The Year in Review: An Estate Planner's Perspective on Recent Tax Developments

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Presented for

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AN ESTATE PLANNER'S PERSPECTIVE ON RECENT TAX DEVELOPMENTS: THE YEAR IN REVIEW

By

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I. INTRODUCTION

The past year (well, 13 months, actually) has witnessed substantial changes in the estate, gift and generation-skipping transfer (GST) taxes and in the income tax laws relating to estate planning.

This outline summarizes the legislation, regulations, revenue rulings and procedures, regular decisions of the Tax Court, the Claims Court and the courts of appeals, as well as selected district court and Tax Court memorandum decisions, private rulings, notices, announcements and other Service and Treasury documents from the past year.[2] This outline includes those developments reported publicly from August 1, 2020 through September 15, 2021.

The tax developments in this outline are divided into 5 categories: Income Taxes, Estate Taxes, Gift Taxes, Generation-Skipping Transfer Taxes, and Wealth Tax.

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[1] The author thanks Probate Practice Reporter for permission to use material published in that journal. Subscriptions to Probate Practice Reporter, of which this author is the tax editor, may be obtained at http://www.probate practicereporter.com/Subscribe.asp.

[2] Private letter rulings (PLRs) and technical advice memoranda (TAMs) are not legal precedents. IRC § 6110(k)(3). They may, however, show how the Service might address a similar case, and they have been cited and discussed by several courts. See, *e.g.*, *Wolpaw v. Comm'r*, 747 F.3d 787 (6th Cir. 1995), *rev'g* T.C. Memo. 1993-322 (taxpayers can rely on 20-year old PLR, absent definitive regulations); *Xerox Corp. v. United States*, 656 F.2d 659 (Ct. Cl. 1981) (stating that PLRs are useful in ascertaining the scope of the doctrine adopted by the Service and demonstrating its continued and consistent application by the Service); *Estate of Blackford v. Comm'r*, 77 T.C. 1246 (1982) (noting that the Service litigation position was contrary to a prior PLR); *Hardy v. Comm'r*, T.C. Memo. 2017-17 (during litigation, IRS released a TAM presenting the same issues as this case, and the court ordered supplemental briefs, and in its opinion, the court stated that "[a]lthough the technical advice memorandum is not precedential [footnote citing Sec. 6110(k)(3)], it shows that the Hardys' grouping was not clearly inappropriate"); *Fanning v. United States*, 568 F.Supp. 823 (E.D. Wash. 1983) (noting that a distinction between the facts of the instant case and those of prior cases had been cited in a TAM, and that TAMs are often relied upon by the courts).

All references to "IRC" or to "Code" are to the Internal Revenue Code of 1986, as amended to date, unless otherwise specifically indicated. References to "Regs" are to the regulations of the Treasury Department, unless otherwise specifically indicated.

Each category is arranged by Internal Revenue Code section, except that a few consolidated discussions examine the developments relating to family partnerships and LLCs, grantor trusts, charitable remainder trusts, and various procedural rules.

There is also an additional section, "Selected Attachments," that includes discussions of certain cases that affect tax planning indirectly, sample forms illustrating some of the planning techniques discussed in this outline, and other related items, such as relevant portions of the IRS "no-rulings" list and the Treasury/IRS Priority Guidance.

II. INCOME TAXES

A. IRC § 1. Income Tax Rates

1. Ways and Means Proposals for Budget Reconciliation Act

The Senate has passed a budget resolution under the reconciliation procedures, so that the bill to implement it need receive only a simple majority vote in the Senate. In the House, the Ways and Means Committee has approved certain tax changes to raise approximately $3 trillion to offset the costs of the programs included in this bill. These proposals were only introduced on September 12, 2021, and reported by the Ways and Means Committee on September 16, 2021. Changes should be expected from the whole House of Representatives, the Senate Finance Committee, the Senate, and if it gets that far, a Conference Committee.

a) Ordinary Income Tax Marginal Rate

The Ways and Means proposals would raise the top income tax rates for individuals, estates, and trusts to 39.6 percent. For trusts and estates, this would be imposed on taxable income above $13,450 in 2022. For years beginning on or after January 1, 2026, this rate is estimated as applying to taxable income of trusts and estates above $14,950.

For taxable years beginning in 2022, the 39.6 percent rate would be imposed on individuals filing a joint income tax return and certain surviving spouses, on taxable income above $450,000. For married individuals filing separate income tax returns, the 39.6 percent rate would be imposed in 2022 on taxable income above $250,000. For single individuals filing as head of household, the 39.6 percent rate would be imposed on taxable income above $425,000. For other unmarried individuals, the 39.6 percent rate would be imposed in 2022 on taxable income above $450,000. For taxable years beginning in 2026, after the expiration of the rate reductions under the Tax Cut and Jobs Act of 2017, the 39.6 percent rate would be imposed on individuals filing a joint income tax return and certain surviving spouses, on taxable income above $492,450, adjusted for inflation. For married individuals filing separate income tax returns, the 39.6 percent rate would be imposed in 2022 on taxable income above $246,225, adjusted for inflation. For single individuals filing as head of household, the 39.6 percent rate would be imposed on taxable income above $465,100, adjusted for inflation. For other unmarried individuals, the 39.6 percent rate would be imposed in 2022 on taxable income above $437,700.

These changes would be effective for taxable years beginning after December 31, 2021. These changes are projected to raise $170 billion in revenue over ten years.

b) Capital Gains Marginal Rate

The Ways and Means proposals would also raise the top capital gains rate for individuals, estates, and trusts to 25 percent. For trusts and estates, this would be imposed on capital gains above $13,250.

For individuals filing a joint income tax return and certain surviving spouses, this would be imposed on capital gains above $501,600. For married individuals filing separate income tax returns, this would be imposed on capital gains above $250,800. For unmarried individuals filing as head of household, this would be imposed on capital gains above $473,750. For all other individuals, this would be imposed on taxable income above $453,800, before 2021 inflation adjustment. For unrecaptured section 1250 gains, the 25 percent rate would continue in effect, and for gains on the sale or exchange of collectibles, the present 28 percent rate would continue in effect.

This would be effective for taxable years ending after September 13, 2021, the date of introduction. These changes are projected to raise $123 billion in revenue over ten years.

Because these changes would apply to taxable year 2021, a transition rule taxes gains and losses for the portion of the year before the date of introduction with a top marginal regular capital gains rate of 20 percent, while taxing gains and losses for the portion of the taxable year after the date of introduction separately with a top marginal regular capital gains rate of 25 percent. A similar transition rule applies for purposes of the alternative minimum tax. A taxpayer's gains or losses allocated from a passthrough entity determines the date of those gains and losses at the entity level. Capital gain recognized in the post-introduction portion of the taxable year will be treated as recognized in the pre-introduction portion of the taxable year if they arise from a transaction that occurs pursuant to a written binding contract entered into on or before the date of introduction, unless the contract is modified in any material respect after September 13, 2021.

c) Net Investment Income (NII) Tax

The Ways and Means proposal would impose the current 3.8 percent tax on net investment of individuals, estates, and most noncharitable domestic trusts, on both net investment income and other gross income derived from a trade or business in which the taxpayer materially participates.

These changes would apply to all taxable years beginning after December 31, 2021. These changes are projected to raise $252 billion in revenue over ten years.

d) Limitation on Deduction of Qualified Business Income

The Ways and means proposals would impose a limitation on the deduction under Section 199A for qualified business income from a partnership, S corporation, or proprietorship. The limitation would be $500,000 for married individuals filing a joint income tax return, $250,000 for married individuals filing separate tax returns, or $400,000 for other individuals. The limitation for estates and trusts would be $10,000.

These changes would be effective for taxable years beginning after December 31, 2021. These changes are projected to raise $78 billion in revenue over ten years.

e) Surtax on Very High Incomes

The Ways and Means proposal would also impose a three-percent surtax on the modified adjusted gross income of an individual, estate, or trust that exceeds a specified amount. For estates or trusts, the three-percent tax would apply to modified adjusted gross income in excess of $100,000.

For married individuals filing joint returns, surviving spouses, and unmarried persons, the three-percent tax would apply to modified adjusted gross income in excess of $5 million. For married individuals filing separate returns, the three-percent tax would apply to modified adjusted gross income in excess of $2.5 million.

For estates and trusts, adjusted gross income will be determined under the rules of Section 67(e). For this purpose, modified adjusted gross income means adjusted gross income, reduced by any deduction (not taken into account in determining adjusted gross income) allowed for investment interest (section 163(d)).

These changes would apply to taxable years beginning after December 31, 2021. These changes are projected to raise $127 billion in revenue over ten years.

Note. Clearly, these changes would increase the income taxes of individuals, trusts, and estates with significant income. The relatively low figure for trusts and estates suggests that many fiduciaries should consider accelerating income that would otherwise be taxed in 2022 or deferring deductions that would otherwise be deducted in 2021, to increase taxable income in 2021 and reduce taxable income in 2022. These changes should be made only when it is practicable to do so and when the taxpayer's liquidity permits the payment of the additional income taxes this year. Of course, fiduciaries will be faced with trying to determine the best interests of the trust and its beneficiaries, which will depend upon whether these changes become law in 2021. A fiduciary who decides that these changes are not yet safely predictable may be faulted if the laws do change and no action is taken, but those who decide that these changes are safely predictable may be faulted if the laws do not change and actions have been taken that accelerate the tax on trust or estate income.

2. Income Tax Rates Adjusted for Inflation. Rev. Proc. 2020-45, §§ 3.01, 302, 2020-46 I.R.B. 1016 (Nov. 9, 2020)

The 2021 income tax rates for trusts and estates under Section 1(e) are as follows:

Income	Rate
Not over $2,650	10%
Over $2,650 but not over $9,550	$265 + 24% on excess over $2,650
Over $9,550 but not over $13,050	$1,921 + 35% on excess over $9,550
Over $13,050	$3,146 plus 37% on excess over $13,050

The kiddie tax was doubled to net unearned income over $2,200, and a parent can again elect to include in gross income up to $11,000 of a child's income in 2020. See IRC § 1(g)(4)(A)(ii)(II).

B. IRC §§ 61 & 101. Income Tax Treatment of Life Insurance

1. Income Taxation of a Split-Dollar Life Insurance Arrangement. *De Los Santos v. Comm'r*, 156 T.C. ___ (No. 9) (April 12, 2021)

Dr. Ruben de los Santos was the sole shareholder of an S-corporation that employed him as a physician and employed his wife as the office manager. There were four other employees. The corporation contributed $1.8 million to an employee welfare benefit plan established by Legacy Benefit Plans, LLC (LBP), which bought through its Legacy Benefit Trust (the Plan Trust) a $12.5 million life insurance policy insuring the lives of the de los Santoses. The plan was structured as multiple-employer welfare benefit plan under Section 419A(f)(6), and LBP was the sponsor and administrator. The corporation elected to participate by adopting a welfare benefit plan pursuant to the terms of a master plan. LBP offered living benefits, including disability benefits, and death benefits payable on the death of a covered employee, to that person's spouse or designated beneficiary. Participating employers selected the types of benefits to be provided to their employees. No employee could withdraw from, borrow against, or surrender his or her interest in LBP. A covered employee designated the beneficiary or beneficiaries who would receive death benefits to which that employee was entitled. LBP determined the amount of the employer contributions through a rate chart, which took into account common risk factors such as age, gender, number of covered dependents, and benefit terms. Employees did not contribute to LBP. Employer contributions were irrevocable and were inaccessible by the participating employer and its creditors. The Plan Trust assets could be used only to fund benefits for participating employees and their beneficiaries or defraying expenses of plan administration. LBP and the Plan Trust never received any IRS recognition of the Plan Trust as tax-exempt under Section 501(a). In 2010, the plan was merged into the Legacy Employee Flex Benefit Plan (the "Legacy/Flex Plan"). The IRS assessed a deficiency against the de los Santoses based on their having received economic benefits from their participation in the plan.

The Tax Court (Judge Lauber) granted the government summary judgment that the arrangement did not involve a genuine multi-employer plan, but rather was taxable as a compensatory split-dollar life insurance arrangement. Thus, the policy owner had to include in gross income the value of the economic benefits conferred on it each year. *De Los Santos v Comm'r*, T.C. Memo. 2018-155 ("De Los Santos I").

The Tax Court, in a second opinion, addressed how the economic benefits should be treated for income tax purposes. The taxpayer argued that the court should follow *Machacek v. Comm'r*, 906 F.3d 429 (6th Cir. 2018), *rev'g and remanding* T.C. Memo. 2016-55, in which the Sixth Circuit had held, in similar facts, that the economic benefits should be taxable as a corporate distribution under Section 301, based on Reg. § 1.301-1(q)(1)(i). The Tax Court, in a unanimous reviewed opinion, disagreed and held that the economic benefits were taxable as ordinary income, rather than as a distribution of property. The court (Judge Lauber) stated that, because the compensatory split-dollar life insurance arrangement afforded benefits to the taxpayer in his capacity as an employee of his S corporation, those benefits could not be characterized as a distribution "by a corporation to a shareholder with respect to its stock." The court considered and rejected the analysis in *Machacek*, stating that under the Sixth Circuit's approach:

> *economic benefits received by a shareholder would invariably constitute a distribution under Section 301, regardless of the relationship that accounts for the payment. We are unable to reconcile that approach either with the text of section 301(a) or with the split-dollar regulations.*

The Tax Court had not addressed the character of the economic benefits when it heard *Machacek* and the taxpayers raised the Section 301 argument for the first time on appeal. The court rejected the analysis of the Sixth Circuit, stating:

> *With all due respect, we are unable to embrace the reasoning or result of the Sixth Circuit's opinion in Machacek, and we are not bound to follow its opinion where (as here) the case is appealable to a different circuit. See Golsen v. Commissioner, 54 T.C. 742, 756-757 (1970), aff'd, 445 F.2d 985 (10th Cir. 1971). To adopt the Sixth Circuit's construction of section 1.301-1(q)(1)(i), Income Tax Regs., would require us to ignore the plain language of section 301(a), the statute under which the regulation was promulgated. We are not permitted to construe a regulation in a manner that ignores its governing statute or that adds to the statute "something which is not there." United States v. Calamaro, 354 U.S. 351, 359 (1957). If "[t]he plain language of a statute determines the meaning of the statute, * * * [we must] 'enforce it according to its terms.'" Progressive Corp. & Subs. v. United States, 970 F.2d 188, 191 (6th Cir. 1992) (quoting Caminetti v. United States, 242 U.S. 470, 485 (1917)).*

Therefore, because the taxpayers received the benefits of the policy as employees, Section 301 and Reg. § 1.301-1(q) did not apply. The court then explained that Section 1372 treats S corporations as partnership for the purpose of fringe benefit payments, and that any fringe benefit for a 2% owner (Dr. De Los Santos was the 100% owner) is treated as a distribution paid to a partner. Therefore, the court held, the economic benefits to the taxpayer was a guaranteed payment under Section 707 and taxable as ordinary income.

Note. The *De Los Santos* cases are significant for estate planners. First, they identify an arrangement that is being marketed to business owners with the promise of tax results quite different from those that are promoted as applying. The formation of what appears to be a multi-employer welfare benefit plan has been the basis for a number of arrangements that have failed to achieve their desired tax results, and practitioners and their clients should avoid most of these structures. Second, without the *De Los Santos* cases and their predecessor, *Our Country Home Enters, Inc. v. Comm'r*, 145 T.C. 1 (2015), it would be easy to overlook the application of the split-dollar rules to a transaction in which the non-owner was not directly entitled to recover its premium contributions. In that sense, the *De Los Santos* cases may be the poster child for the breadth of the split-dollar regulations. Third, *De Los Santos II* concludes that the taxpayer has perhaps the worst possible tax result – compensation income, rather than a deemed distribution of property.

2. IRS Nonacquiesces in Machacek v. Comm'r, 906 F.3d 429 (6th Cir. 2018), nonacq. 2021-2 I.R.B. 1156 (May 24, 2021)

The IRS nonacquiesces in the decision of the Sixth Circuit in *Machacek v. Comm'r*, to the extent that it held that the economic benefits of a compensatory split-dollar life insurance arrangement may be treated as a distribution with respect to stock under Section 301, where the agreement was entered into with a controlling-shareholder who was employed by a corporation as additional compensation.

Note. This puts the IRS in line with *De Los Santos v. Comm'r*, 156 T.C. ___ (No. 9) (April 12, 2021); *De Los Santos v Comm'r*, T.C. Memo. 2018-155; and *Machacek v. Comm'r*, T.C. Memo. 2016-55, rev'd and rem'd, 906 F.3d 429 (6th Cir. 2018).

