

PREPARED BY:
MAROKO and LANDAU
Mark G. Landau, LLM
32255 Northwestern Highway, Suite 214
Farmington Hills, Michigan 48334
(248) 855-8808
© 2008, Maroko and Landau
www.M-L-Law.com
email: Mlandau@M-L-Law.com

JUNE 2008 CURRENT EVENTS

1. No Designated Beneficiary. IRS ignores court reformation. PLR 200742026.
(10/29/2007)
 - a. Facts
 - (1) Decedent died after RBD naming spouse as beneficiary. Spouse died first. No contingent beneficiary was designated.
 - (2) Child successfully petitioned court for reformation of beneficiary designation to her for the purpose of extending the period of payments to her life expectancy.
 - b. Held
 - (1) IRS did not recognize state court proceedings. (The IRS stated that the owner was required to designate beneficiary (although there are PLRs to the contrary (PLRs 200616039 through 200616041)).
 - (a) The PLRs can be distinguished. In the PLRs, spouse survived, and died shortly thereafter.
 - (b) PR of spouse disclaimed
 - (c) As a result of disclaimer, under decedent's Will, children were residuary beneficiaries.
 - (d) Court reformed beneficiary designations to provide for children.
 - c. Result. Use remaining period of owner's life expectancy.

- d. **Significance.** Always make sure there is a designated beneficiary.
2. IRS Approves a Combined IRA, Charity and Life Insurance Strategy (PLR 20074 1016)
- a. **Facts and Holdings**
 - (1) TP's IRA loaned \$ (\$100,000) to charity
 - (a) Held. Not a prohibited transaction
 - (2) Charity agrees to repay loan
 - (a) \$50,000 used to purchase single pay policy
 - (b) Terms: \$10,000/year to repay loan over period of years (5) or upon death
 - (c) Held. Insurance not a IRA prohibited investment
 - (3) Charity purchased life insurance on TP's life (\$50,000 single pay premium)
 - (4) Insurance proceeds excluded from estate.
 - b. **Significance**
 - (1) Charity benefits by excess death proceeds over loan balance
 - (a) Charity may want donor to forgive loan
 - (2) TP does not have to use other assets to make charitable contribution (note – even though the contribution would be deductible, it may be subject to 3% phaseout over AGI (married joint 2008 – \$159,950).
 - (3) TP's IRA has an investment (loan)
 - (4) **Concerns**
 - (a) Alternative to designate charity as owner and beneficiary is easier vs. this transaction with minor benefit to charity.
 - (b) Difficulty in valuing note for RMD purposes.

3. Wash Sale Rules Apply to IRAs (Revenue Ruling 12/21/07). This Revenue Ruling says that the wash sale rules will apply when an individual sells a stock at a loss and buys the same stock in an IRA or Roth IRA within 30 days before or after the sale. The loss on the sale of the stock will be disallowed and there is no increase in the cost basis of the stock in the IRA or Roth IRA.

a. Example

- (1) Basis = \$1,000
- (2) Sale = \$600
- (3) Loss = \$400
- (4) If individual purchases same stock within 30 days →
 - (a) \$400 loss disallowed
 - (b) \$400 loss never recovered when stock is sold or when distributions are taken from IRA.
 - 1) Under wash sale rules, TP life in same financial position before the stock transaction. When repurchased stock is sold, TP can increase basis of stock by disallowed loss (\$600 basis + \$400 loss = \$1,000 basis). This will reduce gain or increase loss.
 - 2) With traditional IRA, \$400 loss is never deductible and all distributions from IRA are ordinary income.
 - 3) With Roth IRA, any gain in Roth IRA will be tax-free. Any loss is deductible subject to 2% AGI limitation.

4. Comments Sought on Gift Tax Consequences of Trust's Use of Distribution Committee. IRS has announced that it is reconsidering a series of PLRs that have been issued on the gift tax consequences under Code Sec. 2511 and Sec. 2514 of trusts that use a distribution committee consisting of trust beneficiaries who direct distributions of trust income and corpus. (IR 2007-127).

- a. Under the PLRs, distribution committees consisting of trust beneficiaries did not have a general power of appointment because exercise of power could only be made jointly with other trust beneficiaries who have a substantial adverse interest to the exercise of the power in favor of the possessor. IRC 2514(c)

- b. IRS is reconsidering this favorable TP position in light of prior Rev Rulings (Rev. Ruling 76-503 and 77-158) that held a co-trustee that had general power of appointment did not have an adverse interest and therefore had a general power of appointment.
- c. **Significance.** Be mindful of individuals holding general power of appointment – assets could be included in their estate or subject to gift tax upon exercise or release.

