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Guidance From the IRS: The Logjam Finally Breaks

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It has been three years since I have written about guidance. In part that is because there has been so much to discuss with regard to legislation, but in part it is because there has been little guidance issued.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRA 2010) [1](#) gave rise to several Priority Guidance Plan projects, and those projects were immediately given the highest priority in the estate and gift area because taxpayers needed the guidance in order to meet return filing deadlines. This summer and fall we saw the guidance relating to 2010 decedents.

Guidance regarding 2010 decedents

On 8/5/2011, the IRS issued Notice 2011-66 [2](#) and Rev. Proc. 2011-41. [3](#) Notice 2011-66 provides guidance on both the carryover basis rules and the 2010 election out of the estate tax. Rev. Proc. 2011-41 focuses primarily on the allocation of additional basis under Section 1022, including guidance on which assets can receive additional basis and how much basis can be allocated to a particular asset. [4](#)

Notice 2011-76 [5](#) was released on September 13, extending the due dates for both the Form 706 and the

Form 8939 for 2010 decedents. [6](#) The Notice also allows estates to request an extension of time to pay any estate taxes due without the need to state a reason. The IRS will charge interest on the late payment, but not penalties. Finally, Notice 2011-82, [7](#) issued on 9/29/2011, reminds taxpayers that they must file a Form 706 in order to take advantage of portability of the unified credit from the deceased spouse to a surviving spouse and creates a presumption that simply filing the estate tax return has the effect of making the portability election, unless there is an explicit indication otherwise. This advice is applicable to 2011 and 2012 decedents. Portability is not available for 2010 decedents.

Forms

The IRS has also been busy producing new forms. The Form 8939, which is to be used to allocate basis and make the election out of the estate tax for 2010 decedents, was released on 10/6/2011. In addition, the IRS has released two new versions of Form 706, one for 2010 decedents and one for 2011 and 2012 decedents. The form for 2011 and 2012 decedents includes instructions pertaining to portability. As explained in Notice 2011-82, the IRS has set up a presumption that if an estate tax return is filed for someone survived by a spouse, the portability election is automatically made unless the executor opts out, either by attaching a special statement to the return, or writing "No Election Under Section 2010(c)(5)" across the top of the first page of the return. The form does not yet seem to provide a way to use exemption transferred to the surviving spouse under portability, even though the death of both spouses in 2011 would put the second estate in a position to use portability as early as the fall of 2011. Moreover, the instructions to the form appear to miscalculate the amount of the exemption available for portability in certain circumstances and will need to be corrected.

Indeed, guidance on portability is reported to be the IRS's number one priority in the estate and gift tax area. Unlike the guidance for 2010 decedents, guidance on portability will have longer-term applicability. Under current law,

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portability is in effect only if both spouses die in 2011 or 2012, but the President's budget proposal includes a provision to make portability permanent, and it is not likely that anyone would oppose that extension other than in the context of a repeal bill.

With the barrage of guidance on 2010, 2011, and 2012 decedents, the logjam seems to have been broken and it appears that the IRS and Treasury can return to work on the backlog of Priority Guidance projects. The Treasury Department and the IRS issued an updated Priority Guidance list on 9/2/2011, [8](#) listing the 317 projects to which the Department intends to allocate resources during the 12-month period from July 2011 through June 2012. There are 17 priority projects listed under the heading "Gifts and Estates and Trusts." Many of these projects will look familiar from the review in this column three years ago. [9](#)

Projects on the Priority Guidance Plan

The 17 items discussed below are on the Priority Guidance list.

1. *Regulations under Section 67 regarding miscellaneous itemized deductions of trusts and estates.* The IRS issued new Prop. Reg. 1.67-4 on this subject on 9/7/11. **10** These new Proposed Regulations replace the Proposed Regulations previously issued on 7/27/07. It is not surprising that the regulations had to be re-proposed because the Supreme Court issued its decision in *Knight* **11** shortly after the 2007 Proposed Regulations were published. The Supreme Court in *Knight* read Section 67(e) differently than the 2007 Proposed Regulations. As a result, the IRS issued a series of Notices postponing the requirement to "unbundle" for deduction purposes fiduciary fees charged by the trustee. **12**

After taking additional public comments, the new Proposed Regulations follow the *Knight* decision more closely. The new Proposed Regulations still require unbundling of fiduciary fees, and request comments on "reasonable methods" on which an allocation of fees could be made. A public hearing is scheduled for 11/19/2011. Notice 2011-37 remains in effect, so taxpayers will not be required to unbundle fiduciary fees until the regulations are made final.

2. *Final regulations under Section 642(c) concerning the ordering rules for charitable payments made by a charitable lead trust.* Proposed Regulations on this subject were issued in June 2008. The IRS expects to issue final regulations during this guidance year.

