Probate & Trust Section, Tax Committee
Tax Updates – May 2014
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GUIDANCE FROM THE IRS

Revenue Ruling 2014-13, IRB 2014-19 May 2014 Rates:

- Section 7520 Rate: 2.4%
- Short Term AFR (0-3 years): 0.33 %
- Mid Term AFR (3-9 years): 1.93%
- Long Term AFR (over 9 years): 3.27%

Chief Counsel Advice 201416007 (April 18, 2014): The IRS denied the estate tax martial deduction for a surviving spouse's elective share of a decedent's estate to the extent that it could only be satisfied from a trust, in which the surviving spouse could obtain no property interest. The trust had been created by the decedent in a foreign country, under whose laws the spouse could not obtain an interest in the trust. The IRS noted that the property that passed from a decedent in trust is considered to have passed to the surviving spouse, only to the extent of the surviving spouse's beneficial interest in the trust citing *Estate of Turner v. Commissioner*, 138 T.C. 306 (2012).

CASES

Palmer Ranch Holdings, Ltd. V. Commissioner, T.C. Memo 2014-79 *(May 6, 2014)****:*** The Tax Court held that a partnership overvalued a conservation easement for purposes of a charitable contribution deduction, but rejected the accuracy-related penalty because there was no gross valuation misstatement and the partnership acted in good faith. The dispute between the IRS and the taxpayer centered around the "highest and best use" of the property before the easement. The "highest and best" use of property must be a use that is reasonably probable in the reasonably near future, though it need not be the current use or an intended use of the property. (*Hilborn v. Commissioner*, 85 T.C. 677 (1985)) The taxpayer argued that the property could be rezoned to permit denser development, thus making the property more valuable. The IRS argued that the proposed rezoning plan was not "reasonably probable," thus the property could only be developed under the less-dense zoning designation. After concluding that the taxpayer's highest and best use of the property was the appropriate basis for valuing the property, the Tax Court did apply a haircut to the taxpayer's value, finding that that the calculations by the taxpayer's appraiser overstated the growth of the real estate market. The Court concluded that the taxpayer's reliance on the appraisal was reasonable and in good faith, thus accuracy-related penalties were not applicable.

Estate of Woodbury v. Commissioner, T.C. Memo 2014-66 (April 14, 2014): The Tax Court held that a decedent's estate could not make a valid election to defer the payment of estate taxes attributable to the decedent's closely-held business interests under Internal Revenue Code section 6166, because it had filed the estate tax return 2 ½ years after the extended return due date. The estate exhausted its administrative remedies within IRS protesting the denial and filed a petition with the Tax Court requesting declaratory relief under section 7479. The estate asserted it had substantially complied with the requirements set forth in Reg. section 20.6166-1. The IRS argued that the doctrine of substantial compliance does not apply to section 6166 elections. The Court held that the IRS properly denied the estate's section 6166 election, because it was not made on a timely filed estate tax return pursuant to IRC section 6166(d). The Court also held that the estate did not substantially comply with the requirements of Reg. section 20-6166-1(b), but did not hold that the doctrine of substantial compliance was inapplicable per se with regard to elections under section 6166.

Estate of Saunders v. Commissioner, 2014 WL 949246 (9th Circuit, March 12, 2014), aff'g 136 TC 406 (April 28, 2011): The Ninth Circuit affirmed a decision of the Tax Court holding that the value of a claim against a deceased attorney's estate for breach of fiduciary duty and malpractice was too uncertain to be valued on the date of death and allowed a deduction only for amounts actually paid. *Saunders* is one example of the long-disputed consideration of post-death events when valuing claims for purposes of the estate tax deduction, under Section 2053(a)(3), for claims against the estate. The IRS issued final regulations on this topic on Oct. 20, 2009, that provided that an estate may deduct yet-unpaid claims against it if "the amount to be paid is ascertainable with reasonable certainty and will be paid." Those regulations further state that a contested or contingent claim "cannot be ascertained with reasonable certainty" and, therefore, can't be deducted by the estate.

Estate of Ellen Foster v. Commissioner, 113 AFTR 2d, 2014-674 *(March 14, 2014):* The Court of Appeals for the Ninth Circuit has affirmed the Tax Court's estate tax valuation determinations, including a determination that claims against the estate didn't create valuation discounts for certain estate assets and certain claims didn't meet the relevant tests for deductibility as liabilities of the estate. The Tax Court said that a willing buyer would not have insisted on a discount on the assets of the marital trusts because the lawsuit wouldn't have affected a buyer's rights. The Tax court said per the lack of marketability, the freeze may have prevented decedent from selling any of the assets of the marital trust but it did not affect the value of those assets. Finally, as to the Estate's liability resulting from the lawsuit, the Tax Court had found the estate had failed to establish the amount of the liability with reasonable certainty, as required by the applicable regulation. The Ninth Circuit used much of the same reasoning as the Tax Court.

PRIVATE LETTER RULINGS

PLR 201418002 (May 2, 2014): the IRS declined to allow an executor to amend Form 8939, "Allocation of Increase in Basis for Property Acquired from a Decedent," on which the executor had elected out of the estate tax for a 2010 decedent. The executor had found no new assets and merely recharacterized assets whose ownership was already established on the original Form 8939. The IRS noted that an executor of a 2010 decedent was required to file Form 8939 to elect out of the estate tax and allocate carryover basis adjustments on or before January 17, 2012.

PLR 201410001 (March 7, 2014): A trust with a distribution committee was not a grantor trust of the grantor or any of the committee members, except possibly with respect to the power under Internal Revenue Code section 675. The ruling also concluded that the powers possessed by the grantor and the distribution committee prevented the grantor's trust contributions from being treated as completed gifts until distributions were made by the trust. The grantor established an irrevocable trust for the benefit of herself, her children and stepchildren and appointed a corporate trustee. The trustee could make distributions as directed by a distribution committee (which consisted of the grantor, her children and stepchildren). This confirmed the incomplete non-grantor trust strategy, in which a taxpayer establishes a trust in another state, usually Delaware or Nevada, to take advantage of a favorable income tax environment, while avoiding gift or estate tax consequences.