

CURRENT EVENTS

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May, 2005

1. **Interest Deduction as Administrative Expenses PLR 200449031**

A. **Denied**

- Estate obtained loan to pay estate taxes based on lottery winnings included in estate
- Estate claimed interest = deductible administrative expense
- Held - not deductible. Reason: loan not necessary to avoid a financial loss to estate
- **Significance** – To show deduction, expenses must be necessary for administration. If asset could be sold to pay taxes, deduction will be disallowed

B. **Allowed**

- Held – deductible as administrative expenses reasonable and necessary for administration of estate
- Trustee considered selling closely-held stock to pay tax - not commercially reasonable

2. **PLRs Waive 60-day rollover requirement and PLR that says No** – Also see April 2005 article in Estate Planning Journal“ IRS Rulings on IRA rollovers have now been Liberalized”. IRC 408(d)(3)(I) and Rev. Proc. 2003-16.

- Error committed by TP former employer and financial institution. PLR 200447051
- Investment advisor failure to a rollover stated amount. PLR 200447039; 200447041
- Medical Condition. PLR 2005078019
- Erroneous advice from bank representative PLR 200507023
- Check not received timely to meet 60-day requirement. PLR 200447042
- Not allowed – PLR 200513032 (4/1/05) Distribution from inherited IRA taxable.
 - Trust beneficiary
 - Trustee collected \$ and attempt to rollover
 - IRS – no. Fully taxable

- Only spouse can rollover. No relief permitted under IRC 408(d)(3)(C)
- **Analysis**
 - Use Inherited IRA or Trustee to Trustee transfer – not rollover
 - Consider Disclaimer. Beneficiaries disclaim – To spouse-rollover

3. **Estate and gift tax provisions of Working Families Tax Relief Act of 2004**

A. Double benefit prohibition which requires capital gain to be reduced by the deduction for estate tax paid on gain that is IRD applies to qualified dividend income. IRC 691(c)(4). Reason: Prevents heirs/estate from receiving double benefit of (1) lower capital gain rates on IRD and (2) ordinary income deduction for estate tax on IRD.

(1) Example. Estate income: \$15,000 taxable interest income + \$5,000 LTCG. Estate tax on LTCG = \$2,050. Now = \$5,000 LTCG – \$2,050 = IRD deduction of \$2,950 (net IRD deduction) subject to lower capital gain rates. Prior law – IRD deduction reduced \$15,000 ordinary income.

B. Act Section 4021(a)(3) trusts and estates now subject to rule formerly requiring only individuals to treat loss on stock as LT capital loss to extent extraordinary dividends (dividends greater than 10% of basis) that are taxed at capital gain rates.

- (1) Example: 10/1 = \$20 dividend/share declared
- (2) 10/2 – individual buys 100 shares @ 100 = \$10,000
- (3) 11/5 – TP \$2,000 dividend (> 10% of 1,000 basis = extraordinary dividend)
- (4) 12/4 – TP sells stock = \$8,000

$$\begin{array}{l} \text{\$}(10,000) \text{ basis} \\ (2,000) \text{ loss} = \text{LT capital loss (w/n held} \\ \text{for 1 year) (not to exceed} \\ \text{\$2,000 dividend)} \end{array}$$

Effect: Long-term capital loss does not offset the \$2,000 of qualified dividend income. Result: Offsets capital gain and \$3,000 of ordinary income subject to carry forward.

4. **IRAs and annuities allocated to charity do not trigger capital gain to estate**

- Background: IRA allocated to charity permitted under state law allowing non-prorata distribution.
- Typically, IRD distributed in satisfaction of specific bequest = capital gain to estate/trust.
- PLR 200452004 – no gain to estate

5. **IRS allows spouse to open a decedent IRA. PLR 200450057 (12/10/2004)**

- Husband died with Company profit sharing plan.
- Wife under age 59 ½ and needed money (Note: (1) if she rolled over Plan balance and took distribution = 10% penalty. IRC 72(t); (2) if she retained money in Plan – 5 year rule = Plan distribution provision
- Held ok for Wife to rollover money to Husband's IRA (not Wife's IRA) and take distribution (no 10% penalty). RMD based on Wife's life expectancy.
 - Wife designates beneficiary.
 - Wife dies before RBD (later of 12/31 after Husband's death or year Husband age 70 ½) = Use beneficiary life expectancy.
 - Wife dies after RBD - use remaining single life expectancy of Wife
 - Avoids Probate