C. IRC §§ 162, 212. Business Expenses and Expenses in the Production of Income

Partnership Cannot Deduct "Tax Insurance" Protecting Benefits of Charitable Gift. C.C.M. 202050015 (Dec. 11, 2020); C.C.M. 202053010 (Dec. 31, 2020)

In C.C.M. 202050015, Partnership paid premiums for a "tax insurance policy" that would reimburse the partners for any governmental reduction in the tax benefits relating to a charitable contribution of a conservation easement made by the partnership.

The Chief Counsel's Office stated that the premiums were not deductible as a business expense under Section 162(a) because the premiums were not sufficiently related to the partnership's trade or business activities. Rev. Rul. 55-264, 1955-1 C.B. 11; Rev. Rul. 58-480, 1958-2 C.B. 62; *Blaess v. Comm'r*, 28 T.C. 710, 714–15 (1957). The Chief Counsel's Office also stated that no deduction was allowed as an expense in the production of income under Section 212(1) or 212(2), because like Section 162(a), these sections require that the deducted expense be directly connected with income-producing activities. *United States v. Gilmore*, 372 U.S. 39, 45 (1965). If the charitable deduction is reduced, the policy would reimburse the partners for the lost tax benefits, regardless of any trade or business or income-producing activities of the partnership, so neither Sections 162 nor 212(1) or 212(2) apply. Section 212(3) allows the deduction of expenses related to the determination, collection, or refund of any tax, such as costs of tax counsel or the preparation of tax returns. The "tax insurance" premiums in this case are not deductible as an expense related to the determination, collection, or refund of any tax under section 212(3), because the policy does not provide, fund, or reimburse any services or materials related to preparing returns, determining a tax liability, or contesting a tax liability.

In C.C.M. 202053010, the contribution was specifically part of a syndicated conservation easement contribution and the taxpayer appears to have been an LLC, rather than a partnership. The IRS analysis cites a few additional authorities but adopts the same analysis and reaches the same conclusions. The IRS analysis in this C.C.M. is highly redacted.

Note. See also Kenneth A. Gary, *New Opportunity for Tax Lawyers: Insuring Tax Transactions*, 2004 Tax Notes Today 130-8, (July 7, 2004); Kyle D. Logue, *Tax Law Uncertainty and the Role of Tax Insurance*, 25 Va. Tax Rev. 339 (2005); and Hale E. Sheppard, *Conservation Easements, Legitimate Risks, And Tax Result Insurance,* 47 Real Est. Tax'n. 31 (2nd Quarter 2020).

D. IRC §§ 170, 642, 4940-4947. Charitable Gifts and Distributions

1. Corona Virus Aid, Relief and Economic Security Act (CARES Act) Expands Charitable Contribution Limitations During 2020. H.R. 133, div. EE, 116th Cong., 2d Sess. (Dec. 27, 2020)

The Corona Virus Aid, Relief and Economic Security Act (CARES Act), Pub. L. 116-36, 116th Cong., 2d Sess. (March 27, 2020), 134 Stat 281, makes two significant changes in the income tax deductibility of charitable contributions. H.R. 133 would extend these changes for an additional year, with some minor modifications.

a) $300 Above-the-Line Deduction for Charitable Contributions

Section 2204 of the CARES Act seeks to encourage Americans to contribute to churches and charitable organizations in 2020 by permitting them to deduct up to $300 of cash contributions, whether they itemize their deductions or not. IRC § 62(a)(22). This change applies only for taxable year beginning in 2020.

Note. It was not clear from the statute whether the $300 limit is per taxpayer or per return; whether a married couple could receive a combined $600 charitable deductions above-the-line. The Staff of the Joint Committee on Taxation, however, stated that the $300 limit was per return. See Staff of the Joint Committee on Taxation, 116th Cong., 2d Sess., *Description of the Tax Provisions of Public Law 116-136, The Coronavirus Aid, Relief, and Economic Security (CARES") Act*, p. 22, note 76 (April 23, 2020).[3]

b) No Limits on 2020 Itemized Deductions for "Cash" Charitable Gifts to Certain Public Charities

Section 2205 of the CARES Act increases the limitations on deductions for charitable contributions by individuals who itemize, as well as corporations. For individuals, the 50% of adjusted gross income limitation under Section

[3] The significance of the descriptions published as Committee Prints by the Staff of the Joint Committee on Taxation is unclear. The Supreme Court rather sternly stated:

> *Blue Books are prepared by the staff of the Joint Committee on Taxation as commentaries on recently passed tax laws. They are "written after passage of the legislation and therefore d[o] not inform the decisions of the members of Congress who vot[e] in favor of the [law]." Flood v. United States, 33 F.3d 1174, 1178 (C.A.9 1994). We have held that such "[p]ost-enactment legislative history (a contradiction in terms) is not a legitimate tool of statutory interpretation." Bruesewitz v. Wyeth LLC, 562 U.S. 223, 242, 131 S.Ct. 1068, 1081, 179 L.Ed.2d 1 (2011); accord, Federal Nat. Mortgage Assn. v. United States,* 379 F.3d 1303, 1309 (C.A.Fed.2004) *(dismissing Blue Book as "a post-enactment explanation"). While we have relied on similar documents in the past, see FPC v. Memphis Light, Gas & Water Div., 411 U.S. 458, 471–472, 93 S.Ct. 1723, 36 L.Ed.2d 426 (1973), our more recent precedents disapprove of that practice. Of course the Blue Book, like a law review article, may be relevant to the extent it is persuasive.*

United States v. Woods, 571 U.S. 31, at 48 134 S. Ct. 557, 187 L.Ed. 2d 472 (2013).

170(b)(1)(A) is suspended for the taxable year beginning in 2020, and cash contributions to a 50% charity (excluding supporting organizations and donor advised funds) are deductible in full against a taxpayer's contribution base. The excess deduction over the taxpayer's taxable income is eligible for a five-year carryforward.

For corporations, the 10% limitation under Section 170(b)(2)(A) is increased to 25% of taxable income. The limitation on deductions for contributions of food inventory under Section 170(e)(3)(C) is also increased from 15% to 25%.

These changes apply only for the 2020 taxable year.

Note 1. The Taxpayer Certainty and Disaster Tax Relief Act of 2020, Pub. L. 116-260, div. EE, 116th Cong., 2d Sess. (Dec. 27, 2020), extends for one additional year these two provisions of the CARES Act. It also makes it clear that a married couple filing a joint income tax return can claim a $600 above-the-line charitable deduction.

Note 2. The change in the limitation on charitable deductions appears to permit the 100% deduction for whatever portion of the gift is made in cash, so that a full deduction should be available for a gift to a public charity that is property equal to 50% of the taxpayer's contribution base and 50% cash. The CARES Act treats 2020 cash contributions to public charities as "qualified contributions" which are "disregarded" in applying the limitations on annual gifts. Qualified contributions do not include cash gifts to an operating foundation, or cash gifts "for the establishment of a new, or the maintenance of an existing, donor advised fund."

Taxpayers who want to use the 5-year carryforward to the extent that their cash gift to a qualifying charity, when added to all other itemized deductions, exceeds 100% of the taxpayer's contribution base. A taxpayer who made multiple cash gifts to qualifying charities may elect as to each gift whether to treat it as subject to the 100% limitation, rather than the 60% limitation.

The CARES Act does not define a "cash" contribution. The Code and regulations are replete with references to "cash," but the few definitions are inconsistent and depend upon the context. The various definitions of "cash" generally include U.S. coins and currency, but sometimes also including cashier's checks, traveler's checks, or money orders and other bank drafts. See Temp. Reg. § 1.71-1T, A-5; Reg. § 1.6050I-1(c)(1)(ii)(B); Prop. Reg. § 1.42-18(c)(6)(i). Section 170(f)(17) states that, for purposes of charitable contributions, "[n]o deduction shall be allowed under subsection (a) for any contribution of a cash, check, or other monetary gift unless the donor maintains as a record of such contribution a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution." This suggests that "cash" and "check" are both monetary gifts, but that they are not necessarily both cash. Prop. Reg. § 1.170A-15(b)(1) defines a "monetary gift" as including "a transfer of a gift card redeemable for cash, and a payment made by credit card, electronic fund transfer ..., an online payment service, or payroll deduction." This suggests that an electronic fund transfer, online payment or credit card payment may not be a cash gift for purposes of the charitable gift limitation. Reg. § 15a-453-1(b)(3)(i), involving the installment sales method, states that "[r]eceipt of an evidence of indebtedness which is secured directly or indirectly by cash or a cash equivalent, such as a bank certificate of deposit or a treasury note...." This suggests that a bank CD or a Treasury note are not necessarily "cash." Any definition issued by the government could say that "cash" does not include payment by check or credit card, because one can still stop payment on a check or contest a charge on one's credit card; it may also say that "cash" does not include money bitcoins or traveler's checks.

Section 643(i) states that "cash" includes "foreign currencies and cash equivalents" for purposes of the taxation of certain loans from foreign trusts. Section 6050l(d) (returns filed by a business that receives a payment of more than $10,000 in cash) states that cash includes foreign currency and checks drawn on foreign currency. Reg. § 1.446-3T(g)(4)(ii)(C)(1) (notional principal contracts) states that cash includes "U.S. dollars or cash in any currency in which payment obligations under the notional principal contract are denominated." These definitions suggest that foreign currency and checks drawn on foreign currency are not necessarily "cash," and that Congress and the IRS know how to state that, in a particular context, cash specifically includes various foreign currencies and checks payable in foreign currency. Section 6867(d) (dealing with certain persons found in possession of more than $10,000 of cash) states that cash includes "cash equivalents" and defines "cash equivalents" to include foreign currency and any bearer obligation. Again, context is important; this limited definition suggests that cash does not otherwise include "cash equivalents," such as foreign currency or bearer obligations.

If one wants to be certain, the safest approach is to give the charity a suitcase full of cash (note: the suitcase is not deductible under the 100% limit). Such a transfer is instantaneous and cannot be undone or its payment stopped.

Also, the 5-year carryover for unused charitable contribution deductions applies only to charitable contributions that exceed "the excess of the taxpayer's contribution base . . .over the amount of all other charitable contributions allowed ...." This appears to be calculated without regard to other itemized deductions. Thus, a taxpayer with $20,000 of other itemized deductions would lose their benefit if he or she made charitable gifts equal to 100% of his or her contribution base.

2. Regulations Clarify Effect of a State or Local Income Tax Credit on the Charitable Income Tax Deduction and the SALT Cap Workaround. T.D. 9907, 85 Fed. Reg. 48467 (Aug. 11, 2020)

Treasury and the IRS issued final regulations clarifying some of the issues raised by the use of a state and local income tax credit for contributions to Section 170(c) organizations (charities and certain state or local governmental entities) to avoid the $10,000 limitation on the income tax deduction for state and local taxes (SALT).

a) Charitable Transfers Deductible as Business Expenses

The regulations clarify that a payment or transfer to a Section 170(c) organization can, in appropriate situations, be deductible as a business expense. Generally, a payment to a Section 170(c) entity that bears a direct relationship to the taxpayer's trade or business and that is made with a reasonable expectation of financial return commensurate with the amount of the payment may be an allowable business expense under Section 162. Reg. § 1.162-15(a)(1). A safe harbor is provided for a C corporation that makes a payment to a Section 170(c) entity and receives or expects to receive a State or local tax credit that reduces its taxes, and it may treat the payment as a deductible ordinary and necessary business expense to the extent of the amount of the credit. Reg. § 1.162-15(a)(3)(i). A safe harbor is also provided a specified passthrough entity (a business entity other than a C corporation that operates a trade or business and is subject to state or local taxes) that makes a payment to a Section 170(c) entity and receives or expects to receive a State or local tax credit that reduces such taxes, and it may treat the payment as a deductible ordinary and necessary business expense to the extent of the amount of the credit. Reg. § 1.162-15(a)(3)(ii). These rules apply to payments made on or after December 17, 2019, but taxpayers may choose to apply them on or after January 1, 2018.

Note. The safe harbors are taken from Rev. Proc. 2019-12, 2019-04 I.R.B. 401 (Jan. 22, 2019).

b) Safe Harbor for Payments by Individuals

The regulations state that an individual's payment to a Section 170(c) organization can be treated as a state or local tax if and to the extent that the donor otherwise has not utilized his or her full $10,000 SALT cap. Reg. § 1.164-3(j)(1). A state or local tax credit that is not applied to offset the individual's state or local tax liability for the taxable year or a preceding taxable year can be carried forward and applied in future taxable years, again to the extent of the SALT cap. Reg. § 1.164-3(j)(2). This applies only to payments of cash or cash equivalents. Reg. § 1.164-3(j)(4).

c) *Quid Pro Quo* Rules Updated

The regulations clarify that a charitable deduction must be reduced by a *quid pro quo* even if it is received from a third party other than the donee. Reg. § 1.170A-1(h)(2)(i)(B). The regulations treat the expectation of a *quid pro quo* as causing a transfer not to be charitable in nature, regardless of from whom that *quid pro quo* is expected. See Rev. Rul. 67-246, Ex. 11, 1967-2 C.B. 104;

Ottawa Silica Co. v. United States, 699 F.2d 1124 (Fed Cir. 1983); and *Wendell Falls Development, LLC v. Comm'r*, T.C. Memo. 2018-45.

Note. Another approach adopted by Connecticut, Wisconsin, Rhode Island, Oklahoma, and Louisiana takes advantage of the fact that the $10,000 SALT cap applies only to individuals. Entity-level state tax is fully deductible even by a passthrough at the federal level, while the distributive share of the tax payment passed on to members is both reduced and offset by the newly created state individual income tax credit.

In Notice 2020-75, 2020-49 I.R.B. 1453 (Nov. 30, 2020), the IRS announced that it will propose regulations clarifying that state and local income taxes imposed on and paid by a partnership or an S corporation are allowed as a deduction by the entity in computing its non-separately stated taxable income or loss for the tax year of payment. Thus, Section 164(b)(6) does not apply and a partner or S corporation shareholder can still obtain the benefit of more than $10,000 of state and local income taxes, if the taxes are imposed on a partnership or S corporation, rather than directly on the partner or shareholder. These rules will apply to "specified income tax payments," defined as "any amount paid by a partnership or an S corporation to a State, a political subdivision of a State, or the District of Columbia (Domestic Jurisdiction) to satisfy its liability for income taxes imposed by the Domestic Jurisdiction on the partnership or the S corporation." They do not include income taxes imposed by U.S. territories or their political subdivisions. Thus, the definition includes state and local income taxes for which a deduction by a partnership is not disallowed under Section 703(a)(2)(B) (taxes paid to certain U.S. possessions or foreign countries), and for which a deduction by an S corporation is not disallowed under Section 1363(b)(2) (the non-passthrough to S corporation shareholders of tax payments disallowed under Section 703(a)(2)(B)). The proposed regulations will clarify that specified income tax payments (as defined in the guidance) are deductible by partnerships and S corporations in computing their non-separately stated income or loss. As proposed, the regulations will apply to specified income tax payments made after November 8, 2020, and they will allow taxpayers to apply the same rules to specified income tax payments made in a tax year of the partnership or S corporation ending after December 31, 2017, and made before November 9, 2020, if a specified condition is met.

Note. Qualified business income under Section 199A (the 20% passthrough income tax deduction) will likely be reduced by the entity's payment and deduction of state and local taxes.

3. Fourth Circuit Affirms Denial of Charitable Deduction for Deconstructed House. *Mann v. United States*, 984 F.3d 317, 2021 WL 41895 (4th Cir. Jan. 6, 2021), *aff'g* 364 F.Supp.3d 553 (D. Md. 2019)

Linda Mann owned title to a house which she gave to Second Chance, a public charity that employs disadvantaged persons to deconstruct properties, salvaging for sale building materials, fixtures, and furniture. Second Chance did not perform the actual demolition and its deconstruction sometimes destroyed part of the subject property. Linda conveyed to Second Chance all of her rights, title, and interest in "the improvements, building and fixtures located on the Premises." In a second document, Linda conveyed to Second Chance various furniture and other personal property associated with the house. Linda also gave $11,500 in cash to Second Chance, to cover the costs of deconstruction. Linda obtained two appraisals of the house and one of the personal property. House Appraisal A valued the entire house at $675,000 and stated that moving it to another site would produce the greatest profit. House Appraisal B valued the house at $313,353, assuming that the taxpayers conveyed the rights in the structure to Second Chance to be used for training purposes and that any salvaged building materials would later be sold by Second Chance. The personal property appraisal listed some of the items of furniture and home decoration, individually valued and photographed, and attributed to them a total value of $24,206, based on the cost of the items if new, less depreciation. Ultimately, Second Chance was unable to extract as much salvage material from the house as they had hoped, though they kept no manifest or record of exactly what materials were salvaged. Second Chance incurred approximately $13,144 in expenses in deconstructing the house. Linda and her husband deducted $675,000 for their gift of the house, $24,206 for their gift of the personal property, and $11,500 for the cash donations. The IRS denied all of the deductions. The IRS also rejected the taxpayers' effort to amend the claimed deduction to $313,353 for settlement purposes, based on an alternative appraisal of the house's value.