5. Trust Severances Addressed in Final and Proposed GST Regs (8/1/07).

- a. Qualified Severance. IRC 2642(a)(3): division of a single trust and creation of two or more trusts if:
 - (1) Single trust was divided on a fractional basis, and
 - (2) Terms of the trusts, in aggregate, provide for same succession of interests
 - (a) Result. Single trust (equally for children and grandchildren) can be divided into 2 separate trusts:
 - 1) One trust for children and grandchildren with inclusion ratio of 1 and another trust for children and grandchildren with inclusion ratio of 0, or
 - 2) One trust for children with inclusion ratio of 1 (no GSKIP allocation here) and another trust for grandchildren with inclusion ratio of 0.
- b. Final Regs Modify Proposed Regs.
 - (1) "Qualified Severance" at top of Form 706 - GST
 - (a) Each severance should be reported
 - (2) Non pro rata funding ok by applying fraction to total value provided:
 - (a) Funding commences immediately, and
 - (b) Occurs within a reasonable time.
 - (c) No valuation discounts. Prop. Reg. 26.2646-6(d)(4)

- (3) Grandfathered GST Trust (irrevocable in 9/25/85) in which addition was made after that date. Reg. 26.2601-1(b)(1)(iv)(A)
- (a) Trust not subject to GST tax (inclusion ratio of \$0), and
- (b) Trust subject to GST tax
- (4) Qualified Severance and then distribution to resulting trusts with one resulting trust having inclusion ratio of zero and another resulting trust having an inclusion ratio of 1. Held, that any taxable event occurs after the severance. Result. No GSKIP tax on funding. Reg. 26-2642-6(f).
- (5) Contingent General Power of Appointment.
- (a) Single trust provides that if inclusion ratio greater than \$0, such resulting trust provides child with general power of appointment upon qualified severance. Reg. 26.2642-6(j), Ex (10)
- (b) Significance. 1 single trust can be drafted that results in no GSKIP tax.

6. Proposed Regs Would Explain 2% of AGI Floor for Trusts and Estates Expenses.
Prop Reg. 1.67-4(7/26/07), effective upon issuance of Final Regs.

a. Under IRC 67(e), miscellaneous deductions subject to 2% floor. IRC 67(a).

b. Expenses unique to administration – not subject to 2% floor:

- * fiduciary accountings;
- * judicial or quasi-judicial filings required as part of the administration of the estate or trust;
- * fiduciary income tax and estate tax returns;
- * the division or distribution of income or corpus to or among beneficiaries;
- * trust or will contest or construction;
- * fiduciary bond premiums; and
- * communications with beneficiaries regarding estate or trust matters.

c. Expenses not unique to administration – subject to 2% floor:

- * custody or management of property;
- * advice on investing for total return;
- * gift tax returns;
- * the defense of claims by creditors of the decedent or grantor; and

- * the purchase, sale, maintenance, repair, insurance or management of non-trade or business property (Prop. Reg 1.67-4(b)).

d. IRS invites comments on safeharbors.

7. Ordering Provisions on Estate and Trust Payments to Charitable Beneficiaries Must Have Economic Effect to be Respected – Proposed Regs Would Clarify Existing Rules. Prop. Reg 1.642(c)-3; 1.643(a)-5. 6/17/2008.

a. Background

(1) Trusts are drafted so that ordinary income is paid first to charitable beneficiaries to obtain charitable deduction.

(a) IRC 642(c) governs charitable deductions.

(b) IRS has issued proposed regs that would provide guidance under Code Sec. 642(c) with regard to the federal tax consequences of an ordering provision in a trust, will, or local law that attempts to determine the tax character of the amounts paid to a charitable beneficiary. Specifically, the regs would confirm that a provision in a governing instrument or local law that specifically provides the source from which amounts are to be paid, permanently set aside, or used for a purpose specified in Code Sec. 642(c), must have economic effect independent of income tax consequences in order to be respected for federal tax purposes. Prop Reg 1.642-(c)-3, Prop. Reg 1.643(a)-5.

b. Significance

(1) Provision in trust that directs income to a charity (example – IRA), will not be respected. Why? Charity will receive same bequest whether or not source is income or principal.

(2) Result. Amount paid to charity is deemed to consist proportionally of income and principal ("the amount to which Section 642(c) applies is deemed to consist of the same proportion that each class bears to the total of all classes").