CURRENT EVENTS IN ESTATE PLANNING

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ESTATE PLANNING UPDATE

A. ESTATE TAX

1. 2018 Estate, Gift and GST Tax Exemption Amounts and New Tax Law Updates.

Revenue Procedure 2018-18. Pursuant to the 2017 Tax Act (the "Act") and Rev. Proc. 2018-18, the inflation adjusted estate, gift and GST tax exemption amount for 2018 is $11,180,000. Rev. Proc. 2018-18 modifies certain 2018 cost-of-living adjustments set forth in Rev. Proc. 2017-58 for the Chained Consumer Price Index for All Urban Consumers. The 2018 gift tax annual exclusion is $15,000 (and $152,000 to a non-citizen spouse).

New Tax Law Section 199A Clarification. New Section 199A generally allows certain taxpayers to deduct 20% of their qualified business income received from pass-through entities. In order to be entitled to the deduction, the income must derive from a qualified trade or business, which includes any trade or business other than a "specified service trade or business."

A specified service trade or business is defined as a business in the fields of health, law, consulting, athletics, financial services, or brokerage services, or ***any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners***.

Architects and engineers were removed from the list of service businesses that would not qualify for the deduction shortly before the bill was passed. However, there was apparent confusion as to whether architects and engineers may nevertheless fall under the catch-all provision (in bold italics above).

2017-2018 Priority Guidance Plan Update. On February 7, 2018, the Treasury Department and the IRS released the second quarter update to the 2017-2018 Priority Guidance Plan. The second quarter update reflects additional projects, including those that have become near term priorities as a result of the Tax Cuts and Jobs Act legislation enacted on December 22, 2017. The Priority Guidance Plan contains guidance projects that are intended to be complete prior to June 30, 2018. The 18 projects identified as related to initial implementation of the Tax Cuts and Jobs Act are:

- Guidance on certain issues related to the business credit under § 45S with respect to wages paid to qualifying employees during family and medical leave.
- Guidance under §§ 101 and 1016 and new § 6050Y regarding reportable policy sales of life insurance contracts.
- Guidance under § 162(m) regarding the application of the effective date provisions to the elimination of the exceptions for commissions and performance-based compensation from the definition of compensation subject to the deduction limit.
- Guidance under § 162(f) and new § 6050X.
- Computational, definitional, and other guidance under new § 163(j).
- Guidance on new § 168(k).
- **Computational, definitional, and anti-avoidance guidance under new § 199A.**

2789/99999-704 CURRENT/101077792v1

- Guidance adopting new small business accounting method changes under §§ 263A, 448, 460, and 471.
- Definitional and other guidance under new § 451(b) and (c).
- Guidance on computation of unrelated business taxable income for separate trades or businesses under new § 512(a)(6).
- Guidance implementing changes to § 529.
- Guidance implementing new § 965 and other international sections of the TCJA. (published 01/22/18 in IRB 2018-04 as Notice 2018-07 (Released 12/29/17)).
- Guidance implementing changes to § 1361 regarding electing small business trusts.
- Guidance regarding Opportunity Zones under §§ 1400Z-1 and 1400Z-2.
- Guidance under new § 1446(f) for dispositions of certain partnership interests. (To be published 02/12/18 in IRB 2018-07 as Notice 2018-08 (Released 12/29/17)).
- Guidance on computation of estate and gift taxes to reflect changes in the basic exclusion amount.
- Guidance regarding withholding under §§ 3402 and 3405 and optional flat rate withholding.
- Guidance on certain issues relating to the excise tax on excess remuneration paid by "applicable tax-exempt organizations" under § 4960

SALT Payments Recast as Charitable Contributions. The new tax law limits the SALT deduction to $10,000, which has prompted high-taxed states, such as New York and California, to consider legislative proposals that would allow their residents to avoid the new limitation.

One proposal currently being considered by at least three states, California, New York and New Jersey, is recasting the SALT payments as charitable contributions and providing state tax credit up to the full amount of the contributions, in effect providing an end-run around the $10,000 annual deduction limitation on SALT payments that does not apply to charitable contributions. California has already introduced legislation – SB 227, the "Protect California Taxpayers Act."

Consider whether a purported charitable contribution to a state is deductible under Section 170(a) in light of the donor receiving a quid pro quo benefit in the form of state tax credits in return for the contribution. If the contribution is considered to lack donative intent and not to have been made voluntarily, the contribution will be characterized as the equivalent of a state tax payment and, therefore, subject to the $10,000 SALT deduction limitation. CCA 201105010 supports the deductibility of such payments under Section 170(a).

2. **Valuation Issues.**

***Estate of Kollsman v. Commissioner*, T.C. Memo. 2017-40, T.C., No. 26077-09, (February 22, 2017).** The U.S. Tax Court found that the estate of a New York taxpayer had undervalued two paintings it inherited by $1.77 million. The presiding judge ruled that the estate's expert was unreliable due to significant conflicts of interest. The paintings were first valued by Sotheby's "based on firsthand inspection" at $500,000 and $100,000, respectively. The $500,000 painting was eventually consigned to Sotheby's and listed at $2.4 million. The estate used the $500,000 and $100,000 valuations on the federal estate tax return. The IRS

issued a deficiency notice, alleging values of $2.1 million and $500,000, respectively. The IRS successfully argued that the Sotheby's valuation expert had direct financial incentive to curry favor with the executor by "lowballing" the values and also provided no comparables to support his valuations. The court ruled that the paintings would be valued at $1.995 million and $375,000.

