



Alpern Rosenthal Tax Newsletter

September 2012 • www.alpern.com

Estate Taxes – Don't Let the Sun Go Down on You

By Brooke T. Anderson, JD – Senior Tax Manager



By this point, everyone has heard the news of the Bush tax cuts sun-setting on December 31, 2012. Will this really happen? What will Congress do? The answer is that nobody knows. The only way, therefore, to address these unknowns is to plan accordingly – at least as much as you can.

Let's look specifically at estate and gift tax. Here is where things stand now: the annual exclusion amount (amount that will be excluded from federal estate tax at death) for an individual is \$5,120,000. Basically, if a person dies with an estate that is less than this amount, no estate taxes will be due. If, however, one has an estate that is greater than the exclusion amount, then the amount over the \$5,120,000 threshold will be taxed at the current estate tax rate of 35 percent. Likewise, an individual has a \$5,120,000 gift tax exemption. As a result, one can gift up to \$5,120,000 without having to pay gift tax of 35 percent.

In addition, we have a special tool this year for married couples called "portability." Let's go back to the basic concept that each individual has an exclusion amount of \$5,120,000. Well, for married couples, should one pass away this year not having used his/her total exclusion amount, any unused portion can be given to the surviving spouse. So, in a simple example, if husband died this year with an estate of \$3,120,000, then husband's unused exemption amount of \$2 million could be transferred to wife and added to her \$5,120,000 personal exemption. As a result, if wife were to pass away in 2012, a total of \$7,120,000 would not be subject to federal estate tax. Portability can be applied to gifting, as well.

Where are estate taxes headed? As of now, on January 1, 2013, the annual exclusion amount is set to drop to \$1,000,000 per person, with the federal estate tax rate rising to 55 percent. Portability will no longer exist. These are the same amounts that were in effect in 2001/2002. This means that each individual has a \$1 million exemption and the value of one's estate over \$1 million will be taxed at 55 percent – ouch!

What else could happen? Congress could decide to change the annual exclusion amount to \$3,500,000 and institute a 45% estate tax rate. Alternatively, Congress could extend the current \$5,120,000 and 35% estate tax rate, figuratively "kicking the bucket down the road" so that they can decide later. Or, maybe another alternative will be considered. There is no way to know what will be decided.

What can you do now? The best action you can take now is to reduce the size of your estate. Consider gifting as much money or as many assets out of your estate as possible. There are many gifting options available – outright gifts to individuals; direct payment of education and tuition expenses; funding of 529 plans; charitable contributions; and gifts to trusts of various types.

Should you decide that taking advantage of this huge opportunity is something you would like to consider, please reach out to us. We can discuss the options that would be most suitable given your particular situation. We can help you to determine what amount and which assets would be most appropriate to remove from your estate. The bottom line is – not acting before the sun goes down on December 31, 2012 could cost a lot of money in the long run – don't let this opportunity pass you by.

IRS Releases Draft of Form W-8IMY, Form W-8BEN and Form W-8BEN-E

By Gretchen J. Wyatt, CPA - Senior Tax Manager, International Taxation Services Group



On August 14, 2012, the IRS released a draft version of Form W-8IMY, Certificate of Foreign Intermediary, Foreign Flow-Through Entity or Certain U.S. Branches for United States Tax Withholding, which has been modified for FATCA purposes. The new draft form has been published on the IRS website along the new W-8BEN and W-8BEN-E, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding (Entities), which was released in draft form in June. Neither form has draft instructions issued yet. The IRS has not formally issued effective dates for these forms.

Prior to the issuance of these new drafts the purpose of the W-8BEN is to provide this form to the withholding agent or payer if you are a foreign person and you are the beneficial owner of an amount subject to withholding. Submit Form W-8BEN when requested by the withholding agent or payer whether or not you are claiming a reduced rate of, or exemption from, withholding, which is also indicated on this form.

The form W-8IMY prior to the issuance of the new form final must be provided by the following:

- A foreign person, or a foreign branch of a U.S. person, to establish that it is a qualified intermediary that is not acting for its own account, to represent that it has provided or will provide a withholding statement, as required, and, if applicable,

IRS Releases Draft of Form W-81MY, Form W-8BEN and Form W-8BEN-E (Continued)

to represent that it has assumed primary withholding responsibility under Chapter 3 of the Code and/or primary Form 1099 reporting and backup withholding responsibility.