The U.S. District Court for Maryland (Judge Chuang) granted summary judgment for the government, allowing a deduction only for the cash payments. The court concluded that the taxpayers never validly transferred an entire interest in the property, because they never recorded the deed transferring the house. Under state law, the donation was comparable to granting a license to Second Chance to access and use the house for salvage and training purposes. Such a license is a nondeductible partial interest. The court also concluded that, even if the house had been severed from the land, the taxpayers' appraisals were not qualified appraisals. The court noted that the second appraisal was inconsistent with the transaction, because the conditions of Second Chance's training program prevented salvaging all building materials, so valuing the building based on the resale value of the building materials overvalued the house. The proper way to value this contribution would be based on the resale value of the specific building materials and contents that Second Chance actually removed from the house in order to resell them. The court also found the appraisals of the personal property to be deficient, because it: (a) did not provide the basis and documentation for valuing each item of household furniture; and (b) included a flawed conclusion as to the value of the personal property by not adhering to its own avowed methodology, which requires both the deduction of certain costs and then depreciation by 42%, rather than merely depreciating the items haphazardly. The court granted summary judgment concluding that the cash donations were properly deductible.

The Fourth Circuit (Judge Niemeyer) affirmed, generally agreeing with the District Court's analysis. The Manns argued that they could deduct the aggregate value of all of the components of the house because they gave Second Chance their entire interest in the house and the donation agreement constructively severed the house from the land. The court disagreed, noting that under Maryland law, they transferred contractual ownership of the house but retained record ownership, including, for example, liability for property taxes. The court held that Maryland does not permit transfer of record ownership in land without a recorded deed. The court also noted that the Manns understood that Second Chance would salvage only some of the components, and that others would be destroyed in the process. Second Chance did not agree to demolish the house; the Manns hired another company to do so. The court noted that under the agreement, Second Chance could take any fixtures and building materials that it wanted, but the parties contemplated that unsalvaged building components would be destroyed or demolished and that demolition would have to be done by the Manns or their contractors. In substance, Linda donated some components of the house for salvage and resale by Second Chance, and some components were destroyed onsite, either for training or to remove salvageable components. Linda maintained the benefits and burdens of ownership of the remaining components which she ultimately paid her contractor to demolish. Thus, she did not donate them to Second Chance. Finally, the court held that the $313,353 appraisal used to claim the deduction was not a qualified appraisal because it assumed that every component of the house would be severed and donated to Second Chance for reuse. Thus, the appraiser valued the wrong assets.

4. Conservation (Including Façade) Easements Raise Numerous and Often Very Expensive Problems

a) Ways and Means Proposals for Budget Reconciliation Act. S.Con. Res. 14, 117th Cong., 1st Sess. (Aug. 24, 2021)

S. Con. Res. 14 was the budget resolution passed by the Senate under the reconciliation procedures, so that the bills implementing this budget can become law with a simple majority vote of both houses of Congress. On September 15, 221, the House Committee on Ways and Means approved legislation to implement this budget, including approximately $3 trillion of proposed tax increased needed to pay for a substantial portion of the budget expenditures. See Staff of the Joint Committee on Taxation, 117th Cong, 1st Sess, *Description of the Chairman's Amendment in the Nature of a Substitute to the Committee Print Relating to Infrastructure Financing (Subtitle F), Green Energy (Subtitle G), The Social Safety Net (Subtitle H), and Prescription Drug Pricing (Subtitle J)* (Sept. 14, 2021). Among these proposals are changes in the charitable deduction for contributions of conservation easements. Specifically, The Ways and Means proposal would eliminate the charitable income tax deduction for participation in abusive syndicated conservation easement transactions, in which the property is held for less than three years before the contribution and the deduction claimed exceeds 2.5 times the donor's basis of the property.

The proposal also modifies the rules on accuracy-related penalties for abusive syndicated conservation easement transactions. Any disallowance under these rules will be is treated as a gross valuation misstatement, increasing the penalty to from 20 percent to 40 percent of the Underpayment and eliminating any defense based on reasonable cause. The requirement for supervisory approval of the penalty assessment under section 6751(b) is also eliminated in these cases. These changes would apply to contributions made after December 23, 2016, the date on which the IRS designated certain syndicated conservation easement arrangements as listed transactions under Section 6111. See Notice 2017-10, 2017-4 I.R.B. 544 (Jan. 23, 2017). These changes are projected to raise $11 billion in revenue over ten years.

Note. The IRS has been aggressively attacking abusive syndicated conservation easements and they have been successful in the cases that have gone to trial. It is not clear that this new rule will do more to eliminate these arrangements than the current IRS efforts, but it will relieve the IRS of the burden of finding technical faults in these transactions, and require only that they establish the required brevity of holding period and the excessive claimed appreciation.

Also, these proposals were only reported by the Ways and Means Committee on September 16, 2021. Changes should be expected from the whole House of Representatives, the Senate Finance Committee, the Senate, and if it gets that far, a Conference Committee.

b) Charitable Protection is Perpetual Even if Donor Can Change Areas in Which Limited Development Is Permitted. *Pine Mountain Preserve, LLP v. Comm'r,* 978 F.3d 1200, 2020 WL 6193897 (11th Cir. Oct. 22, 2020), *rev'g in part, aff'g in part* 151 T.C. 247 (2018)

Over several years and several transactions, Pine Mountain Preserve, LLP (PMP) acquired 6,224 acres of land southeast of Birmingham, Alabama. Over three years, the donor contributed to North American Land Trust, a qualified charitable organization, easements covering portions of the property. Each easement defined a conservation area development of which was restricted in perpetuity. The 2005 and 2006 easements reserved "building areas" within which the donor could construct a single-family residence. The 2005 easement permitted the donor (with the donee's consent) to move the building areas from their initially designated locations to any other location within the conservation area and reserved to the donor the right to build in the conservation area other facilities appurtenant to residential development, such as barns, riding stables, scenic overlooks, and boat storage buildings, some of which could include additional living quarters. Boundary modification was permitted only if: (a) it would not, in the donee's reasonable judgment, have a material adverse effect on any of the easement's "conservation purposes"; (b) the acreage of the building areas was not increased; and (c) it was reflected in a signed, recorded, written amendment to the easement deed. The 2006 easement did not specify the location of the building areas, except to state that these locations must be "approved in advance" by the donee. The donor claimed approximately $33 million in charitable contribution deductions for the three easement gifts, of which $4 million was the 2007 gift. The IRS denied the deductions.

The Tax Court (Judge Lauber and ten other judges), in a reviewed decision with one dissent, held that neither the 2005 nor the 2006 contributions were not deductible, because neither was a qualified real property interest that granted in perpetuity and neither was protected in perpetuity under Section 170(h)(5)(A). The court followed *Belk v. Comm'r*, 140 T.C. 1 (2013), *supplemented by*, T.C. Memo. 2013-154, *aff'd*, 774 F.3d 221 (4th Cir. 2014), which denied a deduction where a developer donated a conservation easement over a golf course, which was surrounded by a single-family residential development. The *Belk* easement permitted the parties by mutual agreement "to change what property is subject to the * * * easement" as long as the developer substituted, and subjected to the easement, a contiguous plot of land of equal or greater size, value, and ecological quality." The Fourth Circuit in *Belk* noted that "requirement that the conservation purpose be protected in perpetuity is separate and distinct from the . . . requirement that there be real property subject to a use restriction in perpetuity." The Tax Court declined to follow *BC Ranch II, L.P. v. Comm'r,* 867 F.3d 547 (5th Cir. 2017), *vac'g & rem'g Bosque Canyon Ranch, L.P. v. Comm'r*, T.C. Memo. 2015-130, which involved facts similar to those in *Pine Mountain*, with the developer retaining similar rights, including the right, by agreement with the donee, to change the location of homesite parcels within the conservation area that could be developed, as long as NALT, in its reasonable judgment, believed that the change did not

> *directly or indirectly result in any material adverse effect on any of the Conservation Purposes," and as long as "[t]he area of each homesite parcel * * * [was] not . . . increased.*

The *BC Ranch II* easement allowed the developer to change the location of the homestead sites only within the conservation area, while leaving the perimeter of the conservation area unchanged. The Fifth Circuit held that these terms were materially different from those in *Belk* and allowed the deduction. The Tax Court noted that a decision in *Pine Mountain* would be appealable to the Eleventh Circuit, so that neither the Fourth nor the Fifth Circuit holdings were determinative, freeing the Tax Court to follow *Belk,* the facts of which it believed to be closer to the facts in this case. The court permitted a deduction for the 2007 contribution, however, noting that that easement designated no "Building Areas" and permitted no residential construction anywhere within the 2007 Conservation Area. The 2007 easement reserved to donor no rights to construct scenic overlooks, barns, riding stables, boat storage buildings, piers, or other structures appurtenant to residential development. The court did, however, in a separate memorandum decision held that the value of the 2007 easements was $4,779,500, as opposed to the $4,100,000 reported on the taxpayer's income tax return, and the $9,110,000 suggested by the taxpayer's appraisal expert at trial. *Pine Mountain Preserve, LLP v. Comm'r*, T.C. Memo. 2018-214.

On appeal, the Eleventh Circuit (Judge Newsom) reversed in part and affirmed in part. The court noted that Section 170(b)(2)(C) requires a restriction in perpetuity on the use of the property, but that a broad limitation on the use of the whole property meets these requirements, even if within that parcel there exist certain narrow exceptions to that limitation. IRC § 170(h)(2)(C). The Eleventh Circuit agreed with the Tax Court that Section 170(h)(2)(C) (a qualified real property interest granted in perpetuity restricting the use which may be made of the property) and Section 170(h)(5)(A) (a contribution is not held "exclusively for conservation purposes" unless the conservation purpose is protected in perpetuity) impose two separate requirements. The Tax Court had held that a grant violates Section 170(h)(2)(C) if even a single sub-parcel of property is exempted from the overall restriction. The Eleventh Circuit disagreed, finding that Section 170(h)(2)(C) is satisfied if the entire property is subject to any conservation restriction that does not alter the actual boundaries of the easement. The Eleventh Circuit also found that the *Pine Mountain* restrictions were dissimilar from the easements in *Belk* because they did not permit changes in the borders of the subject property. Rather, they found the *Pine Mountain* restrictions closer to those in *BC Ranch II,* because the five-acre residential parcels in that case were and had to remain entirely within the exterior boundaries of the easement property. The court agreed with the Tax Court that the 2007 easement's provision allowing the contracting parties to amend the grant did not violate Section 170(h)(5)(A)'s protected-in-perpetuity requirement. The court held that the term "perpetuity," when used in connection with conservation easements, denotes only that the granted easement will not automatically revert to the grantor or the grantor's heirs or assigns. The court noted that "[p]arties to a bilateral contract—which is all a conservation easement is—can *always* agree after the fact to amend their agreement, whether or not they expressly reserve that right to themselves in writing. If the possibility of amendment were a deal-killer, then there could be no such thing as a tax-deductible conservation easement." 2020 WL 6193897 at *7, citing 28 *Williston on Contracts* § 70:154 (4th ed.) and *Restatement (Second) of Contracts* § 89 (1981). Thus, the Tax Court correctly held that the 2007 easement's amendment provision does not cause it to violate Section 170(h)(5)(A)'s protected-in-perpetuity requirement. With respect to the valuation of the 2007 easement, however, the Eleventh Circuit reversed the Tax Court, finding that it had merely picked a number almost exactly midway between the parties' estimates. The Eleventh Circuit remanded the case to the Tax Court with directions that it "apply a discernible methodology" such as the comparable sales or before-and-after methodologies. 2020 WL 6193897 at *8.

c) Warren and Kumar Go to the Tax Court -- $4.9 Million Deduction for Gift of Conservation Easement Sustained Because Easement Value Proved by Recent Sales. ***Rajagopalan v. Comm'r,*** **T.C. Memo. 2020-159 (Nov. 19, 2020)**

Warren Sapp, who had played in the NFL for the Tampa Bay Buccaneers and the Oakland Raiders, and Kumar Rajagopalan, transferred nearly 120 acres of land in western North Carolina to SS Mountain LLC. Warren and Kumar had bought the parcels for about $3 million. The land was in a part of the state where luxury homes for out-of-staters had were a growing sector of the real estate market. Warren and Kumar met with a land developer who found two viable options: subdivide the entire parcel into 37 lots and sell them as homesites or subdivide the parcel into 12 homesites and keep the rest in its natural state. They chose the latter and they began to sell homesites. They sold three homesites to unrelated persons and one to Kumar. The lot sizes ranged from 1.53 acres to 5.61 acres. That same month, an unrelated bank lent the LLC $5 million secured by the 12 lots, based on its own appraisal of the lots which showed each had a value of more than $750,000. The bank required the LLC to sell the remaining lots for a minimum of $750,000 each. Ten of the lots had county assessed values of between $875,240 and $2,102,320. Later that year, the LLC contributed a conservation easement over 89.378 acres to the North American Land Trust (NALT), a qualified charitable organization. The easement required that the land be used exclusively for a conservation purpose. Of the remaining 8 unsold lots, Warren bought one for $1.1 million. The LLC discovered could not close on its sales until the roads and electric were established, which would involve dynamiting some of the land and would take some time. The real estate market then crashed, causing some of the contracts not to close. The LLC filed an income tax return (Form 1065) reporting a charitable gift of $4.9 million and attached a qualified appraisal. The IRS audited the transactions, denied the deduction, and asserted overvaluation penalties.

The Tax Court (Judge Holmes) held for the taxpayers. The court noted that this was an unusual conservation easement case, because it could value the property based on a number of truly comparable sales. In most easement cases, there are no good comparable sales from which to determine the value of the easement property, but here "[t]his property had a recent and reliable, and therefore relevant, transactional history." T.C. Memo. 2020-159 at *16. The taxpayers' expert valued the easement at $2.9 million, and the IRS expert valued it at $720,000. The court held that the prior sales, the bank loans, and the county tax records supported a finding that the property had a "before" value of $26.8 million and an "after" value of $560,000. The court rejected the government's expert testimony because he relied on sales of other properties, rather than the more relevant sales of unrestricted parts of the taxpayers' property. The court admitted that the easement was given at the peak of a real estate "bubble," and that values had since fallen significantly, but stated that the value on the date of the gift was all that was relevant.

Note. The court began its opinion with the following:

> *Conservation easements are to the Commissioner what aunts are to Bertie Wooster: "It is no use telling me there are bad aunts and good aunts. At the core, they are all alike. Sooner or later, out pops the cloven hoof." P. G. Wodehouse, The Code of the Woosters 40 (2d Vintage Books ed. 2015). The cloven hoof in these cases is attached to an LLC named SS Mountain, which assembled and then divided a tract of property into one part for a small development of large homes and into another part with a conservation easement, all at the very peak of an amazingly frothy local real-estate market in 2006.*

T.C. Memo. 2020-159 at *2. Aside from quoting one of my very favorite authors, the court also well summarized the way that most courts look at conservation easement cases.

d) Charitable Deduction for Façade Easement Largely Sustained Because Local Government Limits on Development of Property Within Historic District Subject to Weaker Enforcement than those in Easement. *Kissling v. Comm'r*, T.C. Memo. 2020-153 (Nov. 12, 2020)

Kissling Interests, LLC gave the National Architectural Trust façade easements on three certified historic commercial buildings in the Allentown Historic District of Buffalo, New York. Local law restricted what building owners could do with properties within the district. The LLC deducted $855,900 for the value of the easement. Anthony Kissling, a 90% LLC member, deducted a 90% share of the contribution over three taxable years. The IRS disallowed the deductions in full, finding that the easements had no effect on the value of the properties because the state restrictions on development were as severe as the easement. The IRS also imposed a gross valuation misstatement penalty under Section 6662(h).