***Estate of John F. Koons, III, v. Commissioner*, No. 16-10646, 2017 WL 1501062, at *1 (11th Cir. Apr. 27, 2017).** The Eleventh Circuit (a) agreed with the Tax Court's limitation of a lack of marketability discount to 7.5% instead of 31.7% claimed where most assets of the LLC were liquid, and (b) denied the estate's deduction for interest on a loan (Graegin loan) made by the LLC to the estate because the LLC had sufficient liquidity to have made a distribution to the estate to pay the estate tax liability.

Notice 2017-38 (July 8, 2017). On April 21, 2017 President Trump issued an Executive Order instructing the Treasury to reform unduly burdensome regulations. In response, on July 8, 2017 the IRS and Treasury issued Notice 2017-38, which identifies several regulations that meet the President's criteria. Among those are the proposed Section 2704 regulations that would make it more difficult to obtain valuation discounts on lifetime transfers of minority or nonvoting interests in a closely-held enterprise.

3. **Family Limited Partnerships.**

***Powell v. Commissioner*, 148 T.C. No. 18 (May 18, 2017).** Nancy Powell was terminally ill when her son, using a California power of attorney, undertook "aggressive deathbed tax planning" that began by creating a limited partnership. As Ms. Powell's attorney-in-fact, her son then contributed almost all of her assets ($10 million in liquid assets) to the limited partnership in exchange for a 99% limited partnership interest. In his individual capacity, the son, along with his brother, contributed an unsecured promissory note to the limited partnership in exchange for a 1% general partnership interest. The partnership agreement gave the general partners absolute discretion regarding distributions and investment, but allowed for the partnership to be dissolved upon the consent of all the partners (including the limited partner). Lastly, as Ms. Powell's attorney-in-fact, her son contributed Ms. Powell's 99% limited partnership interest to a CLAT that would pay the remainder to himself and his brother in their individual capacities. Ms. Powell died a week after her son undertook the steps in this transaction.

Ms. Powell's son was also her executor and filed the relevant gift tax return to report the transaction. On Ms. Powell's gift tax return, the transfer to the CLAT was reported but the value of the gift was reported with a 25% discount for lack of control and lack of marketability. Ms. Powell's estate tax return did not include the value of the limited partnership interest or the securities transferred to the limited partnership.

The IRS issued an assessment, arguing that the assets transferred were includable in the decedent's estate under IRC 2036(a)(2) and IRC 2035. Specifically, the IRS argued that the transfer from Ms. Powell to the limited partnership was includible under IRC 2036(a)(2) because under the terms of the partnership agreement, which required unanimous consent of the partners to dissolve the partnership, Ms. Powell effectively retained the ability to designate who could possess or enjoy the property or its income. This, despite the partnership agreement

2789/99999-704 CURRENT/101077792v1

providing explicitly that the general partners had sole discretion regarding distributions. The IRS also argued that Ms. Powell effectively retained control over the limited partnership via her son, who was the general partner individually and had a fiduciary duty as her power of attorney. Accordingly, the IRS stated that the son's powers over distributions should be attributed to Ms. Powell.

The tax court agreed with these arguments fully and found that the family nature of the fiduciary duties held by the son made Ms. Powell's interest in the limited partnership includible under IRC 2036(a)(2). The tax court also agreed that any power to be involved in a distribution or dissolution decision, even if allowed by state law, would subject an interest in a limited partnership to inclusion under IRC 2036(a)(2). Alternatively, the tax court found that the value of the assets transferred were includible under IRC 2035 as a transfer within three years of death. Further, the tax court, without briefing from any parties, noted that if such a transfer were to occur in another case where there was appreciation on the transferred assets, the appreciation may be subject to double taxation in the decedent's estate under IRC 2036(a)(2) and as an interest in a partnership or other entity under IRC 2033.

4. **Payment of Estate Tax.**

***Estate of Hake v. United States*, No. 1:15-CV-1382, 2017 WL 551813, at *1 (M.D. Pa. Feb. 10, 2017).** Middle District of Pennsylvania held that executors were not liable for penalty for late filing of estate tax return where the return was filed within the time frame advised by estate's attorney and estate attorney was incorrect. Court distinguished this case from the Supreme Court case because here, executors relied on substantive advice of attorney (i.e., what the due date was) whereas in the Supreme Court case, executors relied on attorney to prepare and file the return (i.e., an administrative task), and that did not excuse taxpayer from ensuring that the attorney filed the return on time.

SBSE-05-0417-0011 (April 5, 2017). In June 2016 the Specialty Collection, Offers, Liens and Advisory Office took over the investigation and management of requests for discharge of the estate tax lien and began requiring that all net proceeds from sales of decedents' houses be held in an escrow account before discharge. On April 5, 2017, the Treasury issued guidance in SBSE-05-0417-0011 to employees in the Office, informing them that there are circumstances in which an estate may be entitled to discharge of the estate tax lien without escrow.

