Deutsche Asset
& Wealth Management

Blanche Lark Christerson
Managing Director, Senior Wealth Planning Strategist

Tax Topics

2015-12

12/22/15

"Extenders" extended – some permanently!

On December 18, 2015, President Obama enacted omnibus legislation to keep the government funded through September 30, 2016 (the current fiscal year) and to extend a number of tax benefits that had expired at the end of 2014. The "Consolidated Appropriations Act, 2016," which has about $1.1 trillion worth of spending, and the "Protecting Americans from Tax Hikes Act of 2015," which runs at about $622 billion over ten years, were joined in H.R. 2029. Here are some details of this legislation:

Permanent extensions. 22 of the 50+ tax benefits that expired at the end of last year were made permanent and can now offer taxpayers a degree of certainty (these temporary provisions are called "extenders" because they regularly expire and Congress regularly renews them). For example, businesses can now rely on the research and development credit, and individuals can better forecast their taxes, thanks to the permanency of the following:

- The deduction for state and local general sales taxes (in lieu of the deduction for state and local income taxes)
- The $250 above-the-line deduction for certain expenses of elementary and secondary school teachers, which will now be indexed for inflation, and
- Charitable IRA rollovers.

As a reminder, ***charitable IRA rollovers*** let taxpayers who are at least 70½ give up to $100,000 from their IRA to a public charity such as the taxpayer's favorite museum or alma mater (donor advised funds, supporting organizations or private foundations won't work). The distribution:

- Counts towards the taxpayer's "required minimum distribution"
- Is not subject to federal income tax, and
- Is not deductible as a charitable contribution (note that the state income tax treatment may differ).

In addition, the taxpayer can't receive anything in exchange for the contribution (no chicken dinners at the local charity event!), but can use it to satisfy an outstanding pledge. Although the check must be payable directly to the charity, the taxpayer can still deliver it herself; the charity must provide the usual written acknowledgement of the contribution. For taxpayers who have been waiting to make a 2015 charitable IRA rollover, it's a go.

5-year extensions. Four business provisions have been extended through 2019 (this is a five-year extension, since it relates back to January 1, 2015), and include the new markets tax credit and bonus depreciation.

2-year extensions. Over 20 provisions have been extended for two years (again, since the extension relates back to the beginning of this year, these provisions will expire at the end of 2016). Included in this batch of extenders are a) the gross income exclusion for the discharge of mortgage indebtedness, and b) the above-the-line deduction for qualified tuition and related expenses.

Affordable Care Act provisions. This legislation has several provisions dealing with the Affordable Care Act (also known as "Obamacare"):

- The 2.3% excise tax on sales of medical devices will be suspended during 2016 and 2017 (the tax took effect in 2013)
- The annual fee on health insurance providers that took effect in 2014 will be suspended in 2017; and
- The 40% excise tax on high-cost employer-sponsored health coverage – the so-called "Cadillac tax" that was to take effect in 2018 and is payable by the "coverage provider" – has been postponed until 2020; in addition, the tax will now be deductible.

529 plans. There were a few enhancements to 529 plans, a tax-favored way to save for "qualified higher education expenses." These expenses include tuition and room and board, and now permanently include the costs of a computer and related technology.

Comments. This legislation passed with significant bipartisan support and shows that compromise is possible, even in a fractured Congress with great philosophical differences. Whether this portends future compromise legislation in 2016 – an election year! – remains to be seen.

Income tax refunds part of gross estate

If a taxpayer overpays his income tax and dies before receiving his refund, are those dollars includible in his gross estate? The answer is yes, and the question was the subject of a recent Tax Court Memorandum decision (*Estate of Badgett v. Commissioner*, T.C. Memo. 2015-226, 11/24/15).

The facts. D lived in Kentucky and died on March 8, 2012, or about a month before the April 15th due date for his 2011 income tax return. D's executor, E, filed for an automatic extension and filed D's 2011 return on May 1, 2012. In round numbers, D owed $495,000, even though he had paid in $925,000; E applied $25,000 of this $430,000 overpayment to D's 2012 income tax liability, and requested a refund for the balance ($405,000). The IRS issued the refund on May 28th. On December 13, 2012, E filed D's estate tax return, and did not include the $430,000 overpayment in D's gross estate. On April 15, 2013, E filed D's 2012 final income tax return: D owed about $11,000, and the IRS refunded the $14,000 overpayment later that May. On January 6, 2015, the IRS mailed an estate tax deficiency notice to E, claiming that the estate owed nearly $150,000 in estate tax because E did not include the 2011 and 2012 refunds (i.e., the collective $430,000 overpayment) in D's estate. E disagreed and went to Tax Court.

E's argument. E acknowledged that D had overpaid his 2011 and 2012 income taxes, but argued that this $430,000 overpayment did not create a right to an income tax refund, as under Kentucky law, "property must be in existence on the tax assessment date to be subject to tax and cannot be a mere possibility or expectancy." That is, there was no property interest until the refund had been "declared by the Government."

What the Tax Court said. The Tax Court rejected E's argument and sided with the IRS. The court essentially said that because D, at his death, did not have any unpaid Federal tax liabilities for years other than 2011 and 2012, the full value of D's "viable but unasserted" income tax refund claim was an asset of D's estate. In other words, since D had no offsetting tax liability for other tax years, D's estate could compel the IRS to issue refunds for 2011 and 2012. D's overpayments had therefore attained "the status of independent assets," and constituted D's property for estate tax purposes.

Comments. *Badgett* was issued as a "memorandum" opinion, meaning that the Tax Court views the case as involving settled law. Yet it is hard not to wonder about a few things, including why it was a given that D's overpayment was $430,000 *at the moment of death*, the critical "snapshot in time" for estate tax purposes. What if, for example, the IRS had disagreed with positions taken in D's 2011 return, and demanded an adjustment? Or what if, shortly after D's death, the IRS informed D's estate that it was auditing an open income tax year, such as 2010? In those circumstances, the pending refund could be offset against these other tax liabilities – thereby potentially affecting the amount (and therefore includibility) of D's 2011 overpayment. Yet those were not the facts in this case, of course.

Although post-death events theoretically are not supposed to affect the includibility of assets at the decedent's death, it seems possible that several such factors may have done exactly that, and made this an "easy" case for the Tax Court: 1) because D had no other known outstanding tax obligations *at his death* (and none were later discovered between his death and when the estate tax return was filed), his refund seemed assured; and 2) the IRS's prompt refund of D's 2011 overpayment (again, within the same month his 2011 return was filed) indicates that there were no issues with his taxes, from 2011 or otherwise.

The bottom line is that D's estate should have included the overpayment, and owes almost $150,000 in estate taxes.

January 7520 rate

The IRS has issued the January 2016 applicable federal rates: the January 7520 rate is 2.2%, up 0.20% (20 basis points) from where it was in December (and November). The January mid-term rates are also up: 1.81% (annual), 1.80% (semiannual and quarterly) and 1.79% (monthly). The December midterm rates were: 1.68% (annual), 1.67% (semiannual and quarterly) and 1.66% (monthly).

Blanche Lark Christerson is a managing director at Deutsche Asset & Wealth Management in New York City, and can be reached at blanche.christerson@db.com.