- A foreign person to establish that it is a nonqualified intermediary that is not acting for its own account, and if applicable, that it is using the form to transmit withholding certificates and/or other documentary evidence and has provided or will provide a withholding statement, as required. A U.S. person cannot be a nonqualified intermediary.
- A U.S. branch of certain foreign banks or foreign insurance companies to that the it receives is not effectively connected with the conduct of a trade or business within the U.S. and either that it is using the form (a) as evidence of its agreement with the withholding agent to be treated as a U.S. person with respect to any payments associated with the Form W-81MY or (b) to transmit the documentation of the persons for whom it receives a payment and has provided, or provide, a withholding statement, as required.
- A foreign partnership or a foreign simple or grantor trust to establish that it is a withholding foreign partnership or withholding foreign trust under the regulations for sections 1441 and 1442 and that it has provided, or will provide, a withholding statement, as required.
- A foreign partnership or a foreign simple or grantor trust to establish that it is a nonwithholding foreign partnership or nonwithholding foreign simple or grantor trust for purposes of section 1441 and 1442 and to represent that the income is not effectively connected with a U.S. trade or business, that the form is being used to transmit withholding certificates and/or documentary evidence, and that it has provided, or will provide, a withholding statement, as required. Solely for purposes of providing this form, a reverse hybrid entity that is providing documentation on behalf of its interest holders to claim a reduced rate of withholding under a treaty is considered to be a nonqualified intermediary unless it has entered into a qualified intermediary agreement with the IRS.
- A foreign partnership or foreign grantor trust to establish that it is an upper-tier foreign partnership or foreign grantor trust for purposes of section 1446, and to represent that the form is being used to transmit withholding certificates and/or documentary evidence and that it has provided, or will provide, a withholding statement, as required.

Similar to the new draft W-8BEN-E, the new draft Form W-81MY has increased from two pages to seven pages. Both the new Form W-8BEN-E and Form W-81MY have expanded to contain the various new Chapter 4 certifications for the specific FATCA entity types. The IRS has not released details regarding the requirements for the newly required foreign TIN field. The complicated factor to the new W-81MY is that on this form, entities will have to complete two sets of certifications (one for Chapter 3 and one for Chapter 4) which may be confusing to some and may lead to errors in completing the form. In addition, like the new W-8BEN-E, several sections refer to code sections within the U.S. federal regulations. Therefore, non-U.S. person

will need to understand U.S. tax law. This requirement will require increasing numbers of non U.S. persons to employ U.S. representation for tax consulting assistance to fill out these forms.

Changes to Form W-81MY:

The new draft form added Territory Financial Institution to the Chapter 3 status along with a certification section. The new form added the following Chapter 4 entity to the status:

- QI Branch of U.S. Financial Institution
- "Other. Must Enter Code" – It is not clear what this status refers to or what code needs to be entered
- Non-participating FFI with exempt beneficial owners

The new form removed the following Chapter 4 entity types because the entity must be the beneficial owner of the payment and therefore the new W-8BEN-E would be required:

- Exempt retirement plan
- Foreign government or government of a U.S. possession
- Foreign central bank of issue

The new form also removed publicly traded NFFEs and affiliates Chapter 4 status type.

The new form now prohibits "in care of" address for a permanent address. The foreign tax identifying number is now required.

The provisions of the Qualified Intermediary (QI) Certifications have been revised. The major changes include an additional line to enter a branch country and the removal of the certification to assume primary 1099 reporting and backup withholding responsibility. Other changes include adding Chapter 4 to the certification to assume primary withholding responsibility.

The significant change for participating FFI and registered deemed compliant FFI is the addition of the certification to assume primary withholding responsibility for gross proceeds and foreign pass thru payments. Like the Form W-8BEN-E, a new field for a FATCA ID is provided. The new ID will be the ID that withholding agents will use to match against the public list available from the IRS.

A certification was added to indicate the owner-documented FFI is a partnership, simple trust, or grantor trust which indicates that entities of these types must use the Form W-81MY and not the Form W-8BEN-E.

Although not a separate FATCA classification, a certification section was provided for a restricted distributor which it will presumably use to certify its status to a Restricted Fund.

Date fields have been provided for the start-up date for an Excepted Start-up Company and the bankruptcy date for an Excepted Nonfinancial Entity in Liquidation or Bankruptcy. This date will need to be stored and tracked by the withholding agent as it will trigger addition documentation requirements after a certain period of time has elapsed.

IRS Releases Draft of Form W-81MY, Form W-8BEN and Form W-8BEN-E (Continued)

The certification in Part XX of the form will be for Territory Financial Institutions acting as intermediaries and gives the entity the option to either be treated as a U.S. person for Chapter 3 or Chapter 4 purposes, or to provide a withholding statement along with documentation or withholding certificates for underlying payees.

The entity must now certify to provide a new Form W-81MY if any certification made on the form becomes incorrect.

The Department of Justice Continues to Investigate Offshore Investment Accounts

By Jessica Vitullo, CPA - Senior Tax Accountant



The Department of Justice's Tax Division has taken high priority in civil and criminal effort to combat the serious problem of non-compliance with our tax laws by US taxpayers using secret offshore bank accounts. In 2008, a Senate report concluded this problem cost the US Treasury at least \$100 billion annually.

In August 2009, the Internal Revenue Service and the Department of Justice successfully negotiated an agreement with UBS AG, Switzerland's largest bank. Under the agreement reached, the IRS will receive an unprecedented amount of information on United States holders of accounts at the Swiss Bank of UBS.

Per the agreement, the IRS will submit a treaty request to the Swiss government describing the accounts for which it is requesting information. The Swiss government will then direct UBS to initiate procedures to turn over information on the accounts to the IRS. The IRS will receive information on accounts of various amounts and types. Holders of these accounts will be notified that their information is included in an IRS treaty request.

