00 plus 25% of excess over $2,500
Over $5,800, but not over $8,900	$1,200.00 plus 28% of excess over $5,800
Over $8,900, but not over $12,150	$2,068.00 plus 33% of excess over $8,900
Over $12,150	$3,140.50 plus 39.6% of excess over $12,150

Revenue Ruling 2013-17, 2013-38 IRB: IRS Adopts "State of Celebration" Rule:

General Rule: The IRS issued guidance explaining the federal tax implications of the Supreme Court's landmark Windsor decision striking down section 3 of the Defense of Marriage Act (DOMA). The IRS stated that same-sex couples who were legally married in jurisdictions that recognize their marriages (ie: "state of celebration"), will be treated as married for federal tax purposes, regardless of whether their state of residence recognizes same-sex marriage. This treatment applies for all federal tax purposes, including income, gift and estate taxes, and to all federal tax provisions where marriage is a factor. These include filing status, claiming personal and dependency exemptions, taking standard deductions, employee benefits, contributing to an IRA, and claim the earned income tax credit or child tax credit. IRS noted that adopting a state-of-domicile rule would present administrative concerns for both IRS and employers.

Filing Status: Legally-married same-sex couples must file their 2013 federal income tax return using either "married filing jointly" or "married filing separately" status. Same-sex spouses, who filed an original tax return on or after September 16, 2013 for the 2012 tax year, generally must file using a married filing separately or joint filing status.

Amended Returns: Individuals who were in legal same-sex marriages are permitted, but not required to file original or amended returns choosing to be treated as married for federal tax purposes for one or more prior tax years still open under the statute of limitations on refunds (in general, three years from the date the return was filed or two years from the date the tax was paid, whichever is later). Therefore, refund claims may generally be filed for the 2010, 2011, and 2012 tax years.

FAQs: IRS also issued a set of frequently asked questions accompanying Rev Ruling 2013-17.

CASES

Steinberg v. Commissioner, 141 T.C. 8 (Sept. 30, 2013): In a split decision, the Tax Court held that the donees' assumption of potential estate tax liability, if the donor died within three years of the gift, might be consideration under IRC section 2512, thus reducing the amount of the taxable gift. By making this decision, the Tax Court is no longer following its own earlier opinion in *McCord v. Commissioner*, 120 TC 358 (2003), rev'd and rem'd, Succession of *McCord v. Commissioner*, 461 F3d 614 (5th Cir. 2006). The Tax Court's decision in *McCord* had been reversed by the 5th Circuit Court of Appeals, but since Steinberg is not a 5th Circuit case, the Tax Court was not bound by that decision.

Steinberg entered into a binding agreement with her daughters, which stated that in exchange for cash and securities, they agreed to pay any estate tax liability imposed because of the gifts in the event that Steinberg passed away within three years of making the gifts. This situation would result from the inclusion in her estate of any gift taxes paid at the time of the gifts. In calculating for gift tax purposes the fair market value of the property transferred to the daughters, Steinberg reduced the fair market value of the cash and securities by an amount representing the value of the daughters' assumption of the potential estate tax liability. The IRS disallowed the discount and claimed that the recipients' assumption of the potential liability did not increase the value of Steinberg's estate and, therefore, did not constitute consideration for the gifts. The Tax Court concluded that, because the value of the obligation assumed by the daughters was not barred as a matter of law from being consideration in money or money's worth, the fair market value of Steinberg's taxable gift may be determined with reference to the daughters' assumption of the potential estate tax liability. The amount of the offset for the potential estate taxes will be determined in another opinion.

***Zavadil v. Commissioner*, T.C. Memo, 2013-222** (Sept. 9, 2013): The Tax Court held that a company's chief executive officer could deduct charitable contributions made by an S corporation, but only the ones for which he had clearly reimbursed the company. Larry Zavadil was founder and CEO of Americans Solutions for Business (ASB). Zavadil's assistant was responsible for making charitable gifts from ASB, but on behalf of Zavadil. The gifts were tracked on a ledger account and Zavadil was expected to pay the account balance at the end of each month from his personal funds. On some occasions he did pay the balance in full, but other times he did not repay the company. The IRS denied the majority of Zavadil's charitable deductions on his individual federal income tax return based upon two theories. First, the IRS argued that a number of the contributions did not comply with the Sec. 170(f)(8)(B) requirement for a contemporaneous written acknowledgement. Second, the IRS pointed to the fact that some of the contributions were paid for by ASB or Zavadil Development, another one of Zavadil's companies, and, therefore, were not deductible by the Zavadil as an individual taxpayer. The court reviewed the complex accounting issues. It determined that the IRS position was too broad and fails to recognize that Mr. Zavadil at certain times during the years at issue fully paid his ASB ledger account balances with his own funds. Therefore, the Tax Court allowed some of the charitable deductions to stand and disallowed those that could not be proven to have been repaid by Zavadil.

PRIVATE LETTER RULINGS

IRS Letter Ruling 201338028 (Sept. 20, 2013): The IRS stated that the division of the decedent's individual retirement account (IRA) into three sub-IRAs, one for each beneficiary, was not a taxable event. The IRS further declared that the five-year rule of Internal Revenue Code (IRC) 401(a)(9)(B)(ii) would continue to apply to each sub-IRA. The decedent died intestate and his IRA passed to the decedent's three children. The personal representative proposed dividing the IRA into three sub-IRAs. The IRS stated the established of the sub-IRAs would not constitute a taxable transfer of income in respect of a decedent (IRD) under IRC section 691(a)(2), and the three children would include the IRD in gross income when the distributions were actually received by them.