Section 6324 provides that on the day someone dies a federal estate tax lien comes into existence, attaching to all assets of the decedent's gross estate that are reported on a Form 706. The purpose of the estate tax lien discharge is not to evidence payment or satisfaction of the estate tax, but rather to permit the transfer of property free from the lien in case it is necessary to clear title during an estate sale. As a general matter, the IRS always has discretion to determine whether sales proceeds should be held in escrow. If the proceeds are in escrow, a discharge of the lien may be issued. The difficulty is that it can take months or years to receive a closing letter evidencing discharge of the lien, which may hamper efforts to conjure up estate liquidity. To combat this, estate attorneys sometimes draft informal affidavits attesting that all estate debts have been paid and agreeing to indemnify against failure to pay the full estate tax that is due. Buyers often deem this sufficient to clear title on the sale. However, title companies

and managing agents of co-op boards refuse to accept these affidavits and instead require receipt of either estate closing letters or formal discharges of the estate tax lien.

The Treasury's guidance highlights that the primary focus in determining whether to grant the discharge is whether the government's interest is adequately secured. There is only one circumstance in which there can be no discharge of the lien without escrow: if the estimated estate tax liability is greater than the net sales proceeds, and the full estate tax has not been paid, the proceeds must be held in an escrow account. There are several circumstances, however, in which an estate may be entitled to discharge of the lien without escrow: (1) where no estate tax will be due; (2) where the estate tax return has been filed and the reported tax has been paid; (3) where the estate has paid the full estimated tax liability at the nine-month due date and filed for the automatic six-month extension to file the return; (4) where the IRS has determined an adequate amount has been paid in partial satisfaction of the tax due; and (5) where (i) the fair market value of the property is worth at least twice as much as the estimated tax liability and (ii) other liens on the property have priority over the estate tax lien.

From this guidance it is possible to glean a few rules of thumb. If the estate pays all sales proceeds over to the IRS before the estate tax payment is due, and the proceeds or other assets cover the amount of the estate tax, no escrow agent will be needed. If the decedent's house is sold before the estate tax payment is due, but the estate tax liability is higher than the sale price, the estate has two options. It could either pay over all the sales proceeds in hopes that the IRS will consider it partial satisfaction of the liability and grant discharge of the lien, or it could pay an agent to hold the proceeds in escrow (generally title companies only charge around $100 to act as escrow agent). If the house will be sold between the nine-month payment date and the fifteen-month return filing date, or if the fair market value of the house is higher than the estimated estate tax liability, the estate could file for a Section 6161 extension of time to pay the estate tax. This is a strong option when the house is one of the major assets of the estate so liquidity for paying an estimated tax is impossible otherwise *and* the house will be sold within twenty-one months of the decedent's date of death when the 6161 extension will expire. If the house will be sold after the twenty-one month extension date, the sale proceeds will likely have to be held in escrow until an estate administration closing letter is issued.

***United States v. Holmes*, 2017 WL 2458923 (5th Cir., June 6, 2017)**. In *United States v. Holmes*, Shirley Bernhardt died in 1997 and her nephew Kevin Holmes and his wife Barbara (the "taxpayers") became responsible for paying the entire estate tax liability. The taxpayers paid the amount of tax they claimed was due, but when the IRS assessed a deficiency the taxpayers failed to pay or respond for six years. In June 2004 a U.S. Tax Court entered a stipulated decision that the estate owed an additional tax and on July 16, 2004 the IRS entered the new assessment on its books (thus restarting the statute of limitations period). The taxpayers still did not pay and on October 6, 2013, after the government had begun placing liens on their property, they mailed in a request for a due process hearing. In May 2014 the taxpayers renewed their request for a due process hearing, attaching their October 2013 letter as evidence that they had already requested a hearing. The hearing was held and on June 2, 2014 the Office of Appeals sustained the levy amount. Then, in May 2015, the IRS commenced a federal court proceeding against the taxpayers to foreclose outstanding liens and obtain a money judgment for the unpaid taxes, penalties and fees. At that point the taxpayers argued the ten-year limitations period for collecting a tax deficiency had expired.

It is an accepted rule of law that the statute of limitations is suspended during the pendency of a due process hearing; the issue was when the pendency began. The IRS argued that while the IRS filed its case 10 years and 237 days after the limitations period began anew, the period was suspended for 241 days in the interim (between October 6, 2013 and June 2, 2014). The taxpayers had argued the limitations period was suspended only in May and June 2014, but the IRS pointed to the taxpayers' own submission of proof that they had initiated the hearing process back in October. On eventual appeal, the Fifth Circuit sided with the IRS's version and held the government could sue to collect the unpaid estate taxes.

B. GIFT AND GST TAX

1. PLR 201721006 (February 13, 2017).

The IRS addressed the tax consequences of a proposed division of the QTIP trust into two trusts ("Trust 1" and "Trust 2") followed by the renunciation by the Surviving Spouse of any interest in Trust 1.