The Tax Court (Judge Holmes) allowed a $674,000 deduction. All of the expert appraisers agreed that the highest and best use of the properties, both before and after the easement gifts was as residential apartment buildings, and all of them determined value by capitalizing net operating income (NOI). The court rejected one of the taxpayer's experts because he initially claimed a discount of 11% to 12%, based on prior IRS rulings and Tax Court decisions. At trial, that appraiser used a different valuation approach to reach approximately the same figures, but the damage had already been done to his credibility. The court rejected another of the taxpayer's appraisers due to his relatively limited experience with façade easements. The court then compared the determinations by the taxpayer's third expert and the government's expert of the various components of revenue and expense and the rate at which they capitalized the properties' NOI. More importantly, the court then compared the maintenance and preservation requirements imposed by the local agency on structures within the historic district, with those imposed by the easement, and concluded that the easement restrictions were more severe than the local restrictions, particularly in light of relatively lax enforcement by the local agencies. The court examined the history of the historic preservation process in Buffalo and the agencies that enforced their rules, as well as the city's economic condition. The court distinguished *Chandler v. Comm'r*, 142 T.C. 279 (2014) and *Kaufman v. Comm'r*, T.C. Memo. 2014-52, *aff'd*, 784 F.3d 56 (1st Cir. 2015), which had held that similar easement restrictions were no more burdensome than those imposed by the local preservation agencies. The properties in *Chandler* and *Kaufman*, the court noted, were not income-producing, and therefore distinctions between the two sets of restrictions did not have as much tangible effect on their values as the effects on NOI and therefore on value in this case. Buffalo's relatively lax enforcement of its Preservation Code at the time of the easement gifts and its economic problems, which deprived it of revenues with which to increase enforcement, made the easement restrictions, though similar on their face to those of the city, in reality more severe than those of the city. The court noted that when the LLC made alterations in façades without the donee's consent, the donee noticed the alterations and demanded a response, while the city never even noticed the alterations. Thus, the court concluded that the costs of repairs, maintenance, management fees, and professional services would be higher for the properties after the easements than before, reducing the value of the properties after the easement gifts, and that these additional costs justified a lower capitalization rate.

e) No Deduction Where Easement Fails to Follow Reg. § 1.170A-14(g)(6) on Division of Proceeds if Easement is Extinguished

(1) Savings Clause Ineffective to Protect $6.9 Million Deduction for Gift of Syndicated Conservation Easement that Failed to Comply with Regulations on Proceeds of Involuntary Termination. *TOT Property Holdings, LLC v. Comm'r,* 1 F.4th 1354, 2021 WL 2559088 (11th Cir. June 23, 2021), *reh. requested* (Aug. 9, 2021), *aff'g* T.C. Dkt. No. 5600-17 (Bench Order, Dec. 13, 2019)

In 2013, a 98.99% interest in the taxpayer, TOT Property Holdings, LLC ("TOT"), the only significant asset of which was 652 acres of rural, undeveloped real estate in Van Buren County, Tennessee, was bought by an investment fund for $1,039,200. A few weeks later, the taxpayer contributed a conservation easement over the property to a qualifying charity, claiming an income tax deduction of $6.9 million. The deed of gift stated that, were the easement extinguished by judicial proceedings, the donee would receive "the stipulated fair market value of this Easement, or proportionate part thereof, as determined in accordance with Section 9.2 or [Reg.] Section 1.170A-14, if different." Section 9.2 of the deed defined the "stipulated fair market value" as a proportionate share of the value of the easement, reduced by "any increase in value after the date of this grant attributable to improvements." The deed also stated that "[i]t is intended that this Section 9.2 be interpreted to adhere to and be consistent with 26 C.F.R. Section 1.170A-14(g)(6)(ii)." The IRS denied the charitable deduction.

The Tax Court, in a bench order by Judge Gustafson agreed with the denial of the charitable income tax deduction. The court held that the deed did not protect the conservation purpose perpetually because it provided for the donor to receive the value of post-gift improvements in case of an involuntary termination of the easement, in violation of Reg. § 1.170A-14(g)(6)(ii).

The Eleventh Circuit (Judge Anderson) affirmed. The taxpayer did not contest the validity of Reg. § 1170A-14(g)(6)(ii), but rather argued that the deed statements that the donee would receive the stipulated fair market value "or, if different, the value under the regulations," and that the definition of the stipulated fair market value was to be determined consistently with the regulations (the "Override Provisions") protected the rights of the charity and complied with the regulations. The taxpayer argued that the Override Provisions were interpretative and that a local court construe them to assure that the charity received at least as much as was required by the regulations, but the Eleventh Circuit disagreed and held that the "if different" language was a condition subsequent that is not effective for federal tax purposes. The court relied on *Belk v. Comm'r*, 774 F.3d 221, 229 (4th Cir. 2014) (a clause in a conservation easement deed stating that the donee "shall have no right or power to agree to any amendments ... that would result in this Conservation Easement failing to qualify ... as a qualified conservation contribution under Section 170(h) of the Internal Revenue Code and applicable regulations"); and *Comm'r v. Procter*, 142 F.2d 824 (4th Cir. 1944) (a clause in a gift document that required any part of the transfer held subject to federal gift tax must be returned to the donor). The court stated that three features of the Override Provisions render it unenforceable as a condition subsequent; (a) the formula in the deed for dividing the proceeds on a termination was unambiguous, so there was "no open interpretive question for the savings clause to 'help' clarify." 2021 WL 2559088 at *7; (b) the operation of the Override Provisions would rewrite the plain text of the agreement; and (c) the Override Provisions would become operative only upon a future (a determination that the proper interpretation of the regulation is "different" from the formula in the agreement), so the donee's right to proceeds "equal to the [regulatory] proportionate value" is not immediately vested.

Note. The court also held that the Tax Court's valuation of the easement was not clearly erroneous, and thus the 40% gross overvaluation penalty was appropriate. IRC § 6662(h)(1). The Tax Court had, the court stated, correctly determined that the highest and best use of the property before the gift was as an investment property held for recreation and timber revenue, rather than for residential development as a low density destination mountain residential resort, as proposed by the taxpayer's expert. The court found that the evidence presented at trial supported the Tax Court's view. The court also held that the IRS complied with the supervisory-approval requirement for penalties in IRC § 6751(b)(1) and that the transmittal letter signed by the revenue agent's immediate supervisor met these requirements.

(2) Regulations on Division of Proceeds of Involuntary Termination are Valid -- $9.5 Million Deduction Lost. *Oakbrook Land Holdings, LLC v. Comm'r*, 154 T.C. 180 (2020), *app. filed* (6th Cir. Nov. 16, 2020) (Reviewed Opinion)

Oakbrook Land Holdings LLC gave a conservation easement to the Southeast Regional Land Conservancy on 106 acres of its 143-acre tract of land in Chattanooga, Tennessee, retaining the rest for future development. Oakbrook had bought the 143-acre tract just over one year earlier for $1.7 million. It claimed a $9.5 million charitable contribution deduction for the easement gift. The IRS disallowed the deduction, in part, because the deed of easement stated that, if the easement were ever extinguished, the proceeds of the disposition of the property would be divided between the donor and the donee giving the donee an amount equal to the difference between the fair market value of the conservation area as if not burdened by the easement and the fair market value of the conservation area burdened by the easement, determined on the date of the easement, reduced by the value of any improvements made by the donor after the date of the easement. The IRS disallowed the deduction because Reg. § 1.170A-14(g)(6) requires that a division in such cases be based on the relative values of the two shares on the date of the gift, with no other adjustments. It also assessed an accuracy-related penalty under Section 6662.

The Tax Court, in a memorandum decision (Judge Holmes) held that the easement deed did not protect the easement "in perpetuity," as required by Section. 170(h)(5), because the donee's share of the extinguishment proceeds (1) produced a fixed sum based on historical value rather, than a proportionate share of the current value, and (2) was reduced by the value of any improvements made by the donor. The court rejected the taxpayer's contention that the use of the phrase "proportionate value" in the regulations allowed the taxpayer to set a fixed sum on the date of the easement as a measurement of the donee's share. The court agreed that the regulation was ambiguous but using the use of the same language elsewhere in the tax law, construed it as requiring a fractional division. Citing *PBBM-Rose Hill, Ltd. v. Comm'r*, 900 F.3d 193 (5th Cir. 2018); and *Coal Property Holdings, LLC v. Comm'r*, 153 T.C. 126 (2019). The court rejected the penalty under Section 6662, however, finding that the taxpayer reasonably relied on a private letter ruling in which the IRS suggested that a clause like the one in the deed would work. Reg. § 1.6662-3(b)(3) states that a return position generally satisfies the reasonable-basis standard if it is based on, among other types of authorities, private letter rulings. *See also Bunney v. Comm'r*, 114 T.C. 259, 267 n.10 (2000) (private rulings may be authorities showing reasonableness of return position).

The whole court issued a reviewed opinion (Judge Lauber for the majority) which rejected the taxpayer's contention that Reg. § 1.170A-14(g)(6) is not valid. The court noted that the regulation was the result of full notice and comment procedures under the Administrative Procedure Act (APA), and that the majority of the comments received regarding this particular clause had been favorable. It held that the regulation complied with the APA, even though the preamble to the final regulations did not specifically discuss the "basis and purpose" of the extinguishment provision. The court also held the regulation substantively valid, under *Chevron U.S.A. Inc. v. Nat. Res. Def. Council Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed. 2d 694 (1984), finding that the Code did not directly address what should occur if a perpetual easement were extinguished, and the regulation adopted a permissible interpretation of the statute. The court declined to find that the regulation's "proportionate value" approach was "arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. at 844. The court refused to invalidate the proportionate value approach used by the regulation merely because it did not address the treatment of the donor's improvements. The court held that Treasury had "exercised reasoned judgment" by adopting the simple rule dividing sales proceeds based on the relative fractional ownership on the date of the gift and that this division was intended to ensure satisfaction of the statute's "protected in perpetuity" requirement.

Judge Toro concurred that the deduction should be disallowed but questioned the validity of the regulation as a reasoned judgment of the statute. The concurrence stated that the most that a donee can be entitled to receive when a "qualified real property interest" is extinguished in the future is the full value of that interest. The regulations, by insisting that the donor not be entitled to recover the value of post-gift improvements, effectively require that the donor give the donee value attributed to the donor's retained real property interest, which fails the second part of the *Chevron* test. He also stated that the failure of the IRS to explain in the preamble to the final regulations how and why it had reached this conclusion violated the APA's requirement that regulations give reasoned responses to all significant comments. Nonetheless, Judge Toro stated, the easement is not a "qualified conservation contribution" because of its adoption of a pecuniary approach to determining the donee's share of extinguishment proceeds. Judge Toro stated that the court should not have addressed the validity of the regulations as they relate to post-gift improvements, because it was not necessary that the court do so to render its opinion.

Judge Holmes, who presided over the trial, dissented on the basis that the regulations' rule on extinguishment proceeds failed to include the "reasoned responses to *all significant comments* in a rulemaking proceeding" required by the APA. The comments on this issue came from a respected source (the New York Land Conservancy) and Treasury did not address them in the preamble to the final regulations. Allowing Treasury to decide which significant issues it wishes to address and which it does not would effectively permit it to ignore the requirement that an agency to give reasoned responses to all significant comments in a rulemaking proceeding.

Note. See also *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54 (May 12, 2020).

(3) Possible Defenses Prevent Summary Judgment--$20.67 Million Deduction Denied. *Oconee Landing Property LLC v. Comm'r,* T.C. Dkt. No. 11814-19 *(*Aug. 18, 2020)

Carey Station, LLC acquired a 99% interest in Oconee Landing Property, LLC, by contributing a 356-acre tract of land in Greene County, Georgia. Two days later, Oconee Landing Investments, LLC (the taxpayer), acquired a 97% interest in Oconee Landing Property from Carey Station for $2,440,000 and contributed $1.3 million in cash to Oconee Landing Property. Eight days later, the taxpayer gave a conservation easement to the Georgia Alabama Land Trust, Inc., a qualifying donee, over the 356-acre tract and claimed a $20.67 million deduction. The deed provided that, if the easement were eliminated by judicial termination, the donee's share of the proceeds would be adjusted for any improvements made by the donor. It also provided that the proceeds would be divided between the parties after providing for all prior claims. The IRS denied the deduction.

The Tax Court (Judge Lauber) denied cross motions for summary judgment, pointing out possible defenses to charging donee with value of improvements and requiring payment of outstanding claims on judicial termination. Regarding the deed provision that charges the donee with the cost of any improvements made by the donor after the gift, in determining the division of the proceeds of a judicial termination of the easement, the court noted that there appeared to have been no pre-existing improvements, and the taxpayer should have the chance to show that it had reserved no right to make any future improvements, or that any such improvements would be of negligible value. Regarding the deed provision that the proceeds of a judicial termination of the easement should be divided after the satisfaction of prior claims the court noted that the deed appeared to require that such claims be paid from the donor's share of the proceeds, which would not violate the regulations.

(4) 40% Substantial Overvaluation Penalty Rejected; 20% Overvaluation Penalty Imposed--$17.5 Million Deduction Denied. *Glade Creek Partners, LLC v. Comm'r*, T.C. Memo. 2020-148 (Nov. 2, 2020)

As part of a syndicated transaction, Glade Creek Partners, LLC gave to a qualifying charity a conservation easement on 1,313 acres of undeveloped real estate on the Cumberland Plateau in Bledsoe County, Tennessee, and claimed a $17.5 million charitable contribution deduction. The deed stated that the easement would preserve open space for wildlife habitats threatened by development and provide significant public benefit, scenic views of the Cumberland Plateau, and agricultural land, and that the property would be "retained forever predominantly in its natural condition." T.C. Memo. 2020-148 at *13. The deed allowed construction of a single-family dwelling if the donee consented or if it did not object within 30 days of written notice. The deed allowed Glade Creek to engage in other enumerated permitted uses without prior written notice or approval. The deed also provided that in the case of the involuntary extinguishment of the conservation easement, any proceeds would be allocated between the donor and donee in proportion to the value of their respective interests on the date of the gift, except that the value of any improvements made by the donor after the gift would be allocated to the donor. The IRS disallowed the $17,504,000 deduction for the easement contribution and a $35,077 deduction for cash contributed to the donee and asserted a 40% gross overvaluation penalty.

The Tax Court (Judge Goeke) denied the $17,504,000 deduction because the easement deed divided the proceeds of any involuntary extinguishment in a manner not consistent with Reg. § 1.170A-14(g)(6)(i), by allocating to the donor all value attributable to post-contribution improvements by the donor. *Oakbrook Land Holdings, LLC v. Comm'r*, 154 T.C. 180, *app. filed* (6th Cir., by petitioner, Nov. 12, 2020, by respondent Nov. 16, 2020). The court stated that the deed would not have been rejected merely because of the requirement that the donee consent to construction of a single-family dwelling within 30 days. The court stated that this deed differed from the deed rejected in *Hoffman Props. II, L.P. v. Comm'r*, T.C. Dkt. No. 14130-15 (Mar. 14, 2018), *aff'd*, 956 F.3d 832 (6th Cir. 2020), because the agreement in this case applied only to the construction of a single-family residence, and not to all uses, and because the deed in *Hoffman Props.* expressly stated that deemed consent meant the use was not a violation of the deed. The court allowed the deduction for a $35,077 cash charitable contribution paid to the charity at the closing, despite the fact that the donor paid the money to its escrow agent who did not pay it to the charity until January of the following year. The court explained that a charitable contribution is deemed made when its delivery is effected, but that when delivery is made through an agent, the gift is made when the donor relinquishes dominion and control. *Fakiris v.*

Comm'r, T.C. Memo. 2017- 126, at *13-*14. Here, no substantial conditions existed after the closing; any that did exist were so remote as to be negligible. The court declined to impose the 40% overvaluation penalty, finding that neither the government's appraiser nor the taxpayer's appraiser had correctly valued the easement. The court held that the easement's fair market value was near $9 million, so the taxpayer was not liable for a 40% gross valuation misstatement penalty but was liable for a 20% substantial valuation misstatement penalty because the easement's claimed value was more than 150% but less than 200% of the correct value.