3. *Guidance concerning adjustments to sample charitable remainder trust forms under Section 664.* This project has been on the Priority Guidance Plan since 2008, but has clearly been given a lower priority than many other projects. It is not known which specific sample charitable remainder trust forms will be changed.

4. *Guidance concerning private trust companies under Sections 671, 2036, 2038, 2041, 2042, 2511, and 2601.* On 7/11/2008, the IRS issued a proposed revenue ruling that describes two safe harbors for private trust companies. The first situation involves a private trust company created under the laws of a state that has enacted a private trust company statute. The second situation involves a private trust company formed in a state that does not have such a statute. The IRS solicited and received comments from the public on the proposed revenue ruling.

In reviewing the comments, the IRS found two intractable problems. First, as commentators pointed out, the facts presumed in the second situation included terms that would not be enforceable under most state laws. Second, there were difficulties in the way that the IRS had tried to mesh the income tax rules and the transfer tax rules. Consequently, the IRS has returned to the drawing board on this project and anticipates making substantial revisions to the proposed revenue ruling. I would expect another opportunity for public comment before this guidance is finalized.

5. *Regulations under Section 1014 regarding uniform basis of charitable remainder trusts.* This project

was added to the Priority Guidance Plan in 2010, but had to take a back seat to more pressing issues.

6. Guidance under Section 1022 concerning estates of decedents who die during 2010. This item has already been completed in the form of Rev. Proc. 2011-41 and Notice 2011-66, discussed above.

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7. Guidance on portability of unified credit between spouses under Section 2010(c). Think of Notice 2011-82, discussed above, as the sneak preview. This project should be at the top of the list for the IRS, as portability needs to be implemented now. I would expect this guidance to be issued in this guidance plan year. Note that the Joint Committee has already issued "errata" with respect to the three portability examples in the General Explanation. **13** As noted in the errata, Example 3 prepared by the Joint Committee reaches a conclusion that is contrary to the legislative intent. The errata concludes that a technical correction is needed to the language of Section 2010(c) in order to carry out the legislative intent.

Example 3 posits a marriage between H and W, during which H dies. W receives \$2 million in portable exemption from H. She then marries H2 and dies before him. She has assets of \$3 million at death. Example 3 concludes that H2 can receive \$4 million in portable exemption from W. The legislative history, however, indicates that a spouse can receive portable exemption from only her *last* husband. Therefore, W in this example should have lost the \$2 million in portable exemption received from H1 when she married H2, and she should only have \$2 million in portable exemption to give to H2 at her death. The IRS will have to grapple with these and other problems in this guidance project.

8. Regulations under Section 2032(a) regarding imposition of restrictions on estate assets during the six-month alternate valuation period. The Proposed Regulations on this subject were issued on 4/25/2008. The issue arose out of the Tax Court decision in *Kohler*, **14** which considered the ways in which the value of the estate can be reduced during the six-month period after death to enable the estate to qualify for use of the alternate valuation date. The Proposed Regulations limit the reduction to those due to "market conditions," but comments received after publication of the proposed regulations raised serious issues about this definition. Criticism of the Proposed Regulations looks significant enough that it could be necessary to re-propose these regulations.

9. Final regulations under Section 2036 regarding graduated grantor retained annuity trusts (GRATs). Proposed Regulations on graduated GRATs were published on 4/30/2009. The Proposed Regulations covered two issues that were not addressed in earlier regulations under Section 2036:

- How to value a graduated GRAT.
- How to value a reversionary interest after the life estate of another person.

Comments received from the public focused primarily on the formula for valuing reversions adopted by the Proposed Regulations. This project will finalize those regulations.

10. Revenue Ruling on whether a grantor's retention of a power to substitute trust assets in exchange for

assets of equal value, held in a nonfiduciary capacity, will cause insurance policies held in the trust to be includable in the grantor's gross estate under Section 2042. In 2008, the Service issued Rev. Rul. 2008-22, **15** regarding the power to substitute assets, stating that such a power would not result in inclusion of the trust assets under Section 2036 or 2038. People then asked whether the result would be any different if the trust held an insurance policy and the potential inclusion would be under Section 2042 rather than Section 2036. This project, which made its first appearance on the Priority Guidance Plan last year, will address that question.

11. Guidance under Section 2053, regarding personal guarantees and the application of present-value concepts in determining the deductible amount of expenses and claims against the estate. This project and item 12 on the Priority Guidance Plan list both stem from the Section 2053 final regulations issued in 2009. They were raised in comments to the proposed regulations, but were beyond the scope of the proposed regulations. Consequently, the regulations were finalized, and these two issues were added to the Priority Guidance Plan as separate projects. The guidance on personal guarantees will take the form of a proposed regulation filling the reserved space in Reg. 20.2053-1(d)(6).

12. Revenue Procedure providing procedures for filing protective claims for refunds for amounts deductible under Section 2053. Rev. Proc. 2011-48, **16** setting forth the

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procedure for filing a protective claim, was issued on 10/14/2011.