The IRS made the following determinations:

a. Surviving Spouse Not Deemed to Have Made a Gift. The Surviving Spouse will not be deemed to have made a gift of the property in Trust 2 under §2519 (as a reminder §2519 states that any disposition of all or part of a qualifying income interest for life, for which a deduction was allowed under the marital deduction, is treated as a transfer by the surviving spouse.)

b. Renunciation Will Not Result in Zero Value Under Section 2702. Spouse's renunciation of his entire interest in Trust 1 will not result in Spouse's interest in Trust 2 being valued at zero under §2702.

c. Property Deemed Transferred Pursuant to Section 2519 Not Included in Surviving Spouse's Estate. Property owned by the Marital Trust that is deemed transferred pursuant to §2519 will not be included in the Surviving Spouse's gross estate under §2044(a) because of the application of §2044(b)(2).

2. Chief Counsel Memorandum 20172801F (July 14, 2017)

In Chief Counsel Memorandum 20172801F, the IRS reiterated that under Section 6501(c)(9) the statute of limitations will not begin to toll on a gift tax return that lacks adequate disclosure. Under Treasury Regulation § 301.6501(c)-1(f)(2), a gift is adequately disclosed if the return includes (i) a description of the transferred property; (ii) any consideration received by the transferor; (iii) the identity of and relationship between the transferor and transferee; and (iv) a detailed description of the method used to determine the fair market value of the gift.

Under the facts as stated, a taxpayer made gifts in Years 1 through 6 and failed to file Forms 709. The taxpayer made gifts in Year 7 and did file a Form 709, but failed to describe the property transferred or provide a description of the valuation method. The IRS concluded that in Years 1 through 7 the taxpayer failed to adequately disclose the gifts made and so the gift tax could be assessed at any time, without regard to the limitations period. Note that, under Rev.

Proc. 2000-34, a donor can commence the statute of limitations by filing returns for years where returns lacked adequate disclosure by filing complete and accurate Forms 709.

3. **PLR 201808001 (November 16, 2017).** The IRS held that the life tenants' transfer of a section of their real property would not trigger 2702 with respect to the section retained where the original acquisition was entered into before October 8, 1990 (i.e., prior to enactment of Chapter 14). The value of the life tenants' remaining interests in the property would not be included in their gross estates for estate tax purposes.

4. **PLR 201811002 (Released March 16, 2018).** The IRS ruled on the gift and GST tax consequences of gift tax returns that incorrectly reported gifts made by a husband to trusts for his children, and of a subsequent Form 709 making a late allocation of GST exemption. The IRS determined that because the period for assessment had expired on the amount of the original gift, the husband was deemed to have gifted the incorrectly reported amount. As to the late allocation, however, the husband's late allocation is effective only as to one-half of the gift transferred to the trusts for his children.

5. **PLR 201814005 (Released April 6, 2018).** The Grantor created a GST-Exempt trust for his wife and descendants that split into separate trusts, per stirpes, for the Grantor's descendants upon the death of the survivor of wife and Child 1. Two of Grantor's descendants were ultimately disabled, and the Trustees petitioned the state court to modify the trusts for the disabled beneficiary to (a) change the income distribution standard from being mandatory to discretionary, (b) require any income not paid to be accumulated in a separate account to be paid to the beneficiary's estate at his death, (c) remove the disabled beneficiary's lifetime withdrawal rights, (d) grant the disabled beneficiary certain testamentary GPOAs. The Service found, in pertinent part, that these modifications did not shift the disabled beneficiary's interest to a lower generation or extend the time for vesting and thus, these modifications did not affect the GST status of the trust or otherwise cause a taxable distribution or taxable termination.

6. **PLR 201817012 (Released April 27, 2018).** Pursuant to the terms of the trust, the Trustees petitioned the state court to divide a grandfathered GST Trust into separate trusts for each of the Donor's great-grandchildren in order to equalize the available assets based on what each beneficiary had previously received. The Service found that the division did not change the grandfathered status of the trusts because it did not shift any beneficial interests to beneficiaries in a generation lower than the persons holding the beneficial interests or extend the time for vesting beyond the period provided in the trust.

7. **IRS to end offshore voluntary disclosure program.** In IR-2018-52, the IRS announced it will close the 2014 Offshore Voluntary Disclosure Program (OVDP) on September 28, 2018. The IRS urges US taxpayers with undisclosed foreign financial assets to use the OVDP before the program closes. Once the program ends the IRS will continue to use other methods (such as taxpayer education, civil examination and criminal prosecution) to combat offshore tax avoidance.

C. INCOME TAX

1. **<u>Lender Management, LLC v. Commissioner.</u>** The Tax Court ruled that a family office, Lender Management, LLC, was "carrying on a trade or business" as an investment manager rather than serving as a passive investor and therefore was entitled to deduct expenses under Section 162 rather than Section 212.

This is a favorable decision because trade or business expenses generally can be deducted under Section 162 without limitation. In contrast, expenses deductible under Section 212 are miscellaneous itemized deduction, which, under the new tax law, are no longer deductible through 2025.

2. **<u>PLR 201707001 (February 17, 2017).</u>**

The IRS ruled that a surviving spouse could roll over her deceased spouse's Roth IRAs and regular IRA, payable to a trust of which she was sole trustee and beneficiary, into her own Roth IRA and regular IRA. During life, decedent and spouse created a joint revocable trust. On decedent's death, surviving spouse became sole trustee and had authority to allocate trust assets amongst 3 resulting subtrusts: a revocable survivor's trust for her benefit, an irrevocable bypass trust and an irrevocable marital trust. The survivor's trust was to receive the survivor's separate property and whatever portion of the trust was deemed the survivor's community property. Some of decedent's IRAs designated the "main trust" as beneficiary, while others named the resulting irrevocable marital trust.