As a result of the Swiss government's compliance, the United States was able to uncover several instances of tax evasion and fraud. The Swiss bank has handed over names and details of more than 10,000 persons with undisclosed offshore accounts. The release of this information has left Swiss bankers fearful of being arrested. This fear has caused many bankers to be fearful of traveling to other countries. They fear they may be targeted and arrested by US Authorities. This fear is so prevalent, former and current employees of Swiss bank launched suit against the Swiss government. Both criminal and civil complaints were filed with members of the Swiss government for authorizing the release of this information. The charge was that the release of this information violated various provisions under the Swiss Criminal Code, the Federal Act of June 19, 1192 on Data Protection, and banking secrecy provisions under the 1934 Federal Law on Banks and Savings Banks.

In recent development, a decision was issued August 16th where the Swiss attorney general's office declined to investigate these charges. The Swiss federal prosecutor ruled that there were insufficient grounds for opening a criminal investigation. The

prosecutor also ruled that Swiss banking secrecy provisions were not violated because the information handed over to the US Justice Department did not compromise bank clients.

The Swiss bank case is only the beginning of the Department of Justice's continued pursuit of tax evasion and fraud overseas. There are reports that the IRS and Department of Justice are now focusing on banks in Asia and the Middle East, these targets include Singapore, India, and Israel.

Along with compliance from other countries, the IRS is had taken other actions to better track offshore investments. In 2011, Form 8938 was created and required to be filed by taxpayers. This form is used to report ownership of foreign financial assets whose value is more than the applicable reporting threshold. Failure to file this form can warrant a maximum penalty of \$50,000. The IRS has also increased scrutiny and come down heavily on penalties for not filing Form TD F 90-22.1 properly. This form is used to report a financial interest or signature authority over foreign financial accounts greater than \$10,000.

This issue of offshore investments will no longer be treated lightly. As these investments continue to grow and evolve so will the investigations conducted by the IRS.

Taxation and Valuation of Mineral Rights and Natural Gas Interests for Pennsylvania Inheritance Tax

By Joshua Lefcowitz, CPA/ABV/CFF, CVA, CFE, ASA - Senior Manager, Business Valuation and Litigation Support Services

Christopher B. Miller, CPA/ABV/CFF, Manager, Business Valuation and Litigation Support Services



On July 10, 2012 the Pennsylvania Department of Revenue issued Inheritance Tax Bulletin 2012-01 (the "Bulletin"), "Taxation and Valuation of Mineral Rights and Natural Gas Interests for Pennsylvania Inheritance Tax." The Bulletin clarifies the Inheritance and Estate Tax Act of 1991, (72 P.S. §§ 9102, 9121). Specifically, the Bulletin explains that all mineral and natural gas rights shall be reported on *Inheritance Tax Schedule E (REV-1508)* as Cash, Bank Deposits & Misc. Personal Property and that the taxable value should be determined using the same methodology used to value real property and/or tangible personal property interests.

Taxable value of mineral rights is most clearly established by a bona fide sale. If there has not been any sale a computed value can be determined for mineral rights, based upon the Assessed Tax Value. In the event that there is no sale and no computed value, then the taxable value is the interest's actual monetary worth.

With regard to natural gas rights, taxable value is most clearly established by determining the actual monetary worth of the interest determined by a bona fide sale. Otherwise, if there is no bona fide sale, natural gas rights can be determined from a credible appraisal. Unlike mineral rights, a computed value using assessed value cannot be accomplished because natural gas rights do not have assessed values.



Taxation and Valuation of Mineral Rights and Natural Gas Interests for Pennsylvania Inheritance Tax (Continued)

According to the Bulletin, absent a *bona fide* sale, an appraisal or other credible evidence to the contrary, value should be determined specifically as follows:

- (i) Leased and producing properties** – the value of the natural gas rights are determined by multiplying the aggregate of all amounts received attributable to actual production of the natural gas interests during the twelve months prior to the decedent's date of death by two.
- (ii) Leased, non-producing properties** – interests should be reported at a value of zero unless, at the time of death, the properties were part of a contractual arrangement whereby they generated fixed future payments, in which case the natural gas rights shall be calculated by reducing the fixed future payments to present value as of the decedent's date of death using established Internal Revenue Service actuarial tables as found in *IRS Publication 1457 Actuarial Values Table B, Section 3 Annuity, Income, and Remainder Interests For a Term Certain*.
- (iii) Non-leased, non-producing properties** – interests should be reported at a value of zero.

Natural gas wells generally have a significant "flush period" where a significant portion of the estimated ultimate recovery of natural gas is produced. If the well in question has reached the end of the flush period, an appraisal may be warranted as the formula indicated above (§ i) may overstate the value of the remaining natural gas rights.

If you have any questions or desire further information on any of the articles provided in this newsletter, please contact your Alpern Rosenthal representative.

For more information on Alpern Rosenthal's Tax Services:

▶ Visit: www.alpern.com/corporate-tax-planning.php

▶ Follow us on Twitter: @alpernrosenthal