(5) Rights of Lender Must be Subrogated to Rights of Charity to Assure that Conservation Easement Offers Protection in Perpetuity. In *901 South Broadway Ltd. Partnership v. Comm'r*, Tax Ct. Dkt. No. 14179-17 (April 28, 2021)

901 South Broadway, Ltd. is a partnership that gave a façade easement to the Los Angeles Conservancy, a qualified charity, encumbering a building that the partnership owned in Los Angeles. The property was subject to several mortgages. The deed of easement prohibits the partnership from making any changes to the building's exterior without the "prior express written approval" of the donee, but it requires that the donee must act within 30 days of a request by the partnership and, if it does not act, it is deemed to have consented to the action. The deed also provides that, if the easement is ever extinguished by judicial proceeding, any proceeds from the sale of the property will be divided between the donor and donee based on the ratio of their interests in the easement property on the date the easement was created. Unfortunately, it also provided that that division was subject to the rights of any lender and to the "prior claims and net of expenses reasonably incurred . . . in connection with such taking." It also states that: "Lender and its assignees which are the holder or beneficiary of the Deeds of Trust (together with Lender, a "Beneficiary") shall have a prior claim to all insurance proceeds as a result of any casualty, hazard, or accident occurring to or about the Property and all proceeds of condemnation proceedings, and shall be entitled to same in preference to Grantee until the Deeds of Trust are paid off and discharged". The IRS disallowed the charitable contribution deduction and the taxpayer requested redetermination of the assessment.

The Tax Court (Judge Halpern) denied the taxpayer's request for partial summary judgment, finding that it was not clear that the easement met the perpetuity requirements. The court noted that, in *Kaufman v. Comm'r (Kaufman I*), 134 T.C. 182, 186 (2010), *vac'd in part sub nom Kaufman v. Shulman (Kaufman III)*, 687 F.3d 21 (1st Cir. 2012), the Tax Court held that the rights of the lender must be subordinated to those of the creditor, but the First Circuit reversed, explaining that Reg. § 1.170A-14(g)(6) requires only that the donee's right to the proceeds must be absolute against the donor, but not necessarily against third-persons. The Tax Court reiterated that a lender's rights must be subordinated to those of the donee in *Palmolive Bldg. Inv'rs, LLC v. Comm'r*, 149 T.C. 380, 394-395 (2017), and it reaffirmed its prior holding in *Kaufman I*. The court here refused to give *Kaufman III* a greater dignity than *Palmolive Bldg. Inv'rs, LLC*. The court noted that this case would not be appealable to the First Circuit, so the court was not bound by *Kaufman III*. The court also reviewed its sustaining of the regulation itself in *Oakbrook Land Holdings v. Comm'r*, 154 T.C. 180 (2020), and rejected a request that it reverse that position.

(6) See also the following cases denying conservation easement contribution deduction because the deed failed to comport with Reg. § 1.170A-14(g)(6):

(a) State Law on Rights when Conservation Easement Terminates is Clear and Does Not Require Certification to State Supreme Court. Montgomery-Alabama River LLC v. Comm'r, T.C. Memo. 2021-62 (May 17, 2021), mot. for summary judgment denied, Tax Ct. Dkt. 9254-19 (June 11, 2021)

Montgomery-Alabama River, LLC (MAR) acquired by contribution to capital a 132-acre parcel of land on Elmore County, Alabama. Later that same year, another LLC bought a 95% interest in MAR for $3.4 million. Two weeks later, MAR gave a conservation easement over the property to the National Wild Turkey Federation Research Foundation. The easement deed said that, in case of judicial extinguishment of the easement, the amount of the proceeds to which the donee would be entitled would be determined under a specified section of the deed of easement gift, unless state law provides otherwise. The specific section of the deed of easement gave the donee a specified share of any future proceeds in the event of an extinguishment. This formula did not comport with the requirements of Reg. § 1.170A-14(g)(6). The IRS disallowed the $12,700,000 charitable deduction. The taxpayer argued that state law gave the donor the right to all of the proceeds in such cases and that reliance on such a state law was expressly authorized by the regulation. The taxpayer asked that the issue be certified to the Alabama Supreme Court.

The Tax Court (Judge Lauber) held that Alabama law was clear that the donee had a right to a share of the proceeds in case of an involuntary termination of the easement. Citing *Sells v. Commissioner*, T.C. Memo. 2021-12 (Jan. 28, 2021); *Smith Lake, LLC v. Comm'r*, T.C. Memo. 2020-107; *Hewitt v. Comm'r*, T.C. Memo. 2020-89. The court explained that Alabama law unambiguously treats conservation easements as real property interests and entitles easement holders to compensation if the easement is extinguished. The court agreed that the regulations make an exception from the requirement that the donee receive a proportionate share of such compensation if state law grants the donor "the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction." T.C. Memo. 2021-62 at *2. However, this was not the case in this instance.

Thereafter, the IRS moved for summary judgment that the donor improvement language clearly failed under the regulations. The Tax Court (Judge Lauber) denied the motion. MAR noted that a week after the easement gift, it had given the donee the fee simple interest in the property. The IRS had denied the entire deduction for the easement gift and most of the deduction for the fee simple gift, the latter based on a dispute over valuation. MAR argued that the easement deed's adjustment for the value of donor improvements was immaterial, because the donee owned the fee and would own those improvements. The IRS argued that there were two gifts and that the easement adjustment for donor improvements was relevant to disallowing the deduction for the first gift. The court stated that MAR could present evidence that the entire transaction was a gift of a fee simple, rather than a mere easement.

(b) Summary Judgment Denying Deduction but Requiring Trial on Penalty Approval. *Soddy Creek Preserve, LLC v. Comm'r,* T.C. Dkt. 22271-17 (Feb. 10, 2021)

Granting partial summary judgment disallowing the charitable deduction because the easement deed failed to comply with Reg. § 1.170A-14(g)(6)(i), (ii), but declining summary judgment on whether IRS obtained written supervisory approval of the Section 6662 accuracy-related penalties as required by Section 6751(b).

(c) Deduction Denied, but No Penalties Imposed. *Sells v. Comm'r,* T.C. Memo. 2021-12 (Jan. 28, 2021)

Kevin Sells, Charlie Williams, Steve Moses, Butch Welch, Jay Pumroy, John Davis, Lori James, and Stephen Whatley created Burning Bush Farms, LLC, which bought from Steve Moses a 236-acre parcel of mountainous land near Anniston in Calhoun County, Alabama. Steve had serious financial problems and had to sell the property at what he believed to be a low figure of $1.4 million. Less than a year-and-a-half later, the LLC contributed a conservation easement over the property to Chattoawah Open Land Trust, Inc. (COLT), a qualified charity, and claimed a $5.4 million deduction. The deed stated that on extinguishment by judicial proceeding, the proceeds would be divided between the donor and donee based on the relative value of the easement at the time of the gift, less any increase in the value of post-gift improvements, which share would go to the donor. The LLC obtained a qualified appraisal of the easement and attached a copy to each tax return.

The Tax Court (Judge Holmes) denied the deductions. The court stated that the easement deed extinguishment by judicial proceeding provision violated Reg. § 1.170A-14(g)(6), by crediting to the donor the value of post-gift improvements. Citing *Oakbrook Land Holdings, LLC v. Comm'r*, 154 T.C. 180 (2020); and *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54. The members argued that Reg. § 1.170A-14(g)(6)(ii) does not require the usual division of such proceeds where "state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction." They noted that Alabama law states that an easement owner is not entitled to the proceeds if the land is "taken for and devoted to [a] public purpose." *Burma Hills Dev. Co. v. Marr*, 229 So.2d 776, 782 (Ala. 1969). The court noted that under Alabama law, the condemnation of a property subject to an easement results in condemnation awards only to the property owner, not the easement owner. These cases, however, involved conventional easements between neighboring property owners, which create contract rights, rather than property rights. Eminent domain allows compensation only for property rights and a conservation easement gives the donee such rights. Ala. Code § 35-18-1. Thus, *Burma Hills Dev. Co.* would not apply.

Note. The court imposed no penalties with respect to the easement contribution. The IRS had obtained penalty approval under Section 6751(b)(1) (requiring that the "initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination") only for Steve Moses, Jay Pumroy, and their spouses. The IRS approval only related to substantial understatement and gross misvaluation by the Moseses and for negligence, substantial understatement, and gross misvaluation by the Pumroys. The court found reasonable cause for the position taken by the taxpayers regarding the validity of the conservation easements, both because they relied on PLR 200836014 (decreasing the donee's proceeds by the grantor's permissible improvements did not violate the regulation) and the advice of the executive director of the donee, who had substantial experience in this area. With respect to the gross overvaluation, the court noted that this penalty applies even if an underpayment is not caused by overvaluation. Citing *RERI Holdings I, LLC v. Comm'r*, 149 T.C. 1, 21-24 (2017), *aff'd*, 924 F.3d 1261 (D.C. Cir. 2019); and *PBBM-Rose Hill*, Ltd., 900 F.3d 193, 214-15 (5th Cir. 2018)). The court rejected parts of the valuation analysis of both parties' experts. It rejected the taxpayers' expert because he did not provide substantiation for his estimated construction costs, and it rejected the IRS's expert, because he grossly overstated his construction costs and because he made some math errors. The court determined that the best use for the property was as a luxury housing development and it valued it based on comparables selected primarily by the IRS's expert. The court valued the easement at $2,250,000, which did not justify a gross misvaluation penalty. Thus, the only penalties assessed were negligence and possibly substantial underpayment against the Pumroys with respect to the timber gift.

(d) Partial summary Judgment Denies $27,400,000 Deduction; Trial Required on Question of Reasonable Cause and Penalties. *St. Andrews Plantation LLC v. Comm'r,* T.C. Dkt. No. 20849-17 (Nov. 17, 2020)

(e) Substantial Overvaluation Penalty and Accuracy-Related Penalty Rejected--$2.8 Million Deduction Denied. *Hewitt v. Comm'r,* T.C. Memo. 2020-89 (June 17, 2020), *app. filed,* (11th Cir. Oct. 9, 2020)

(f) $4,592,000 Deduction Denied. *Cottonwood Place, LLC v. Comm'r,* T.C. Memo. 2020-115 (Aug. 4, 2020)

(g) $4,110,500 Deduction Denied. *Red Oak Estates, LLC v. Comm'r,* T.C. Memo. 2020-116 (Aug. 4, 2020)

(7) Chief Counsel's Office Explains Why Subtracting Post-Donation Improvements from the Donee's Share of Extinguishment Proceeds Disqualifies a Charitable Contribution of a Conservation Easement. CCM 202130014 (July 30, 2021)

The IRS Chief Counsel's Office was asked whether a conservation easement fails to satisfy the requirements of Section 170(h) if the deed contains language subtracting from the donee's extinguishment proceeds the value of post-donation improvements or the post-donation increase in value of the property attributable to improvements?

The IRS stated that decreasing the portion of the proceeds that is required to be allocated to the donee upon extinguishment under Reg. § 1.170A-14(g)(6)(ii) causes the easement to fail to satisfy the requirements of Section 170(h) unless state law provides that the donor is entitled to the full proceeds from the conversion. It noted that Reg. § 1.170A-14(g)(6)(i) recognizes that conditions surrounding the property could unexpectedly change and make continued use of the property for conservation purposes impossible or impractical. In that situation, the conservation purpose can be protected if the easement is extinguished by judicial proceeding and if the donee organization uses all of its proceeds from the sale or exchange of the property in a manner that is consistent with the original contribution's conservation purposes. The regulation then states that the deduction is allowed only if the perpetual conservation restriction gives rise to a property right, immediately vested in the donee, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift bears to the value of the property as a whole at that time. That proportionate share of the value must remain constant, though the value may itself change. The regulation states that the donor must agree to these requirements at the time of the donation for the donor to be eligible to claim a charitable contribution deduction. The IRS noted that the Tax Court sustained these rules and held that they must be strictly construed. Carroll v. Comm'r, 146 T.C. 196, 212 (2016). Reducing the portion of the grantee's proceeds by the value of any post-donation improvements or any post-donation increase in value of the property attributable to improvements reduces the grantee's proportionate share of proceeds and violates the regulations, unless state law provides that the donor is entitled to the full proceeds from the extinguishment. Citing *PBBM- Rose Hill, Ltd. v. Comm'r*, 900 F.3d 193, 208 (5th Cir. 2018); *Coal Property Holdings, LLC v. Comm'r*, 153 T.C. 126, 144 (2019). The IRS also noted that a judicial proceeding is the exclusive manner in which a perpetual conservation restriction may be extinguished, and then only if a subsequent unexpected change in the conditions surrounding the property has made the continued use of the property for conservation purposes impossible or impractical.

f) Failure to Substantiate Cash Gifts Results in Loss of Deduction. *Chancellor v. Comm'r*, T.C. Memo. 2021-50 (May 4, 2021)

Viola Chancellor claimed to have given $6,000 in cash to her church and to have expended $500 incident to volunteer work for the church. She deducted the $6,500 and the IRS denied the deduction for lack of substantiation.

The Tax Court Judge Urda) held that the deductions were properly because Viola failed to maintain sufficient substantiation. The court noted that even with respect to cash gifts, the law requires that a taxpayer retain "a record of such contribution a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution" or "reliable written records showing the name of the donee, the date of the contribution, and the amount of the contribution." See IRC § 170(f)(17); Reg. § 1.170A-13(a). Here, the taxpayer had no documentation whatsoever.

5. Failure to Provide Appraisals Not Excused by Reasonable Reliance on Tax Experts; Multi-Million Dollar Charitable Deductions Denied. *Pankratz v. Comm'r*, T.C. Memo. 2021-26 (March 3, 2021)

Dr. Duane Pankratz is a veterinarian and extremely successful South Dakota businessman. In 2008, Duane donated his interests in four oil and gas projects to Missionary Church, Inc. Duane valued the donation at $2 million based on his purchase price as well as what he said he expected its appreciation to be. He did not obtain a professional appraisal of these interests before he filed his return. In 2009, Duane donated a conference center — both the building and surrounding land — to another religious charity. To determine its value, Duane contracted with a certified general appraiser who declined to provide an appraisal, stating that he felt uncomfortable with the undertaking because the property was a very elaborate complex, and he had never seen a similar building in his career. The appraiser gave Duane general information on three traditional valuation methods — comparable sales, income, and replacement cost — and said that of the three methods, the replacement cost approach had "the most solid evidence." However, due to the lack of any comparable properties (which were needed for this approach), the appraiser did not want to undertake this valuation. Duane deducted his cost of buying the land and constructing the conference center. The IRS denied the deductions for lack of a qualified appraisal.

The Tax Court (Judge Holmes) held for the government, noting that while the law requires a qualified appraisal for noncash charitable contributions worth more than $5,000 and requires that the appraisal be attached to the income tax return if the value is more than $500,000. IRC § 170(f). Section 170(f)(11)(A)(ii)(II), however, states that the deduction is not denied for failure to provide a qualified appraisal, if the failure is "due to reasonable cause and not to willful neglect." Reasonable cause requires that the taxpayer exercise ordinary business care and prudence. *United States v. Boyle*, 469 U.S. 241, 246 (1985). The taxpayer claimed that he exercised such care and prudence because he relied on the advice of a tax professional. This would constitute reasonable cause if the taxpayer can show that: (a) the professional was a competent tax adviser with sufficient expertise to justify reliance; (b) the taxpayer provided the professional with necessary and accurate information; and (c) the taxpayer actually relied in good faith on the professional's advice. *Alt. Healthcare Advocates v. Commissioner*, 151 T.C. 225, 246 (2018); *Neonatology Assocs., P.A. v. Commissioner*, 115 T.C. 43, 99 (2000), *aff'd*, 299 F.3d 221 (3d Cir. 2002). In this case, the taxpayer allowed his long-time bookkeeper to work with the taxpayer's CPA to have the return prepared. The court held that the CPA was a competent tax adviser, but that the bookkeeper had no substantial tax experience or training. Furthermore, the CPA had said that an appraisal was required, but the taxpayer's bookkeeper did not tell the taxpayer to obtain one and the taxpayer never spoke directly with the CPA. Furthermore, the bookkeeper did not actually advise the taxpayer; he merely took the data provided by the CPA and input it into tax preparation software. Thus, the taxpayer did not rely on the CPA's advice. Further showing that the taxpayer did not reasonably rely on expert advice is the fact that the taxpayer, though very educated, did not read the tax return. Form 8283 states at least four times that a qualified appraisal is required. The taxpayer also did not rely on the appraiser, who declined to appraise the property as too complex.