Surviving spouse obtained a court order to designate the main trust as the beneficiary of the "marital trust IRAs;" she thereafter allocated all original "main trust IRAs" to the survivor's trust and evenly split the modified marital trust IRAs amongst the survivor's trust and the marital trust. The IRS deemed the IRAs allocated to the survivor's trust are not "inherited IRAs" under IRC 408, but that surviving spouse could roll over distributions therefrom to her own IRAs. By making the rollovers, spouse could avoid taking lifetime required minimum distributions ("RMDs") from the Roth IRAs, and would be treated as the owner of the regular IRA for purposes of computing lifetime RMDs from that account.

3. **<u>*McManus v. United States*, 2017 BL 66227, Fed. Cl., No. 1:15-cv-00946 (March 3, 2017).</u>**

The U.S. Court of Federal Claims rejected a creative treaty-based claim for refund on U.S. income taxes paid on $17.4 million in U.S. source gambling winnings earned over 3 days. The taxpayer, an Irish citizen living in Switzerland, sought a refund under the U.S.-Ireland treaty by arguing that his payment of Ireland's "domicile levy" made him an income tax resident of Ireland under the treaty. Ireland does not tax gambling winnings and the U.S.-Ireland treaty states that income types not described by the treaty, such as gambling winnings, are taxable only in the taxpayer's country of residence.

Unfortunately for the taxpayer, the IRS obtained advice from Ireland's Office of the Revenue Commissions that the domicile levy was not an income tax covered by the treaty and that the taxpayer had not been subject to Irish income tax since 1995. The Court of Federal

2789/99999-704 CURRENT/101077792v1

Claims found this advice from the Irish "competent authority" persuasive and, as such, ruled against the taxpayer.

4. ***Ruiz v. Publix Super Markets, Inc.*, No. 8:17-CV-735-T-24 TGW, 2017 WL 1180095, at *1 (M.D. Fla. Mar. 30, 2017).**

ESOP and 401(k) beneficiary designations did not take effect because of failure to strictly comply (rather than substantially comply) with the requirements of beneficiary designation forms.

5. ***Shank v. Commissioner*, T.C. Memo. 2018-33.** In *Shank*, the Tax Court concluded that the taxpayer's individual retirement account established basis in an amount equal to his initial nondeductible contributions for a portion of a lump-sum distribution from the account, but that the IRS had correctly determined the bulk of the distribution is taxable.

6. ***Mazzei v. Commissioner*, 150 TC No. 7 (Mar. 5, 2018).** In *Mazzei v. Commissioner*, the Tax Court sustained the IRS determination that certain family members were the owners of, and liable for tax on, funds they rerouted from their family business through a Bermuda-based foreign sales corporation and into Roth IRAs that they had established for this purpose.

The court declined to uphold penalties under Section 6651(a) and (b), but held the taxpayers were liable for excise tax under Section 4973 for excess contributions to Roth IRAs.

D. CHARITABLE PLANNING

1. **PLR 201713003 (March 31, 2017).**

IRS held that CRUT was not subject to Code section 4947(a)(2) (i.e., private foundation rules, including self-dealing and excess business holdings rules) because the grantor has never taken a charitable deduction, even though a charitable deduction as allowable.

2. ***Fakiris v. Commissioner*, T.C. Memo 2017-126 (June 28, 2017).**

IRS held that judicial termination of CRUT (which was not respected as a CRUT throughout its existence) to noncharitable recipient would result in excise taxes under Code sections 4941 and 4945 and may also result in additional tax under Code section 507.

In *Fakiris v. Commissioner*, the Tax Court denied a taxpayer's charitable deduction because the taxpayer retained the power to alter the beneficial enjoyment of the gift by prohibiting retransfer of the donated property within five years and retaining the right to transfer the property to another charity.

The taxpayer, George Fakiris ("Fakiris"), was a 60% member of Grou Development LLC ("Grou"), which rented and developed real estate. Grou acquired a dilapidated but historic theatre on Staten Island with plans to raze it and erect a new high-rise building. The community opposed the plan and eventually Grou decided to offset its costs by donating the theatre to a tax exempt organization and getting a charitable deduction.

A recently-organized dance company called Richmond Dance Ensemble, Inc. ("Richmond") showed interest in acquiring the theatre, but because it had not yet received recognition by the IRS as a tax-exempt organization, Fakiris was unsure the donation would qualify for the charitable deduction. Richmond had a relationship with WEMGO Charitable Trust, Inc. ("WEMGO"), which did have tax-exempt status. With the understanding that Grou would ultimately transfer the theatre to Richmond, the parties determined that Grou would officially sell the theatre to WEMGO and when Richmond received its tax-exempt status Grou would be able to, in essence, take the theatre back from WEMGO and donate it to Richmond. In the contract of sale the parties memorialized these terms, specifically agreeing that WEMGO could not transfer the theatre to anyone other than Richmond within five years of the sale and that Grou retained the right to take the theatre back when Richmond received its tax-exempt status. The contract stated the agreed-upon provisions would "survive closing," but the provisions were not memorialized in the deed between Grou and WEMGO.