6. **Final Regulations address pro-taxpayers GRAT/GRUT decisions. Reg 25.2702-2, -3, -7 (2/24/05). Effective – Trusts created after 7/25/04.**

- A unitrust/annuity trust interest payable for a specified term of years to grantor, grantor's estate, or grantor's spouse's successor in interest (if qualified interest) = qualified interest
- **Result: applies even if transferor has right to revoke**
 - A. Retained interest (qualified interest) subtracted from gift. Valued as a period ending after a term of years (vs. shorter of fixed term or period ending at death).
 - B. Low AFR (May 2005 7520 rate = 5.2%) together with higher value of retained interest, results lower (or no) gift of remainder

7. **IRS Updated FAQ on Health Savings Accounts (2/2005)**

8. **IRS provides guidance on automatic rollover of mandatory distributions from Qualified Plan Notice 2005-5 (effective on or after 3/28/05)**

- Applies to mandatory distributions that are eligible rollover distributions greater than \$1,000 and before participant attains the later of 62 or normal retirement age. If no election to receive distribution, must rollover the full amount.
- Plan must be amended by first plan year after 3/28/05.
- Rollover to IRA created by employer

9. **Proposed Regs explain Roth IRA option for 401(k) Plan Contributions.**

Commencing 1/1/06, elective deferrals can be treated as Roth IRA contributions. Prop. Regs 1,401(k)-1, -2, -6. (3/2/05)

- Contribution included in income

- Qualified distribution excluded from income
 - After 5 years from contribution and (1) after 59 1/2 , (2) Death, (3) Disability.
 - Separate accounting
 - Subject to discrimination rules; required minimum distribution
10. **“Wrap fees” are not treated as additional IRA contributions** provided fees are paid with funds that are not part of the client’s retirement account. PLR 200507021. Fees deductible under IRC 162 (trade or business expense) or IRC 212 (miscellaneous itemized deductions subject to 2% floor). If pay fees inside IRA, less available in IRA.
11. **Surviving Spouse’s Withdrawal and Purchase did not prevent qualified disclaimer of joint brokerage account. PLR 200503024 (1/4/05)**
- Husband died owning ½ interest in brokerage account. Wife owned other ½
 - Wife withdrew money.
 - Wife disclaimed within 9 months
 - Held:
 - A. Although Wife accepted benefits, amount not accepted, ok to disclaim.
 - B. As a result of disclaimer, pass to Husband’s trust. Wife = co-Trustee.Held: not acceptance of benefits. Reason: ascertainable standard. Wife could not participate in decision re: brokerage account.
12. **Final Estate Alternative Valuation Regs (1/4/05)**
- A. IRC 2032(c)(2) – Election can be made only if decrease in value of estate and estate tax and GST. Final Regs 20.2032 – (1)(b)(1) provide reference point is decedent’s death (since not certain to determine whether GST will be imposed until such later time).
- B. Can request extension of time to make election (and protective) under Reg. 301.9100-1 and-3 provided 706 filed within 1 year after its due date (including extensions.)
- **Planning** – also file application for relief and refund claim before S/L expires in event request is granted.
 - Automatic extension of time 12 months for regulatory election
 - Automatic extension of time 6 months for statutory election
 - Discretionary extension of time if TP acted in good faith
13. **House of Representatives pass the Permanent Estate Tax Repeal Act of 2005 (which would terminate sunset provisions) and rejected a Democratic attempt to increase exemption to \$3,500,000 (4/13/05)**
14. **New safe harbors for determining fair market value of life insurance contracts distributed from Plans. Rev Proc 2005 – 25 (effective after 2/13/04).**

