Estates and Trusts: A Major Disagreement on Tax Brackets, Cut-off Points and Rates

Neil E. Harl
Iowa State University

Follow this and additional works at: http://lib.dr.iastate.edu/aglawdigest

Part of the Agricultural and Resource Economics Commons, Agricultural Economics Commons, Agriculture Law Commons, and the Public Economics Commons

Recommended Citation
Available at: http://lib.dr.iastate.edu/aglawdigest/vol24/iss9/1
Estates and Trusts: A Major Disagreement on Tax Brackets, Cut-off Points and Rates

-by Neil E. Harl

Minor differences between and among tax information sources occur occasionally but the differences are usually small and border on the inconsequential. However, the differences in the 2013 tax rates, brackets and cut-off points among the brackets for income taxation for estates and trusts have broke new ground. The differences are substantial and jarring. Moreover, this author doubts there is authority for taxing the income of estates and trusts in 2013 at the 39.6 percent rate in any event as noted below.

The contrasting authorities

The Internal Revenue Service, in Rev. Proc. 2013-15 specifies the following rates and brackets for estates and trusts for 2013:

- Not over $2,450: 15%
- Over $2,450 but not over $5,700: 25%
- Over $5,700 but not over $8,750: 28%
- Over $8,750 but not over $11,950: 33%
- Over $11,950: 39.6%

In contrast, Commerce Clearing House (CCH) in its version of the 2013 Internal Revenue Code specifies the following rates and brackets for estates and trusts for 2013:

- Not over $1,500: 15%
- Over $1,500 but not over $3,500: 28%
- Over $3,500 but not over $5,500: 31%
- Over $5,500 but not over $7,500: 36%
- Over $7,500: 39.6%

The differences are substantial and raise the question of which is correct and whether either is correct.

The apparent source of the problem

In drafting Title I of the American Taxpayer Relief Act of 2012, in General Extensions, the Congressional drafters were coping with a maze of different extensions of tax legislation over more than a decade. The Congress had modified tax rates, brackets, and cut-off points in three major tax bills, not to mention several minor pieces of legislation. In the 2012 ATRA, the drafters chose to deal with all of that in Section 1(i) of the Internal Revenue Code with cross references to the various provisions affected. For trusts and estates, for which the tax treatment is prescribed in I.R.C. § 1(e), the key authority was added as an amendment to I.R.C. § 1(i).
That Code subsection (I.R.C. § 1(i)) deals with “rate reductions after 2000.” I.R.C. § 1(i)(2) prescribes the tax brackets and rates for married taxpayers filing jointly (authorized in I.R.C. § 1(a)); for heads of households (authorized in I.R.C. § 1(b)); for unmarried individuals (other than surviving spouses and heads of households) (authorized in I.R.C. § 1(c)); for married individuals filing separate returns (authorized in I.R.C. § 1(d)); and for estates and trusts (authorized in I.R.C. § 1(e)). Note carefully the subsections for each category and note particularly the subsection for estates and trusts, subsection (e).

I.R.C. § 1(i), providing overall guidance for the subsections, proceeds to state that for all five subsections – (a), (b), (c), (d) and (e) -- the tax tables for brackets are to be applied by substituting “25%” for “28%”, “28%” for “31%” and “33%” for “36%” wherever each appears. That was done in Rev. Proc. 2013-15 but not in the CCH version of the Internal Revenue Code. The latter does not contain any explanation for why the statute was not followed.

Then in I.R.C. § 1(i)(3)(A)(i), the statute states that for taxpayers in categories (a), (b), (c) and (d), but not (e) the highest tax rate is to be 35 percent except for certain high tax bracket taxpayers and for those taxpayers the top rate is to be 39.6%. That is in Clause 1(i)(3)(A)(i). Clause 1(i)(3)(A)(ii) states that “. . . the 39.6 percent rate of tax under such subsections shall apply only to the taxpayer’s taxable income in such bracket in excess of the amount to which clause (i) applies.” Clause i, as just noted, applies only to categories (a) through (d) but not to (e). Both the IRS authority and the CCH version of the Internal Revenue Code specify a 39.6 percent rate for estates and trusts.

If the 39.6 percent rate is to be applied to estates and trusts it would appear that a technical amendment will be needed. Imposing such a rate on taxable income somewhere between $7,500 and $11,950 – the sources are that far apart in the point at which the tax rate would jump to 39.6 percent -- would appear to be punitive in relation to the point at which the same rate is applied for the other four categories and will provide a strong incentive to reduce the use of trusts, in particular. Although there have been instances of abuses, discouraging the use of trusts in estate (and business) planning in such a manner on a wholesale basis seems to be an unwise policy move. If the intent was to raise more revenue, that could be done more effectively with a slightly higher rate for all taxpayers than to target estates and trusts only.

It does seem that there is no strong policy argument for imposing such a high rate at such a low level for just one category of taxpayer.

Other incentives

Unless amended, and an amendment is in order simply to clarify what the Congress intended, the 39.6 percent rate (applied as low as taxable income of $7,501), will certainly encourage distributions to beneficiaries during the taxable year and, under the special provision which has been available for several years, to make distributions within the first 65 days of the next taxable year and be considered to have been made in the preceding year.

Finally

Certainly unless and until a technical correction is passed, it would be helpful if the tax information sources could reach agreement as to how estates and trusts are to be taxed in 2013. In the meantime, it seems prudent to follow the Internal Revenue Service authority in Rev. Proc. 2013-15. After all, it is IRS that audits returns.

ENDNOTES


3 I.R.C. § 1(e).

4 I.R.C. § 1(e).


6 I.R.C. § 1(i)(2)(A), (B), (C).


9 I.R.C. § 663(b)(1).