In November 2003 Grou had obtained an appraisal for the theatre at $4.5 million. In June 2004, just before the transfer, Grou obtained a new appraisal that estimated the theatre's value at $5 million. Grou sold the theatre to WEMGO for approximately $470,000 in June 2004 and WEMGO transferred the theatre to Richmond (on a date before Richmond received its determination letter from the IRS but after the "effective as of date" of tax-exempt status once it did receive the determination letter). Grou reported a bargain sale of $470,000 on its Form 1065 return but no charitable contribution. Fakiris then reported a charitable contribution of $3 million on his 2004 income tax return.

The court noted that for a bargain sale to be a charitable contribution (i) the seller must have requisite charitable intent and (ii) the fair market value of the property must exceed the selling price. The contribution is not deductible unless it constitutes a completed gift, meaning the donor has relinquished dominion and control over the contributed property. Treasury Regulation § 1.170A-1(e) provides that no deduction is allowed where the transfer is subject to a condition or power that is not so remote as to be negligible. The IRS argued Grou's transfer wasn't a completed gift because it retained dominion and control over the theatre when it sold to WEMGO. Fakiris argued that since the restrictions weren't memorialized in the deed, they weren't determinative as to whether Grou retained dominion and control and, under the terms of the deed, the sale to WEMGO evidenced a completed gift.

Under New York law, the provisions of a contract for sale generally merge with the deed, with the deed extinguishing any claims arising under the contract after closing of title. However, where there is clear intent evidenced by the parties that a particular provision survives delivery of the deed, that rule does not apply. Here, in the contract for sale the parties had clearly manifested their intent to transfer the theatre from WEMGO to Richmond when the latter received its IRS determination letter. Therefore, the contract for sale did not merge with the deed, and the provisions in the contract for sale evidencing Grou's retention of dominion and control prevailed.

Thus, the court held that Grou's transfer wasn't a charitable contribution because it was not a completed gift. Where a taxpayer is not entitled to a claimed charitable deduction, the value of the property contributed is deemed to be zero, and any claimed value above that is considered a valuation misstatement. Since the misstatement was over 400% the amount of the actual value of zero, an accuracy-related penalty of 40% for gross misstatement of valuation was

assessed against Grou.

3. **Green v. United States – Charitable Contribution Deduction under Section 642(c).**

The 10th Cir. Court of Appeals addressed the question of the amount a trust can claim as a charitable contribution deduction under Section 642(c)(1) when it donates appreciated property. Reversing the district court, the 10th Cir. held that Section 642(c)(1), which allows trusts a deduction without limitation for any amount of gross income paid for a charitable purpose, does not allow a trust a charitable deduction for the excess of fair market value over adjusted basis of property contributed to a charity, where the property had been purchased by the trust with the trust's gross income.

4. ***RERI Holdings, LLC I v. Commissioner*, 149 T.C. 1 (July 3, 2017)**

When a taxpayer donates property and claims a charitable contribution deduction in excess of $500, the donor must file a Form 8283, and if the claim is in excess of $5,000 the donor must obtain a qualified appraisal and the charity must sign the Form 8283 acknowledging the gift. A Form 8283 requests information about the donated property, including (i) the date of the contribution, (ii) the date and method of acquisition by the donor, (iii) the donor's cost or adjusted basis, (iv) the fair market value at the time of contribution and (v) the method used to determine fair market value.

In *RERI Holdings, LLC I v. Commissioner*, a partnership owned an LLC that owned real property. The partnership split its LLC interest into a term-of-years interest and a remainder interest and then sold the remainder interest to the donor (another partnership) for $3 million. A year later, the donor gifted its LLC remainder interest to a university and claimed a $33 million deduction. The donor filed a Form 8283, complete with a qualified appraisal and the university's acknowledgment of receipt, but failed to note the donor's cost or adjusted basis. The Tax Court denied the donor's entire $33 million deduction, arguing that the omission of the donor's $3 million cost basis was an intentional omission hiding a potential overvaluation, and thus its absence did not permit application of the substantial compliance doctrine.

The Court also found that the taxpayer's qualified appraisal of $33 million was faulty. First, the donor used an eighteen-month old appraisal, which was too old to be used to determine the value of the remainder interest. Second, the appraiser used the Section 7520 tables, which was not the appropriate method of valuation. These tables only apply when the donor retains a present interest in the property and has an obligation to preserve its value. Since the tables could not be used, the appraiser should have determined the actual fair market value of the interest based on what a willing buyer and willing seller would have agreed upon. This value would have been a number much lower than the $33 million value at which the appraiser arrived. As a result, the IRS imposed a Section 6662(h) gross valuation misstatement penalty for claiming a deduction equal to 400% or more of the property's actual value.