13. Notice on decanting of trusts under Sections 2501 and 2601. Aside from the portability project, the Notice on decanting is the only new addition to the Priority Guidance Plan this year. The IRS had been receiving a lot of private letter ruling requests on decanting issues. In January 2011, decanting was included on the annual list of "no rule" areas, stating that this was an area in which no private letter rulings would be issued until regulations, a revenue ruling, or a revenue procedure is issued. **17** It is not surprising now to find that a guidance project on this subject has been opened.

14. Final regulations under Section 2642(g), regarding extensions of time to make allocations of the generation-skipping transfer tax exemption. Proposed regulations on this topic, giving GST issues their own more specific version of the 301.9100-3 regulations, were published on 4/17/2008. A review of the public comments does not reveal anything that should stand in the way of finalizing these regulations. Thus it seems that this project just needs to make it to the top of the pile in order to be completed.

15. Regulations under Section 2704, regarding restrictions on the liquidation of an interest in certain corporations and partnerships. This project wins the "old timer" award for the greatest number of years on the Priority Guidance Plan with no apparent progress. Making its ninth annual appearance on the Plan, this project is presumably intended to exercise the regulatory authority granted in Section 2704(b)(4). Perhaps this is not such a high priority after all.

16. Guidance under Section 2801 regarding the tax imposed on U.S. citizens and residents who receive gifts or bequest from certain expatriates. Section 2801 was added to the Code by the Heroes Earning

Assistance and Tax Relief Act of 2008 (the HEART Act). **18** That Code section applies a transfer tax to certain gifts and bequests received from persons who have expatriated from the U.S. Although the legislation states that it applies to "covered gifts and bequests" received on or after 6/17/2008, the IRS announced in Notice 2009-85 **19** that "satisfaction of the reporting and tax obligations for covered gifts or bequests received will be deferred, pending the issuance of guidance." Thus, to date, the IRS has not enforced Section 2801 against any taxpayer. This guidance, when issued, will allow the IRS to implement Section 2801.

17. *Final regulations under Section 7520, updating the mortality-based actuarial tables to be used in valuing annuity interests for life, or term of years, and remainder or reversionary interests.* This project is the statutorily mandated update of the actuarial tables in Section 7520 in accordance with the decennial census. Finalized in regulations published on 8/10/2011, these regulations update the actuarial tables to reflect the 2000 census. There is a substantial time lag between the census and the analysis of actuarial data gathered. Even if this project had been completed by its statutory due date of 12/31/2009, it would be basing the actuarial tables on nine-year-old data. By the time the 2010 census data makes it into the Section 7520 regulations, the current tables will be nearly 20 years out of date.

Conclusion

The Treasury Department and the IRS have a considerable backlog of guidance on which to work. Almost two years have been lost while the IRS has grappled with the nearly constant flow of new legislation from Congress. Hopefully some of the projects on the Priority Guidance Plan will be completed before the next round of legislation affecting the 2013 tax year is enacted.

1

Pub. L. No. 111-312, 124 STAT. 3296 (2010).

2

2011-35 IRB 184.

3

2011-35 IRB 188.

4

For a discussion of these two pieces of guidance, see Stevens, "IRS Issues Carryover Basis Guidance for 2010 Estates," 38 ETPL 10 (October 2011).

5

2011-40 IRB 479.

6

The taxpayer must request an extension of time for the Form 706 using a Form 4768, but the application

for extension will be approved automatically. By comparison, with respect to the Form 8939, the due date is simply extended to 1/17/2012 for all filers.

7

2011-42 IRB 516.

8

See http://www.irs.gov/pub/irs-utl/2011-2012_pgp.pdf.

9

Kaufman, "Checking in With the Guidance Department," 35 ETPL 37 (December 2008).

10

REG-128224-06, 9/7/2011.

11

101 AFTR 2d 2008-544, 552 US 181, 169 L Ed 2d 652, 2008-1 USTC ¶50132 (2008).

12

See Notice 2008-32, 2008-1 CB 593; Notice 2008-116, 2008-52 IRB 1372; Notice 2010-32, 2010-16 IRB 594; and Notice 2011-37, 2011-20 IRB 785.

13

Errata to General Explanation of Tax Legislation Enacted in the 111th Congress, JCX-20-11 (3/23/2011), available at <http://www.jct.gov/publications.html?func=startdown&id=3774>.

14

TC Memo 2006-152, RIA TC Memo ¶2006-152, 92 CCH TCM 48 , *nonacq.* AOD 2008-01 (3/3/2008).

15

2008-1 CB 796.

16

2011-42 IRB 527.

17

See Rev. Proc. 2011-3, 2011-1 IRB 111.

18

Pub. L. No. 110-245, 122 STAT. 1624 (2008).

19

2009-45 IRB 598.