- Significance. Determine amount included of gross income
- Scope
 - IRC 72 – Annuity rules
 - IRC 79 – Group terms level with permanent insurance
 - IRC 83 - Property transferred in connection with performance of services.
- Safe Harbor for Non-Variable Contracts
 - Greater of
 - (a) Sum of (i) Interpolated terminal reserve and any unearned premiums and (ii) Prorata of portion of dividends; and
 - (b) Product of non-variable PERC amount and (ii) average surrender value
 - (1) Nonvariable PERC amount = aggregate of
 - Premium paid +
 - Dividends applied to purchase insurance +
 - Any amounts credited to policyholder +
 - Mortality and other changes
 - Distribution, withdrawals and partial surrender before valuation date
 - Safe Harbor for Variable Contracts
 - (a) Same as non-variable and
 - (b) Product of variable PERC amount and average surrender value
- (1) Variable PERC Amount
 - Premium Paid +
 - Dividends applied to increase value of contract
 - Adjustments that reflect investment returns
 - Mortality and other changes
 - Distribution, withdrawals or partial surrender
- (2) Average Surrender Value
 - If no adjustment is permitted = 1.00
 - Distribution/sale from qualified plan if contract provides for surrender charges = unweighted average over 10 years
 - Applicable surrender facts = greater of (i). 70 and (ii) fraction

$$\frac{\text{Cash Available}}{\text{Projected/Actual PERC}}$$

Applicable surrender value = 1.00 where no surrender charge
 Additional amount included in income

- Dividends – included if employee has rights to dividends
- Loans – Terminate loan made to employee in connection with performance of service.
- Effective Date – 2/13/04 (can rely on Rev Proc 2004-16 before 5/1/05)

15. New Bankruptcy Act (April 20, 2005 – effective 6 months after)

- A. Self Settled Trust. (Section 548)
- (1) 2 year rule look back rule for fraudulent transfers
 - (2) 10 year look back rule for fraudulent transfers (“Actual intent to defraud”) to self-settled Trusts: debtor remains eligible to receive income and/or principal from Trust
 - (3) **Planning** – Document reasons for transfer (estate planning) other than intent to defraud

B. **Retirement Plans**

(1) **Bankruptcy - Broader Scope of Protection**

(a) More than just “ERISA” Plans – excluded from bankruptcy estate. Retirement Plans/IRAs(Roth). Eliminate distinction between sole business owners (Patterson v Shumate – sole business owners not protected) and other qualified plans.

1) Applies w/n state/federal exemption. Not necessary to show “need” for it to apply (prior federal exemption).

(b) Qualifies for Exemption

1) State Exemption (MCLA 600.5451(l) (IRAs to extent deductible) and (m) (retirement plans) 522(b)(3). Exceptions

- Amounts contributed within 120 days filing
- QDRO
- Child Support

2) Federal Exemption. 522(d) – retirement plans/IRAs (need for support N/A)

- Unlimited

3) Special Rule for only IRAs (Roth) - \$1,000,000 ceiling (plus rollovers), unless “interest of justice so require” - increase cap

- Keep rollovers separate – no cap
- Qualified Plans – no ceiling (unlimited)

4) Not clear if elect state exemption (unlimited IRA protection) w/n overrides 522(n) rollover plus \$1,000,000 ceiling

5) Excess IRAs – greater than \$1,000,000 (non-rollover) Rousey v Jacoway (2005 SCT 2004 WL 742304) exempt IRAs if elect federal exemption and if IRA funds needed for support.

6) Distributions Not Protected

(2) **Non-Bankruptcy** – MCLA 600.6023(1)(k)(IRAs) and (l) (retirement plans)

C. Homestead 522(p)

- (1) Value exempt as to \$125,000 (inflation adjustment) (N/A to farmers). Excess exempt – 3 years 4 months after purchase.
 - (a) Excess exempt if reasonably necessary for support of debtor or any dependents.
 - (b) Value of homestead reduced if within 10 years filing – non exempt property converted to homestead with intent to defraud.
 - (c) Must reside in state for 2 years before can qualify for state homestead exemption.

16. **Power over Income and Corpus Not Enough to Qualify for Marital Deduction PLR 200505022 (2/4/05).**

- Trust – Income distribution subject to ascertainable standard
- Power to withdraw with consent of co-Trustee
- “Held” – no marital deduction as power of appointment trust (IRC 2056(b)(5) or QTIP Trust (IRC 2056(b)(7))

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rev. 5/6/05