The Philanthropic Enterprise Act of 2017. The Act was included as part of the Bipartisan Budget Act of 2018, signed by the President into law on February 9, 2018. Lobbied for by Paul Newman's "Newman's Own Foundation", the "Newman's Own Exception" as it is being called now permits private foundations to own for-profit businesses if certain requirements are met. The prohibition against excess business holdings (which prohibits a private foundation from

owning more than 20% of voting stock (or 35% in certain instance) of a business will no longer apply to such qualifying private foundations and business. There are a series of requirements that must be met, including: (1) the private foundation must own 100 percent of the business's voting stock, (2) the private foundation cannot be controlled by the family members of the creator of the private foundation, and (3) all profits of the business must be distributed to the private foundation.

E. PRENUPTIAL AGREEMENTS AND DIVORCE

F. PLRs 201707007 and 201707008 (February 17, 2017).

The IRS ruled on the tax effects of a divorcing husband's contribution of company shares to a trust created pursuant to a property settlement agreement. Ex-wife was entitled to net trust income and principal subject to trustee discretion or under a limited annual withdrawal right, but the trustee was prohibited from distributing or selling the company shares. Ex-wife lacked any powers of appointment and the remaining principal at her death was to revert to ex-husband or his estate. The IRS ruled that:

1. Neither party would recognize gain or loss on the share contribution (deemed considered made for full and adequate consideration) or be treated as a donor;

2. IRC 2702 (a) won't apply to determine whether the transfer of the term interest in the trust is a gift or for purposes of determining the transfer's value;

3. The FMV of trust principal on ex-husband's death, reduced by the value of ex-wife's outstanding term interest, is includible in ex-husband's gross estate; and

4. Ex-wife's estate will only include the value of any unexercised withdrawal rights.

G. SERVICE AND LEGISLATIVE DEVELOPMENTS

1. California Assembly Bill 691

On September 24, 2016, California adopted the Uniform Fiduciary Access to Digital Access Act, effective as of January 1, 2017.

The act, which has the support of online juggernauts such as Facebook, Google and Yahoo, dictates who will have access to a decedent's digital property and online accounts.

If the decedent, during his or her lifetime, uses a service provider's online tool to directly designate a particular person to have post-death access to a digital account, that

designation will be respected by the California courts. If the decedent did not utilize any such online tool, then any directions regarding digital assets set forth in the decedent's will or revocable trust will prevail. If the will and revocable trust are silent on the subject of digital assets, then post-death access will be determined according to the service provider's standard terms of service.

It is advisable that, going forward, wills and revocable trusts for California residents include provisions authorizing access to their online accounts, to avoid default application of any standard terms of service, which may entirely prohibit post-death access to online accounts.

2. **California Ballot Initiative to Establish State Estate Tax.** The College for All Act of 2018 is a California ballot initiative that proposes a state estate tax on estates over $3.5M, with a proposed 22% rate on estates over $5.49M in order to fund a program that would provide free college access to all California residents. The proponents needed to obtain over 585,407 signatures by April 24 to get the ballot initiative on the November 2018 ballots. As of this presentation, it is unclear whether the proponents obtained the necessary signatures.

3. **Notice 2017-12, 2017-4 IRB 1 (January 6, 2017)**

This notice provides guidance on the methods available to confirm the closing of an examination of the estate tax return. Of interest, the notice announces that an account transcript issued by the IRS can now substitute for an estate tax closing letter.

Prior to June 1, 2015, the IRS issued an estate tax closing letter for almost every estate tax return filed, however, for estate tax returns filed after June 1, 2015, the IRS changed its policy and now it will only issue an estate tax closing letter at the request of an estate, which request is to be made at least four months after the filing of the estate tax return.

Now, in addition to requesting an estate tax closing letter, the IRS has announced that an account transcript may substitute for an estate tax closing letter and it is available at no charge. An account transcript is a computer-generated report that provides the current account details. The information reported on an account transcript includes: (1) the return received date, (2) the payment history, (3) refund history, (4) penalties assessed, (5) interest assessed, (6) the balance due with accruals, and (7) the date on which the examination was closed. It does so by including transaction codes together with descriptions of those codes. So, for example, a transcript that includes transaction code "421" and the explanation "closed examination of tax return" indicates that the IRS's examination of the estate tax return has been completed and that the examination is closed. The notice concludes that an account transcript showing a transaction code of "421" is the "functional equivalent of an estate tax closing letter."

As with estate tax closing letters, an account transcript will indicate the closing of an estate that will not be reopened except for circumstances described in Rev. Proc. 2005-32 (*i.e.,* fraud, for example), or for determination of the transfer tax liability of the second spouse to die who made a portability election.

An account transcript may be requested by having an estate or authorized representative file Form 4506-T, Request for Transcript of Tax Return via mail or fax.

4. **Rev. Proc. 2017-34 (June 26, 2017).**

Generally a portability election is effective only if made on an estate tax return that is timely filed within nine months of the date of death. Estates that were not required to file *any* estate tax return often did not timely file simply to elect portability. As a remedial measure, the IRS began requiring executors to seek a private letter ruling to file a late estate tax return electing portability. However, in light of an onslaught of ruling requests, the IRS has now eliminated that requirement if (i) the executor did not have to file an estate tax return because the estate was under the filing threshold and (ii) the decedent was a U.S. citizen or resident. In such a circumstance, the executor now has until before the second anniversary of the decedent's death to file an estate tax return and state at the top of the Form 706: "FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER SECTION 2010(C)(5)(A)."