6. **Charitable Contribution Deductions Denied for Insufficient Substantiation. *Chiarelli v. Comm'r,* T.C. Memo. 2021-27 (March 3, 2021)**

Luke Joseph Chiarelli, an attorney, gave to charity several items of personal property he inherited from his mother. He attached an appraisal summary (Form 8283, Noncash Charitable Contributions), to his returns, but the summary failed to include the donee's name and address, a description of the property, or an explanation of how the fair market value of the property was established. He also failed to provide the date of the gift, the date he acquired the property, the manner of its acquisition, his cost or adjusted basis therein, and the method he used to determine the fair market value. Luke just described the gifts as "miscellaneous household items" in "excellent condition" with an appraised value of $89,110 in one year, $93,087 in a second year, and $77,300 in a third year. He also failed to provide the name of the appraiser, his signature, and his qualifications, for items with a value of over $5,000. The IRS denied all of the deductions.

The Tax Court (Judge Nega) held for the government. The court noted that:

- for noncash contributions worth $5,000 or less, the taxpayer failed to retain receipts with sufficient detail to identify the individual properties contributed. Reg. § 1.170A-13(b)(1);

- for noncash contributions worth $250 or more, the taxpayer failed to obtain contemporaneous written acknowledgements from the donee. IRC § 170(f)(8)(A);

- for groups of noncash items valued at more than $500, the taxpayer failed to maintain written records including detailed descriptions of the properties contributed. IRC § 170(f)(8)(B);

- with respect to donated items worth more than $5,000 the taxpayer failed to obtain a qualified appraisal and to attach to each tax return a completed appraisal summary on Form 8283. IRC § 170(f)(11)(C) and Reg. § 1.170A-13(c)(a);

- the taxpayer's appraisals were not qualified because they did not include the physical condition and age of individual items, the qualifications of the appraiser, a statement that each appraisal was prepared for income tax purposes, and the appraised fair market values of individual items donated. IRC § 170(f)(11)(C) and Reg. § 1.170A-13(c)(2);

- the taxpayer had not substantially complied with the substantiation requirements nor had he cured any defects by supplying supplemental information within 90 days of the government's request for that information. Reg. § 1.170A-13(c)(4)(iv)(H); and

- the taxpayer was responsible for a 20% negligence accuracy-related penalty and that the taxpayer failed to show reasonable cause.

7. Gift of Standing Timber on Conservation Easement Property Is Not Deductible. *Sells v. Comm'r,* T.C. Memo. 2021-12 (Jan. 28, 2021)

Kevin Sells, Charlie Williams, Steve Moses, Butch Welch, Jay Pumroy, John Davis, Lori James, and Stephen Whatley created Burning Bush Farms, LLC, which bought from Steve Moses a 236-acre parcel of mountainous land near Anniston in Calhoun County, Alabama. Steve had serious financial problems and had to sell the property at what he believed to be a low figure of $1.4 million. Less than a year-and-a-half later, the LLC contributed a conservation easement over the property to Chattoawah Open Land Trust, Inc. (COLT), a qualified charity, and claimed a $5.4 million deduction. The deed stated that on extinguishment by judicial proceeding, the proceeds would be divided between the donor and donee based on the relative value of the easement at the time of the gift, less any increase in the value of post-gift improvements, which share would go to the donor. The LLC obtained a qualified appraisal of the easement and a copy was attached it each tax return. The LLC also made a separate gift to COLT of standing timber valued at $275,340, for which it had a separate appraisal. The IRS denied each member's income tax deductions related to the charitable gifts.

The Tax Court (Judge Holmes) denied the deductions. The court stated that the easement deed extinguishment by judicial proceeding provision violated Reg. § 1.170A-14(g)(6), by crediting to the donor the value of post-gift improvements. Citing *Oakbrook Land Holdings, LLC v. Comm'r*, 154 T.C. 180 (2020); and *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54. The court also denied the deduction for the contribution of standing timber, because the timber donated was unharvested standing timber on the easement property. Under state law, that timber belonged to the donor, but the cutting of that timber and its conversion into lumber is not a conservation purpose and was prohibited by the deed. IRC § 170(h)(4)(A); Reg. § 1.170A-14(e). Thus, the gift was either a partial interest in real estate, which is never deductible, or a gift of a future interest in tangible personal property that is deductible only when the timber is severed from the property. IRC § 170(a)(3). Either way, the members of the LLC could not now deduct the timber gift.

Note. The court imposed very few penalties and those only on one member of the LLC. The IRS had obtained penalty approval under Section 6751(b)(1) (requiring that the "initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination") only for Steve Moses, Jay Pumroy, and their spouses. The IRS approval only related to substantial understatement and gross misvaluation by the Moseses and for negligence, substantial understatement, and gross misvaluation by the Pumroys. The court found reasonable cause for the position taken by the taxpayers regarding the validity of the conservation easements, both because they relied on PLR 200836014 (decreasing the donee's proceeds by the grantor's permissible improvements did not violate the regulation) and the advice of the executive director of the donee, who had substantial experience in this area. This, however, did not protect the Pumroys from negligence or substantial underpayment penalties with respect to the timber donation, because Jay Pumroy was a real estate attorney, and should have been aware that if the LLC gave a conservation easement, it could not also give away timber whose value was based on chopping trees down in violation of the conservation deed. With respect to the gross overvaluation, the court noted that this penalty applies even if an underpayment is not caused by overvaluation. Citing *RERI Holdings I, LLC v. Comm'r*, 149 T.C. 1, 21-24 (2017), *aff'd*, 924 F.3d 1261 (D.C. Cir. 2019); and *PBBM-Rose Hill, Ltd. v. Comm'r*., 900 F.3d 193, 214-15 (5th Cir. 2018)). The court rejected parts of the valuation analysis of both parties' experts. It rejected the taxpayers' expert because he did not provide substantiation for his estimated construction costs, and it rejected the IRS's expert, because he grossly overstated his construction costs and because he made some math errors. The court determined that the best use for the property was as a luxury housing development and it valued it based on comparables selected primarily by the IRS's expert. The court valued the easement at $2,250,000, which did not justify a gross misvaluation penalty. Thus, the only penalties assessed were negligence and possibly substantial underpayment against the Pumroys with respect to the timber gift.

8. 40% Gross Overvaluation Penalty Applies where Charitable Gift Was not a Completed Transfer; Court Does Not Need to Determine Actual Value of the Property. *Fakiris v. Comm'r*, T.C. Memo. 2020-157 (Nov. 19, 2020), *on mot. to reconsider* T.C. Memo. 2017-126

George Fakiris was a commercial real estate developer in New York City, and 60% partner in Grou Development, LLC. In 2001, the LLC paid $700,000 for a 1929 Staten Island movie and vaudeville house that was dilapidated and in need of substantial repairs and restoration. The LLC planned to raze the theater and construct a high-rise building, but those plans were opposed by the community. Instead, the LLC wanted to give the theater to the Richmond Dance Ensemble, Inc., a nonprofit corporation that wanted to restore it and use it for public performances. Richmond Dance, however, had not yet been recognized as a tax-exempt organization eligible to receive deductible contributions. The LLC then agreed to sell the theater to WEMGO, a qualified public charity that agreed to retransfer the property to Richmond Dance after the latter obtained tax-qualified status. The sales contract prohibited WEMGO from transferring the property for five years, unless directed by the LLC to transfer it to Richmond Dance. The actual deed of transfer, however, included no restriction on WEMGO's ability to retransfer the theater and no power in the LLC to direct a transfer. WEMGO assumed $470,000 of debt on the property. WEMGO immediately transferred the property to Richmond Dance, before it had received tax qualification. Richmond Dance got its determination letter a few months later. A qualified appraisal in the year of the transfer to WEMGO valued the theater at $4.5 million. A qualified appraisal by the same appraiser the next year valued it at $5 million. George recognized a $405,518 capital gain and claimed a $3 million charitable deduction. The IRS disallowed the deduction.

The Tax Court (Judge Gale) denied the income tax deduction because the LLC's retained power to direct when WEMGO could retransfer the property rendered the gift incomplete for income tax purposes. Citing *Rosano v. United States*, 245 F.3d 212, 213 (2d Cir. 2001); *Pollard v. Comm'r*, 786 F.2d 1063, 1067 (11th Cir. 1986), *aff'g* T.C. Memo. 1984-536; *Pauley v. United States*, 459 F.2d 624, 626-627 (9th Cir. 1972). The court also sustained a 40% gross overvaluation penalty under Section 6662(h). The court determined that the correct value of the property was zero for purposes of the penalty, because the transfer was not a completed gift. Citing *Bosque Canyon Ranch, L.P. v. Comm'r*, T.C. Memo. 2015-130, *vac'd and rem'd sub nom. BC Ranch II, L.P. v. Comm'r*, 867 F.3d 547 (5th Cir. 2017), and *United States v. Woods*, 571 U.S. 31 (2013).

The taxpayer moved for reconsideration contending that the court needed to determine the actual value of the theater in order to determine the amount of the overvaluation penalty. Section 6662(e)(1)(a) states that the overvaluation penalty is 20% if the valued claimed is 150% or more of the correct valuation, or 40% if the value claimed is 200% or more of the correct valuation. In *Woods*, the Supreme Court held that a Section 6662(b)(3) accuracy-related penalty applied even when the transaction was disregarded for lack of economic substance. The court noted that the Second Circuit, to which this case would be appealed, applied this analysis to the now-repealed penalty for overvaluation under Section 6659, following the analysis of seven of the nine circuits that had considered the issue. The Tax Court held that the determination that a donor has not relinquished dominion and control over the gift property is analogous to the determination that a partnership is a sham and does not exist for tax purposes. Woods held that, where a charitable gift is a sham, the value of the property transferred is deemed to be zero. That same analysis should apply here. Under the regulations, this is treated as a 400% undervaluation.

9. When Failure to Provide Basis Information is Acceptable. *Hewitt v. Comm'r*, T.C. Memo. 2020-89 (June 17, 2020), *app. filed*, (11th Cir. Oct. 9, 2020)

David F. Hewitt granted to a qualified charitable organization a conservation easement over farmland that has been in his family for nearly 60 years. The easement covered 257 acres of a 1,325-acre tract that the taxpayer and his sister owned. David decided that he wanted to preserve the land because of his father, and he wanted his children and future generations to have the same opportunity that he had had to enjoy and live on the land. David hired a CPA firm with special expertise in conservation easements to handle the transfer, and he hired three local professionals to appraise the value of the easement. The deed also provides for the allocation of proceeds from an involuntary extinguishment with an adjustment for "any increase in value after the date of this grant attributable to improvements." David filed an appraisal summary indicating that basis information was not available. He had received much of the property by gift from his father, and he had no records of when or how his father had obtained the property. David deducted $57,738 in the year of the gift and $1,868,782 and $861,480 in the next two years. The IRS disallowed the carryover deductions.

The Tax Court (Judge Goeke) held that no charitable deduction carryover was allowable because the provision for the division of the proceeds of a judicial termination of the easement did not comply with the regulations, which do not permit adjustments for post-contribution improvements provided by the donor. The court noted that it would not have disqualified the easement merely because the appraisal summary submitted by David did not include basis information. David had received much of the property by gift from his father, and despite best efforts, he had been unable to determine the date and circumstances of his father's acquisition of the property, and thus could not determine the basis. Section 170(f)(11)(A)(ii)(II) provides a reasonable cause defense for a failure to comply with the reporting requirements if "the failure to meet such requirements is due to reasonable cause and not to willful neglect." The court believed that David's efforts to determine his basis were sufficient and the basis information was not reasonably obtainable.

10. No Gain Recognized by Donor Who Repeatedly Gave Stock to Donee Charity which then Submitted it for Redemption by Closely-Held Corporation. *Dickinson v. Comm'r,* T.C. Memo. 2020-128 (Sept. 3, 2020)

Jon Dickinson was the CFO and a shareholder of Geosyntec Consultants, Inc. (GCI), a privately held company. GCI's board of directors authorized its shareholders to donate GCI shares to Fidelity Investments Charitable Gift Fund (Fidelity), a 501(c)(3) organization. The board's authorization stated that Fidelity's program required that it "immediately liquidate the donated stock". Jon contributed appreciated GCI shares to Fidelity, signing a letter of understanding that confirmed Fidelity's discretion regarding any disposition and that it was not obligated to redeem, sell, or otherwise transfer the stock. Shortly after each of the three donations, Fidelity redeemed the GCI shares for cash. The IRS assessed a deficiency taxing Jon and his wife (they filed a joint return) on the appreciation in the stock, together with an accuracy-related penalty under Section 6662(a). Jon filed a motion for partial summary judgment.

The Tax Court (Judge Greaves) granted the taxpayers' motion. The IRS argued that the repeated contribution of GCI shares to Fidelity followed by its submission of the shares for cash redemption established a prearrangement for the redemption. The court held that substance should not prevail over form if Jon gave the shares away absolutely to Fidelity before the property was sold. Citing *Humacid Co. v. Comm'r*, 42 T.C. 894, 913 (1964); *Grove v. Comm'r,* 490 F.2d 241, 246 (2d Cir. 1973), *aff'g* T.C. Memo. 1972-98; *Carrington v. Comm'r,* 476 F.2d

704, 708 (5th Cir. 1973), *aff'g* T.C. Memo. 1971-222; *Behrend v. United States*, 31 A.F.T.R.2d 73-406, 1972 WL 2627, at *3 (4th Cir. 1972); *Rauenhorst v. Comm'r*, 119 T.C. 157, 162-163 (2002). The court noted that the documentation clearly stated that Fidelity had "exclusive legal control" over the stock given to it. The court rejected the IRS's argument that the fund's regular policy of promptly redeeming the donated stock sufficed to show a lack of absolute control by Fidelity, stating that neither a pattern of stock donations followed by donee redemptions, nor of stock donations closely followed by donee redemptions, nor of a selection of a donee on the basis of the donee's internal policy of redeeming donated stock demonstrates that the donor did not transfer all his rights in the donated stock. Citing *Grove v. Comm'r*, 490 F.2d at 242- 245; *Carrington v. Comm'r*, 476 F.2d at 705-706; *Palmer v. Comm'r*, 62 T.C. 684, 692-693 (1974), *aff'd*, 523 F.2d 1308 (8th Cir. 1975). Furthermore, the assignment of income doctrine applies only if the redemption was practically certain to occur at the time of the gift and would have occurred whether the shareholder made the gift or not. Citing *Palmer v. Comm'r*, 62 T.C. at 694-695; *Ferguson v. Comm'r*, 174 F.3d 997, 1003-1004 (9th Cir. 1999), *aff'g* 108 T.C. 244 (1997); *Hudspeth v. United States*, 471 F.2d 275, 276 (8th Cir. 1972). Here, Jon could have held onto the stock and not realized a gain.

Note. The court declined to follow Rev. Rul. 78-197, 1978-1 C.B. 83, which focuses on the donee's control over the disposition of the appreciated property. The court noted that the Tax Court does not follow Rev. Rul. 78-197, and instead looks at whether the redemption and the shareholder's corresponding right to income had already crystallized at the time of the gift.

11. Substantial Compliance Doctrine Saves Developer's $4 Million Deduction. *Emanouil v. Comm'r,* T.C. Memo. 2020-120 (Aug. 17, 2020)

In 1999, Peter C. Emanouil bought for $470,000 197 acres of undeveloped property in Westford, Massachusetts ("the Granite Hill property"). Peter spent several years trying to develop or sell the Granite Hill Property, including extensive negotiations with the town of Westford to approve his development of the land. Ultimately, Peter obtained from the town approval to build an affordable housing project comprising 164 units on 104 of the 197 acres. In 2008 and 2009, Peter gave the town 87 acres of the remaining land for which he claimed a $4 million charitable contribution deduction. Peter attached an appraisal to his tax returns supporting the valuation, but the appraisal did not include the date of the gifts or a statement that it was prepared for income tax purposes. The IRS denied the deduction for failure of the appraisal to meet the qualified appraisal rules. See IRC § 170(f)(11)(C); Reg. § 1.170A-13(c)(3)(i).

