

CURRENT EVENTS

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1. IRS attacks “abusive” springing value life insurance in retirement plans. Rev Rulings 2004-20 and 2004-21. Effective 2/13/04.
 - Plan purchases life insurance with significant premiums (use: IRC 412(i) plans)
 - Policy structure – little or no cash value
 - Plan distributes policy to participant
 - Abuse – low value for contribution and distribution
 - Held: FMV will include cash value, dividends, premiums through transfer date, plus any supplemental agreements reduced by mortality charges

2. Regs revise trust accounting income under IRC 643(b). Effective tax years after 1/2/04.
 - A. **Significance.**
 - Marital deduction
 - CRTs
 - Capital gain included in income
 - IRAs

 - B. Michigan enacts Uniform Principal and Income Act (eff. 9/1/04).
 - Unless provided otherwise, 10% of RMD = income. If not required payment – all to allocated principal. Power to adjust under IRS Regs. Marital deduction savings clause UPIA 104(A), UPIA 409(3) and (4).
 - Example. “\$1,000,000 IRA RMD = \$100,000. “All Income”. Income = \$10,000 (1% of IRA) – See Trusts & Estates, July 2004. Choate’s article, “Trustees’ dilemma with Section 643”.

3. Estate tax marital deduction allowed despite ambiguous authority to withhold income in case of disability.
 - Marital Trust. "All income." Qualifies for QTIP
 - **Planning**
 - Trust must define IRA income as Trust income (assume 5% = \$50,000).
 - Invest for Total Return.
 - General Power. Withhold income for any beneficiary who is disabled.
 - Held. Marital deduction still OK. Estate of Whiting, Jr. vs IRS, TC Memo 2004-68
 - **Significance**. Draft away provisions that would jeopardize marital deduction.

4. IRS loses retained interest argument under Bona Fide Sales Exception to IRC 2036(a). *Kimbell vs. US* (CA5, May 20, 2004) 93 AFTR 2d 2004-985.
 - Reverses D Ct (held retained interest)
 - Donor transfers and receives proportionate share in return = adequate consideration. Also, donor did not control. Result. Not a retained interest

5. Trust assets are included in estate when grantor controls the distributions. PLR 200419011 (5/10/04).
 - Grantor creates Irrevocable Trust
 - Trustee needs approval from advisory committee – including grantor.
 - Held: revocable transfer. IRC 2038.

6. Transfer of Stock to FLP Value Without Discounts (Sendra vs IRS, TC Memo 2004-160 (7/12/04))
 - After partnership formed – gift made
 - Formalities not respected

7. Buy Sell Agreement did not fix estate tax value of stock. *Estate of Blount* (TC Memo 2004 - 116)
 - IRS = \$2.3MM deficiency
 - 1981 Buy Sell Agreement (Grandfathered under IRC 2703 as long as not substantially modified after 10/10/90).
 - Change in price, terms. Held: substantial modification – Grandfather rule N/A.
 - No lifetime restrictions. Unilateral right to amend agreement.

- No showing of comparable terms.
 - Held. Estate Tax value not fixed.
 - **Planning**
 - Do not change pre 10/9/90 Buy Sell Agreement
 - Include lifetime restrictions.
8. Double Benefit – IRS rules that (1) Irrevocable Trust funded with stock is excluded from Grantor’s estate (no obligation to reimburse grantor) and (2) Grantor’s payment of Irrevocable Trust’s income tax does not constitute a further taxable gift. Rev. Ruling 2004-64 (7/1/04). Also, reimbursement not a gift from beneficiaries since Trustee’s discretion.
- **Planning**. Client can transfer assets to Irrevocable Trust, exclude the assets and its growth from his estate and make additional tax-free gifts. Key. Trustee discretion. Note – In RR, Trustee not related or subordinate to Grantor under IRC 672(c). See Trusts & Estates, September 2004.
9. Taxability of Disability Benefits Under Employer’s Disability Income Plan. Rev. Ruling 2004-55 (May 12, 2004)
- Employer’s Plan: Employer pays premiums. Employee election, year by year, to include/exclude premiums from income
 - Held: If elect prior to beginning of year of disability to include premiums as income, benefits tax free.
10. Carefully drafted Trusts avoid reciprocal trust doctrine. PLR 200426808 (6/25/04).
- 2 Irrevocable Trusts – H creates for W. W creates for H
 - Terms vary – W Trust: vary distribution
 - Held – no reciprocal trust
 - **Planning** – do not make IT identical
11. Prop. Regs (26.2632-1) offer guidance on GST elections (7/13/04 – effective with Final Regs. Election to treat Trust as GST Trust effective on timely filed 709.)
- **Significance**: Currently, there is an automatic allocation of GSKIP exemption to direct/indirect direct skips to GST Trusts. The Prop. Regs. provide procedure for 1 time election (vs. annual filing) to avoid allocation of exemption. **Reason** – distribution unlikely to skip person.

12. IRS Issues Detailed Q & A Guidance on Health Savings Account (Notice 2004-50)
13. Separate accounts – RMD. Under Reg. 1.401(a)(9)-8, A-2, the IRS provided that if separate accounts are created as of the year following the year of the employee's death, the separate accounts can be used to determine the required minimum distribution for the year following the year of the employee's death.
- **Significance.** Separate accounts allow a stretch-out using each beneficiary's life expectancy. Under the old rules, the minimum distribution rules for each beneficiary would have been determined in the year after the creation of the separate accounts.
 - **Example:** If separate accounts are established in 2005, each beneficiary could calculate their RMD on their separate shares in 2005 (not 2006) based on their own ages, using the December 31, 2004 account balance.
14. PLR 200410020(March 5, 2004) permits trusts as a designated beneficiary allowing the use of the oldest beneficiary's (spouse) life expectancy. The trust provided that the IRA could not be distributed for the benefit of the employee's estate, charity or any non-individual beneficiary, and further not to pay any taxes.
- **Significance.**
 - (1) Make sure your trust has language prohibiting the payment to a non-individual
 - (2) Contingent beneficiaries were not even discussed in the ruling.
15. Request to Change QTIP Election for Overfunded Marital Trust. PLR 200422050 (5/28/04). TP made QTIP election for full Marital Trust. After 706 filed, estate determined full QTIP did not take advantage of TP's full applicable exclusion amount. Held: IRS denied partial revocation of QTIP election. Compare Rev. Proc. 2001-38 which permits QTIP election to be disregarded in order to reduce estate tax liability to zero vs. partial QTIP election.