5. **IR-2017-102.**

Beginning June 15, 2017 taxpayers requesting letter rulings, closing agreements and certain other rulings from the Internal Revenue Service will need to make user fee payments electronically using the federal government's Pay.gov system. In the past the user fees could only be made by check or money order. Between June 15 and August 15, 2017, taxpayers may choose to make user fee payments either through Pay.gov or by check or money order. Note that Pay.gov is for payments only, the original, signed ruling request and supporting materials must still be submitted by mail or hand delivery to the IRS.

6. **New Tax Law**

a. Unified Credit Increased

The new tax law increased the unified credit for gifts made/deaths occurring after 12/31/2017. The credit is now $10M, adjusted for inflation from 2011, which for $2018 is 11,180,000.

Importantly, the increase in the unified credit "sunsets" on 12/31/2025, meaning that for deaths after that date or gifts made thereafter the unified credit falls back to $5M adjusted for inflation from 2011. There is no provision in the law for a "claw back" of any benefit accomplished through gifts made before the sunset, though some commentators raise the question as to whether a claw back will be enacted later.

b. **Generation-Skipping Tax Exemption Increased**

A similar increase/sunset to the generation-skipping tax exemption is also part of the new tax law.

c. **Basis Step-Up (or Step-Down)**

Basis step-up (or step-down) at death is retained.

d. **Initial Planning Thoughts**

i. For now, the elimination of the deduction for "below the line" types of expenses eliminates the ability to deduct many administrative expenses for income tax purposes. There is an expectation that a technical corrections bill will "fix" this change to the law, but for now, things like trustee's fees, executor's commissions, etc. are only deductible under IRC Section 2053 on the estate tax return.

ii. Clients should review estate planning documents where gifts are made on a formula basis of the "unified credit" or "the amount of the GST exemption". Since those amounts increased, perhaps too much is going to the specific legatees of those gifts.

iii. For surviving spouses worth $5 - $10 million, consider distributing the assets of the bypass trust to the survivor if he or she is expected to die before 2026. That allows another basis step-up for the assets that would otherwise be held as part of the unified credit trust on the second death, and shouldn't result in estate tax due to the increased unified credit. Be careful though; if the survivor dies after 2025 and the unified credit falls back in amount, he or should would have wished the assets remained in the unified credit trust. Perhaps have that survivor make a gift of assets to children before 2026 to "retain" the benefit of the increased unified credit? Or make distributions from the unified credit trust effective 5 minutes before the survivor's death only if the survivor dies before 2026? Also, consider paying assets out of ILITs, SLATs, etc. to accomplish the same end.

iv. As in 2012, make sure that gifts are made to use the increased unified credit before it sunsets. Expect a demand for SLATs, perhaps forgiveness of loans that arose out of sales to IDITs in the past, and other gifting techniques to accomplish this goal. Note the increased leverage for sales to IDITs (if you need "10% seed money", now you can give $22.4M and sell $224M to the IDIT).

v. Use the increased GST exemption to "clean up" trusts that do not have inclusion ratios of zero. Qualified severances may be unnecessary in some circumstances. Make sure these projects are completed before the end of 2025.

vi. Consider using multiple non-grantor trusts to get the use of a number of $10,000 SALT deductions. Remember that Treasury Regulations Section 1.641(a)-0(c) requires the trusts to be "different enough" to be treated as separate trusts for income tax purposes. Instead of a pot trust create separate trusts for children and grandchildren? Instead of one trust that distributes outright at 30, 35 and 40, consider three separate trusts – on that distributes outright at 30, one that distributes outright at 35, and another that distributes outright at 40? Consider petitioning the court to allow existing trusts to be divided into multiple trusts under California Probate Code Section 15412? It doesn't seem like much savings, but for each extra trust you get

both another ride up the low income tax bracket ladder and additional $10,000 of deductions – per trust the annual savings is $3,111.50/year. There will be additional income tax returns required, but (especially for clients with a family office that prepares the returns) the savings should exceed the cost. And if the trusts invest in one LLC, the administration of the assets should not be increased. The potential savings should be weighed against the benefits of reducing the client's estate for estate tax purposes by using grantor trusts rather than non-grantor trusts – but for clients who don't want to take advantage of that approach, this may work.

vii. Individuals can no longer deduct fees paid to investment advisors, but wealthy families are still looking for ways to still get the benefit of that type of deduction. Many are considering a structure similar to the Lender's Bagel family to accomplish this end. See *Lender Mgmt., LLC v. Commissioner*, T.C. Memo. 2017-246, T.C., No. 25617-15, 12/13/17

Parent creates a management company (either C corp or LLC) which is the manager of family partnerships. Those partnerships are structured like hedge funds – for example, the management company gets a fee equal to 2% of assets under management and 20% of the profits. The 2% fee is not deductible under the new tax law, but the 20% of profits is really a profits interest for the manager – meaning that it is income to the management company when paid but it is never earned by the partnerships or "paid" by them to the manager. The manager then pays the investment advisory fees from the management company and deducts them as Section 162 trade or business expenses – preserving the deduction that would not be deductible if taken by the family member as an individual.