The Tax Court (Judge Gustafson) held for the taxpayers, finding that while the appraisal had technical flaws, it substantially complied with the requirements for a qualified appraisal. The court stated that the purpose of the qualified appraisal rules is to provide the IRS with sufficient information to deal more effectively with overvaluations. *Cave Buttes, L.L.C. v. Comm'r*, 147 T.C. 338 (2016); S. Rpt. 98-169 (vol. 1), 98th Cong., 2d Sess. 444-445 (1984); and Staff of J. Comm. on Taxation, *General Explanation of the Revenue Provisions of the Deficit Reduction Act ["DEFRA"] of 1984*, 99th Cong., 2d Sess. at 505-508 (J. Comm. Print 1985)). This case did not involve any organized tax shelter promotion, but rather a conventional outright gift of real estate to a qualifying donee. The court held that Peter's failure to provide the dates of the gifts was not a substantial flaw because the appraisals were dated within 30 days of the contributions and each explicitly stated that it gave "a current market value," rather than a historic value. Also, Peter disclosed the contribution dates on the appraisal summary (Form 8283, "Noncash Charitable Contributions"). Similarly, the failure to state that the appraisal was prepared for income tax purposes was not a substantial flaw because each appraisal valued the asset according to the correct standard used for income tax purposes. Thus, the failure to include this statement did not prevent the IRS from properly examining the details of the contribution. The government also argued that the gift was not made with a charitable intent, because Peter gave the land to the town merely to induce it to approve his other building permits. The court noted that, throughout the approval process, Peter made various concessions to mitigate Westford's concerns regarding the size of the development (including the number of units and the acreage), its impact on traffic and other resources, and environmental concerns. The court noted that the gift to the town occurred after the development had been arranged, and that it was made when no opportunity was found to develop or sell the contributed property. The court also rejected the application of accuracy-related penalties.

12. IRS Adds to No-Ruling List Transactions Involving Private Foundations Owning LLC Interests. Rev. Proc. 2021-40, 2021-38 I.R.B. 426 (Sept. 22, 2021)

The IRS stated that it will no longer issue private letter rulings regarding whether self-dealing occurs under Section 4941 when a private foundation or other entity subject to that section owns or receives an interest in an LLC or other entity that owns a promissory note issued by a disqualified person. This applies to all ruling requests pending or received on or after September 3, 2021.

Note. This arrangement arises where a disqualified person cannot borrow money from or lend money to a private foundation, under the self-dealing rules of Section 4941. To get around these limitations, the disqualified person and others form a partnership or LLC in which the disqualified person controls less than 35% of the entity. The partnership or LLC can then lend money to or borrow it from the private foundation in exchange for a promissory note. This is allowed unless the arrangement constitutes indirect self-dealing, which term is not clearly defined.

13. QTIP Trust Payment of Estate Taxes on Surviving Spouse's Estate is Not an Act of Self-Dealing Where Private Foundation is Residuary Beneficiary of QTIP Trust. PLR 202042007 (Oct. 16, 2020)

Foundation is a private foundation created by H and W, who are its only contributors. H's revocable trust provides for the distribution of all trust assets to Foundation at H's death. W's revocable trust creates a QTIP for H's lifetime benefit at W's death, with the residuary trust fund at H's death to be paid one-half to Foundation and one-half to trusts for W's children and grandchildren. The QTIP trust instrument requires that the trustee reimburse H's estate for any estate taxes attributable to the QTIP trust assets. H's trust similarly directs that his personal representative recover those estate taxes from the QTIP trust. W died and then H died. H's estate owes a significant estate tax attributable to the inclusion in H's estate of assets remaining in QTIP trust at W's death. (No estate tax is attributable to the assets of H's trust because the distribution to Foundation qualifies for the charitable deduction under Section 2055.) The Probate Court confirmed that the estate taxes owed by H's estate is attributable to the QTIP trust assets and ordered that the QTIP trust reimburse H's estate by transferring share of Corporation's stock the value of which is equal to the amount of the estate tax imposed on H's estate. H's estate proposes paying the estate tax and to obtain reimbursement from the QTIP trust in the form of shares of Corporation stock.

The IRS stated that the QTIP trust's reimbursement of H's estate with Corporation shares equal in value to the amount of estate tax to be paid by H's estate is not an indirect act of self-dealing under Section 4941(d)(1)(E). The IRS explained that Section 4941(a)(1) imposes a tax on any act of self-dealing between a "disqualified person" and a private foundation, and that "self-dealing," in part, is any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation. The estate of a deceased substantial contributor is a disqualified person. See Reg. § 53.4941(d)- 1(b)(3); *Estate of Reis v. Comm'r*, 87 T.C. 1016 (1986) (estate of Mark Rothko was a disqualified party with respect to the Mark Rothko Foundation); and *Rockefeller United States*, 718 F.2d 290 (8th Cir. 1983). The payment of the estate taxes is not an act of self-dealing, because the QTIP trust requires the trustee to reimburse H's estate for the QTIP trust's share of the estate taxes. Thus, the reimbursement by the QTIP trust is payment of a necessary expense associated with the administration of the trust, and while Foundation has an interest in the QTIP trust as a residuary beneficiary, it has no interest in the shares transferred to H's estate to pay the estate taxes, the payment of which is required before the calculation of the residuary estate.

14. IRS Explains Abusive Syndicated Conservation Easement Settlement Options. Chief Couns. Notice 2021-001 (Oct. 1, 2020)

The IRS provided detailed guidance in a Q&A format on a settlement options regarding abusive syndicated conservation easement transactions in some cases pending before the Tax Court. Among the key points made in the guidance are:

a) By Invitation Only and Docketed Cases Only

The settlement is available only to those partnerships that have cases pending in the Tax Court and that receive written invitations from the IRS to enter into the settlement. CCN 2021-001 § II.B.1. Furthermore, only cases that are already docketed in the Tax Court are eligible to receive an offer. CCN 2021-001 § II.B.4. While the settlement offer was announced on June 25, 2020, Chief Counsel may extend the offer to cases docketed later, in which case those partnerships will receive a written invitation to settle. CCN 2021-001 § II.B.5. A partner with one docketed case cannot automatically extend the settlement offer to cases that have not yet been docketed. CCN 2021-001 § II.B.6.

b) Everyone Plays or No One Plays

All partners in the partnership must agree to the settlement or none can take advantage of it. The IRS will negotiate with a group representing fewer than all of the partners, but at least a significant percentage of the partnership interests, but the settlement offered will be less favorable than one negotiated with all of the partners and still will not be finalized unless all of the partners agree to it. In extraordinary circumstances (not elaborated upon in the Notice), the Chief Counsel can treat a group of fewer than all of the partners as if 100% of the partners participated. CCN 2021-001 §§ II.B.2 and II.B.3. A partner who participates in multiple syndicated conservation easements can settle some of them without having to settle all of them. CCN 2021-001 § II.B.7.

c) Financial Settlement Terms

- The partnership is required to make a lump sum payment covering the aggregate tax, penalties, and interest due from each partner. No individual tax will be assessed against the individual partners. CCN 2021-001 §§ II.C.1, II.C.2. The deficiency is the tax that would have been assessed against each partner for each year. This is calculated by denying all deductions, losses, or other tax benefits to Category One Partners arising from the contribution. Category One Partners include all partners who organized or participated in the sale or promotion of any transaction involving the syndicated easement, or received fees for any such activities, or received fees for providing any appraisal, legal, or tax advice. It also includes any donee of the easement or any material advisor (under Section 6111(b)) with respect to the transaction, and any partner in a partnership or employee of a person who did any of the foregoing, or any related person. CCN 2021-001 §§ II.C.3 and II.C.4.

- Category Two Partners are all partners who are not Category One Partners. Category Two Partners can deduct an amount equal to their net out of pocket costs paid to participate in the transaction, including only any cash or property contributed to the partnership. This amount is reduced by any partnership distributions from the partnership. CCN 2021-001 §§ II.C.3 and II.C.5.

- The Notice explains how the penalties under Sections 6662 and 6707A are calculated and aggregated. CCN 2021-001 §§ II.C.6, II.C.7, and II.C.8.

- Partner- and partnership-level defenses must be waived. CCN 2021-001 § II.C.9.

- The IRS may additionally assert promoter penalties (Section 6700), material advisor penalties (Section 6707), appraiser penalties (Section 6695A), tax return preparer penalties (Sections 6694, 6695, 6701, 6713), criminal penalties and other enforcement actions. CCN 2021-001 § II.C.10.

- All penalties are included in each partner's amount due and paid in the aggregate part of the Settlement Amount, and the Settlement Amount is paid by the partnership (or the settlement group, if not all partners agree to the settlement). CCN 2021-001 § II.C.12.

- Interest accrues as with other tax deficiencies, but the suspension of interest and certain penalties where Secretary fails to contact taxpayer under Section 6404(g) will not be available. CCN 2021-001 §§ II.C.13 and II.C.14.

- Generally, the partnership must provide computations of the various components of the Settlement Amount within 90 days from the date the partnership elects to participate, but in "rare cases" that period may be extended one time. CCN 2021-001 §§ II.C.6, II.C.7, and II.C.8.

d) Additional Settlement Terms

Partnerships and partners must also: (a) if the case is in Appeals, consent to Appeals returning the case to Chief Counsel for implementation of the settlement; (b) agree to cooperate fully with the Chief Counsel during the settlement, including providing requested additional information and communications; (c) execute Form 8821 (Tax Information Authorization), if needed; (d) execute a Closing Agreement (Form 906), consistent with terms and conditions of the settlement and consent to the entry of a decision under Tax Court Rule 248(a). CCN 2021-001 § II.D.1.

e) Procedural Guidance

The Notice provides guidance on how a partnership can elect to participate in the settlement. CCN 2021-001 § II.B.8 - 10. It also explains what settlement documents will be required. CCN 2021-001 § II.E.

E. IRC § 280E. Expenditures in Connection with the Iillegal Sale of Drugs

Medical Marijuana Dispensary Cannot Deduct Charitable Gifts Made as Part of Its Business Activities. *San Jose Wellness v. Comm'r,* 156 T.C. ___ (No. 4) (Feb. 17, 2021)

San Jose Wellness operated a medical cannabis dispensary in California. In 2010-2015, it incurred various business expenses, as well as depreciation and charitable gifts. The IRS disallowed the deductions under Section 280E, which denies any deduction: (a) for an amount paid or incurred during the tax year, (b) for an amount paid or incurred in the carrying on of business, and (c) incurred by a business consisting of trafficking a controlled substance.

The Tax Court (Judge Toro) noted that it had held in earlier cases that running a cannabis dispensary constitutes a business of trafficking a controlled substance, even if the business also sells other items, such as T-shirts. *Patients Mutual Assistance Collective Corp. v. Comm'r,* 151 T.C. 176, 190 (2018). With respect to the charitable contribution deductions, the Tax Court held that charitable gifts can certainly be made for the good of a business, and that the taxpayer had not shown that these were otherwise. The fact that a charitable gift is not a business expense under Section 162 does not prevent it from being an expenditure incurred "in the carrying on of" the business.

Note. The court also rejected the contention that depreciation deductions are not "paid or incurred during the tax year," noting that the law treats them as having been paid or incurred during the tax year, even though the expenditure that generates them occurs years earlier. See *Comm't v. Idaho Power Co.*, 418 U.S. 1, 17 (1974) *N. Cal. Small Bus. Assistants Inc. v. Comm'r* ,153 T.C. 65, 73 (2019); *Patients Mut. Assistance Collective Corp.,* 151 T.C. at 190. The court also held the taxpayer liable for an accuracy-related penalty, finding that the taxpayer failed to establish that it acted with reasonable cause and good faith regarding its underpayment.

F. IRC §§ 401-409A. Retirement Plan Benefits

1. The Tax on Early Distributions is a Tax, Not a Penalty; Supervisory Approval is Not Required. *Grajales v. Comm'r,* 156 T.C. ___ (No. 3) (Jan. 25, 2021)

In 2015, Kirgizia I. Grajales, then 42 years of age, took loans in connection with her New York State pension plan. She received a Form 1099-R ("Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc."), reporting $9,026 in distributions. Kirgizia did not report the distributions as income on her tax return. The IRS assessed a deficiency including the $9,026 in gross income and assessing a 10% additional tax on early distributions under Section 72(t).

The Tax Court (Judge Thornton) held for the government. Kirgizia claimed that she was not liable for the additional tax because it is a penalty or additional amount and written supervisory approval was not obtained as required under Section 6751(b)(1). The court held that the additional tax under Section 72(t) is a tax, rather than a penalty, so the written supervisory approval requirement under Section 6751(b)(1) does not apply. The court noted that Section 72(t) expressly labels the exaction a tax and the larger statutory structure supports that conclusion. The court also rejected the argument that the 10% additional tax should be treated as a penalty under *National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012), regarding the individual mandate of the Affordable Care Act. In that case, the Supreme Court explained that an exaction might be considered either a "penalty" or a "tax" depending on the context. In this case, however, the court found no context to support treating this tax as a penalty.

2. Exception from Early Distribution Tax Does Not Apply to IRAs. *Catania v. Comm'r*, T.C. Memo. 2021-33 (March 15, 2021)

John A. Catania retired from his job with Home Depot when he reached age 55. At Home Depot, he participated in their Section 401(k) retirement plan. Upon retirement, John had the entire plan balance transferred to his IRA. John then received a $37,000 distribution from the IRA. The IRS assessed a 10% additional tax on the premature distribution under Section 72(t)(1).

The Tax Court (Judge Vasquez) held for the government. The taxpayer argued that he should not be subject to the tax because the distribution was made after a separation from service, and thus qualified for the exception under Section 72(t)(2)(A)(v). The Tax Court, however, noted that this exception does not apply to distributions from an IRA, because the IRA is not an employer plan, so that the taxpayer cannot be separating "from service" with respect to the IRA. Citing IRC § 72(t)(3)(A); and *Emerson v. Comm'r*, T.C. Memo. 2000-137, 2000, at *20 n.4.

3. Retransfer of Assets to IRA from Non-IRA Account is Not Permitted. PLR 202125007 (June 25, 2021)

Spouse died and Decedent became the owner of Spouse's IRA. Decedent named Trust as the IRA beneficiary. Decedent then exercised a power under the instrument and named each of Decedent's children as trustees and beneficiaries of Trust. Decedent died, and IRA became an inherited IRA for Trust's benefit. Within a few months, the IRA custodian advised the trustees that they could not trade stocks in the IRA and that its assets must be transferred to a non-IRA account in order to trade stocks. Following the custodian's advice, the trustees transferred substantially all of IRA's assets to a non-IRA account held by the custodian for Trust's benefit. The trustees now wish to reverse the transfer and retransfer the assets to an inherited IRA account for Trust's benefit.

The IRS stated that (a) Trust may not transfer the assets currently held in the non-IRA account into an inherited IRA for Trust's benefit; (b) Trust must include in gross income the distribution made from the IRA or the distribution made to the inherited IRA account; and (c) the transfer into an inherited IRA can be made to any inherited IRA and need not be made back into the original IRA. Section

408(d)(3)(A) states, in part, that there is no inclusion of an IRA distribution in the distributee's gross income if the individual distributee repays the entire amount into an IRA for the individual's benefit not later than the 60th day after the day on which the individual receives the payment or distribution. Upon Decedent's death, the IRS stated, IRA became an inherited IRA for Trust's benefit. The only permitted method of transferring assets from an inherited IRA to another inherited IRA is via a trustee-to-trustee transfer, which requires a direct transfer from one IRA to another IRA. Once the assets have been distributed from an inherited IRA, there is no permitted method of transferring them back into an IRA. In this case, the assets of IRA were transferred to a non-IRA account and cannot now be transferred to an IRA account. Trust will be required to include in gross income for the year in which the distribution from IRA occurred, any portion of the amounts transferred from IRA that is not investment in the contract. Trust may not transfer IRA's assets currently held in the non-IRA account into any IRA account.

4. How to Determine the Applicable Distribution Period for an IRA Payable to a Trust with Multiple Beneficiaries. PLR 202044001 (Oct. 30, 2020)

Decedent's revocable trust was the sole named beneficiary of her six IRAs. Decedent died before reaching age 70½ and before the applicability date of the SECURE Act. The trust then established Subtrust to hold assets from Decedent's retirement accounts, including Decedent's IRAs. The terms of Subtrust require that the trustee pay income and principal from Subtrust to Spouse, as the trustee deems appropriate, but that Spouse may require the trustee to distribute as much of Subtrust's assets as he demands. At Spouse's later death, the remaining assets of Subtrust go to the children of Decedent and Spouse, their children, and the descendants of any child who may not survive Decedent and Spouse. Decedent died survived by Spouse, both children, and some grandchildren.

The IRS stated that Spouse and the two children will be treated as designated beneficiaries of Decedent's IRAs for purposes of determining the applicable distribution period, and that the applicable distribution period will be calculated based on Spouse's life expectancy. Reg. § 1.401(a)(9)-4, Q&A-5. Beneficiaries of a trust may be designated beneficiaries only if: (1) the trust is valid under state law; (2) the trust is or becomes irrevocable upon the death of the employee; (3) the individuals who are trust beneficiaries with respect to the employee's benefit are identifiable from the trust instrument; and (4) certain documentation has been provided to the plan administrator. Reg. § 1.401(a)(9)-4, Q&A-6. If there are multiple beneficiaries, the applicable distribution period is based on the life expectancy of the beneficiary with the shortest life expectancy. Reg. § 1.401(a)(9)-4, Q&A-7(a). For this purpose, a contingent beneficiary is a beneficiary for purposes of determining the shortest life expectancy. Reg. § 1.401(a)(9)-4, Q&A-7(c)1). In this case, Spouse and the children are the only beneficiaries taken into account to determine the applicable distribution period, and because Spouse has the shortest life expectancy, his life expectancy is used.

5. Transfers from IRA Held by Decedent's Estate to IRAs Held by Beneficiaries are Neither Taxable Distributions nor Rollovers

a) PLR 202039002 (Sept. 25, 2020). IRA Paid to Decedent's Estate Transferred to New IRAs for His Son, Partner, and Grandson

Decedent died after his required beginning date, unmarried and survived by his son, partner, and grandson (the "beneficiaries"). Decedent's estate was the sole beneficiary of two IRAs. After Decedent's death, the IRAs were transferred into IRA Z, titled as "IRA of Decedent (Deceased) f/b/o Estate A." Decedent's will left the residuary estate, including the assets of the two IRAs, to the beneficiaries in equal shares. The personal representatives propose to transfer the IRA Z assets to three separate IRAs by means of trustee-to-trustee transfers. Each transferee IRA will be titled "Decedent (Deceased) IRA f/b/o [name of beneficiary] as beneficiary of Decedent's estate."

The IRS discussed Rev. Rul. 78-406, 1978-2 C.B. 157, which states that a direct transfer from one IRA trustee to another is neither a distribution to a participant nor a rollover. The IRS stated that: (a) because each transferee IRA is created and maintained in the name of the Decedent for the benefit of a beneficiary of his estate, the transfer of each beneficiary's interest in IRA Z to each transferee's IRA is neither a taxable distribution nor a rollover; (b) after the transfer of assets to the transferee IRAs, Decedent's estate will not include in its gross income, and the custodian of the transferee IRAs will not report as income to the estate, any amounts distributed from the transferee IRA to a Beneficiary.

Note. The ruling did not so state, but the transferee IRAs would have to withdraw the IRA funds within either five years or based on the Decedent's remaining life expectancy.

b) PLR 202042012 (Oct. 16, 2020). Pass-Through Trusts for Decedent's Five Children are Designated Beneficiaries of Decedent's IRA

Decedent died after her required beginning date, survived by all five of her children. Trust, established by Decedent, was revocable during her lifetime, became irrevocable at her death, and was named beneficiary of IRA Z. After Decedent's death, the assets of IRA Z were transferred in a trustee-to-trustee transfer to IRA X, which is titled as "IRA of Decedent (Deceased) f/b/o Trust." In the year following that of Decedent's death, IRA X's custodian was provided with information concerning the terms of Trust T and the identities of its beneficiaries. Trust's terms direct that the residual balance of the trust property, including IRA X, will be divided into separate trusts for each of Decedent's descendants, per stirpes – her five children. The trustee proposes to separate the assets of IRA X by a trustee-to-trustee transfers to five separate IRAs, one for each one of the five children. Each transferee IRA will be titled "IRA of Decedent (deceased) fbo (name of child beneficiary), as beneficiary of Trust

T." Distributions from each transferee IRA will be made over the life expectancy of Decedent's eldest child. Each transferee IRA will use the Social Security Number of the individual child beneficiary for reporting purposes.

The IRS stated that (a) each child beneficiary of Trust will be treated as a designated beneficiary of IRA X, to determine the distribution period; (b) the required minimum distributions from IRA X will be based on the life expectancy of the oldest child beneficiary; (c) the trustee-to-trustee transfers to IRAs titled "Decedent (deceased) fbo (name of child beneficiary), as beneficiary of Trust T" are not taxable distributions or rollovers under Section 408(d); and (d) each inherited IRA may use the Social Security Number of the individual child beneficiary for reporting purposes. The IRS noted that Reg. § 1.401(a)(9)-4, Q&A-5 states that a trust is not a designated beneficiary, but its beneficiaries can be treated as designated beneficiaries if: (1) the trust is valid under state law, or would be but for the fact there is no corpus; (2) the trust is irrevocable or will, by its terms, become irrevocable upon the death of the employee; (3) the beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit are identifiable from the trust instrument; and (4) relevant documentation has been timely provided to the plan administrator. These requirements were met in this instance. Also, Reg. § 1.401(a)(9)-5, Q&A-7 states, in general, that if more than one beneficiary is designated as a beneficiary with respect to an employee, the designated beneficiary with the shortest life expectancy will be the designated beneficiary for purposes of determining the applicable distribution period.

Note. The use of the intermediary IRA X to divide IRA Z into five separate shares, one for each child, is how banks, stockbrokers and other IRA custodians typically effect such divisions after an individual's death. This step may seem unnecessary, but it appears to be universally used and, as the ruling shows, it causes no harm.

6. Merger of Two Trusts Creates a Valid See-Through Conduit Trust. PLR 202035010 (Aug. 28, 2020)

Decedent established Irrevocable Trust and Revocable Trust. Upon Decedent's death, Revocable Trust became irrevocable. Decedent named Revocable Trust as beneficiary of Decedent's two IRAs. Revocable Trust named Decedent's three children, Child A, Child B, and Child C, as beneficiaries of its assets, including the IRAs. Child A is the oldest of the three children. Decedent died before his required beginning date. Before September 30 of the year after Decedent's death, the trustees agreed that the Revocable Trust would be merged into the Irrevocable Trust, that Irrevocable Trust would be the surviving entity, and that the merger would occur before September 30 of the year after the year of Decedent's death. The Revocable Trust instrument gave its trustees the discretion to change the rights of the three children after Decedent's death, but the merger agreement negated this authority. The three children were the only beneficiaries of the IRA's as of the date of Decedent's death, and as of September 30 of the year following the year in which Decedent died.

The IRS stated that the three children are identifiable beneficiaries of the IRAs, because the merger deleted the ability of the trustee to change the rights of the three children. Irrevocable Trust, after the merger, is a valid see-through conduit trust and the IRA assets may be distributed to the beneficiaries using the remaining life expectancy of the oldest beneficiary, Child A.

Notes. Decedent apparently died before the January 1, 2020 effective date of the SECURE Act. A distribution to a conduit see-through trust for three children of the decedent after the effective date of the SECURE Act would have to be distributed within 10 years, unless one or more of the children were minors, in which case the distributions would have to be made within 10 years after the beneficiary reached majority.

7. Surviving Spouse May Roll-Over Decedent's IRA Otherwise Payable to Trust or Estate for Spouse's Benefit

a) PLR 202040003 (Oct. 2, 2020). IRA Payable to Trust Spouse Can Revoke and for which Spouse is Sole Trustee and Sole Lifetime Beneficiary

Decedent died after his "required beginning date" survived by his spouse, Spouse. Decedent owned IRA X and named Trust as the sole beneficiary. Under the terms of Trust, Spouse is the sole trustee and has the sole right to amend or revoke the Trust and to distribute all income and principal for her own benefit. Spouse proposes to roll over amounts from IRA X into one or more IRAs held in the name of Spouse.

The IRS stated that Spouse, as Decedent's surviving spouse, can roll over a distribution from IRA X into one or more IRAs established and maintained in Spouse's own name, if the rollover occurs no later than 60 days following the day the distribution from IRA is received. It also stated that Spouse need not include the proceeds from IRA X in her gross income for Federal income tax purposes for the year in which the proceeds are distributed and rolled over into Spouse's IRAs, to the extent that the proceeds are timely rolled over into an IRA set up and maintained in the name of Spouse. In this case the surviving spouse of Decedent is the trustee and sole beneficiary of the Trust and is entitled to all income and the entire corpus of the Trust. Thus, Spouse is effectively the individual for whose benefit IRA X is maintained.

b) PLR 202034002 (Aug. 21, 2020). Community Property Interest in Survivor's Subtrust of Joint Revocable Trust

At D's death, D owned IRA D, the sole beneficiary of which was Trust, which was created by D and S, D's surviving spouse. D and S live in a community property state and the IRA was community property. The terms of Trust state that upon D's death, S becomes the sole trustee of Trust and all of its subtrust, one of which is the Survivor's Trust. The Survivor's Trust is to receive all of S's interest in community property owned with D (including S's interest in the IRA). S can withdraw all of the income and principal of Survivor's Trust at any time. S proposes to distribute the Survivor's Trust's interest in IRA to herself, in order to complete a rollover of the assets into one or more IRAs in her own name.

The IRS concluded that (a) S will be treated as having acquired her one-half community property interest in IRA that is used to fund the Survivor's Trust directly from D, and not from Trust, because S is the sole beneficiary of Survivor's Trust and the sole trustee; (b) S can roll over her one-half community property interest in IRA that was used to fund the Survivor's Trust to one or more IRAs established and maintained in her name; (c) S need not include in gross income any portion of the rolled-over IRA distributions; and (d) the Survivor's Trust's receipt of the one-half community property interest in IRA and the rollover of the one-half community property interest in IRA D one or more IRAs set up and maintained in S's name are not transfers of IRD under Section 691(a)(2).

G. IRC §§ 641-663. Fiduciary Income Taxation

New Section 67(g) and 642(h) Regulations Regarding Beneficiary's Deduction for Estate Excess Deductions. T.D. 9918, 85 Fed. Reg. 66219 (Oct. 19, 2020)

On the termination of an estate or trust, Section 642(h) gives the beneficiaries succeeding to the entity's property the benefit of any unused net operating or capital loss carryovers of the estate or trust, and any unused estate or trust deductions for the last taxable year. Section 67(e) states that two sets of deductions are treated as adjustments to gross income, rather than miscellaneous itemized deductions: (1) deductions for amounts paid or incurred in connection with the administration of the entity and which would not have been incurred if the property were not held in such estate or trust; and (2) deductions for the personal exemption of the entity (Section 642(b)), and the distribution deduction (Sections 651 and 661. Section 67(g), added by the Tax Cut and Jobs Act of 2017, eliminated the deduction for miscellaneous itemized deductions, for taxable years beginning after December 31, 2017, and before January 1, 2026. Treasury and the IRS have issued final regulations on this issue, stating that:

- The items described in Section 67(e) as adjustments to the gross income of an estate or nongrantor trust and previously deductible without regard to the 2% limitation on itemized deductions, remain deductible by the trust or its succeeding beneficiaries as adjustments to the gross income. Section 67(g) does not deny an estate or non-grantor trust (including the S portion of an electing small business trust) a deduction for expenses described in Section 67(e)(1) and (2), because these deductions are allowable in arriving at adjusted gross income and are not miscellaneous itemized deductions under Section 67(b).

- The character, amount, and allocation of these deductions succeeded to by a beneficiary under Section 642(h)(2) on the termination of an estate or nongrantor trust will be the same as the character, amount, and allocation of the items in the hands of the entity.

- The fiduciary must separately identify deductions that may be limited when claimed by the beneficiary.

- The principles of Reg. § 1.652(b)-3 apply in allocating each item of deduction among the classes of income in the year of termination for purposes of the excess deductions under Section 642(h)(2). Section 1.652(b)-3(a) provides that deductions directly attributable to one class of income are allocated to that income and any remaining deductions not directly attributable to a specific class of income, as well as any deductions that exceed the amount of directly attributable income, may be allocated to any item of income (including capital gains), although a portion must be allocated to any tax-exempt income. Reg. § 1.652(b)-3(b) and (d).

- The regulations apply to tax years beginning after the date they are finalized, but taxpayers may choose to rely on the proposed regulations for specified tax years beginning after December 31, 2017.

Note. The preservation of the character of the trust's or estate's deductions in the hands of the beneficiaries succeeding to the entity's assets should permit the beneficiaries to deduct both items that were adjustments to gross income for the entity, such as administration expenses, personal exemptions, and distribution deductions, as well as items that were not miscellaneous itemized deductions to the entity, such as interest and state and local taxes. This should preserve a substantial portion of the value of the terminating deductions paid to the successors to a trust or estate.

The text of the final regulations is the same as that of the proposed regulations (REG-113295-18, 85 Fed. Reg. 27693 (May 11, 2020)), but the IRS made several changes in Reg. § 1.642(h)–5**,** Example 2 to demonstrate that, after any deductions allocable to tax-exempt income, the fiduciary can select which deductions to allocate to income and which to retain for the beneficiaries. Example 2 permits a trustee to allocate personal property tax to trust income, so that only deductions that would have been deductible as adjustments are left for distribution to the beneficiary.

H. Capital Gains at Gift or Death Proposals. Biden Administration's Proposed American Families Plan, Dept. of Treas., "General Explanations of the Administration's Fiscal Year 2022," pp. 61-64 (May 2021) (the "Green Book"); White House Fact Sheet (April 28, 2021), [https://www.whitehouse.gov/brief-ing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan](https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan); H.R. 2286, 117th Cong., 1st Sess. (March 29, 2021); Van Hollen Senate Discussion Draft (March 29, 2021)

The Administration has proposed, as have members of both the House and Senate, that capital gains be recognized at death and on lifetime gifts. The Biden Administration's proposal was first released in a Fact Sheet for the Proposed American Families Plan, published on the White House web site, and then in the Treasury Department's Green Book. In the Senate, Senator Chris Van Hollen (D-Md.) circulated a discussion draft of a proposed "Sensible Taxation and Equity Promotion (STEP) Act of 2021" among a group that includes Sen. Sheldon Whitehouse, who is on the Senate Finance Committee. This bill is not yet been assigned a bill number. In the House of Representatives, Rep. Bill Pascrell (D-N.J.), a member of the House Committee on Ways and Means, has introduced a similar, though distinct bill.[4] That bill has three co-sponsors, all of whom are Democrats. (Please note that this discussion will sometimes refer to H.R. 2286 as the House Bill and the van Hollen discussion draft as the Senate Bill, though neither has yet been put to a vote.

1. Tax Capital Gains on Gifts or at Death

All three proposals would make a lifetime gift or a transfer at death a realization and recognition event with respect to appreciated property. The House and Senate proposals would add a new Section 1261, "Gains from Certain Property Transferred by Gift or Upon Death." Generally, H.R. 2286 states that the transfer of property "by gift or at death" after December 31, 2021 will be treated for income tax purposes as if it were sold for its fair market value on the date of the gift or the date death. Prop. IRC § 1261(a). Both the House and Senate bills also give the transferee a full fair market value basis in the asset, reflecting the recognition of gain.

The general rule of the Van Hollen discussion draft (Van Hollen") is almost the same as H.R. 2286, except that it explicitly applies to transfers "by gift, in trust, or upon death." This is a material difference, because it states that, except for transfers to certain trusts discussed below, any transfer to a trust will be treated as a constructive sale of the transferred property.

The most glaring difference between the Biden proposal and the other two is that the Biden proposal would also treat as a realization and recognition event a transfer of property into or a distribution of property out of a trust, partnership, or

[4] It is, perhaps, unfair to attempt to compare the Biden Administration's proposal to the two bills that have been introduced, because the Biden proposal does not yet have legislative language. Thus, we have far fewer details about the Biden proposal than about the House and Senate proposals. Of course, one works with what one has.

other noncorporate entity. This is the only proposal that addresses the taxation of transfers into and out of a partnership.

2. $1,000,000 Exclusion for Transfers at Death

All three proposals provide that gross income does not include up to $1,000,000 of net capital gains for transfers at death to which Section 1261(a) applies. H.R. 2286, Prop. IRC § 1391(a); Van Hollen, Prop. IRC § 1391(b). This exemption is indexed for inflation. H.R. 2286, Prop. IRC § 1391(b); Van Hollen, Prop. IRC § 1391(c).

The Biden proposal, unlike the other two, expressly makes this exclusion portable to a surviving spouse.

3. $100,000 Exclusion for Lifetime Transfers

Van Hollen also provides a $100,000 lifetime exclusion for gain on gifts. Van Hollen, Prop. IRC § 1391(a). Neither the Biden proposal nor the House proposal has a similar provision.

4. Long-Term Trusts – Periodic Deemed Dispositions

The Biden proposal states that gain on unrealized appreciation also would be recognized by a trust, partnership, or other non-corporate entity that owns appreciated property that has not been the subject of a recognition event within the prior 90 years, with the testing period beginning on January 1, 1940. The first possible recognition event for any taxpayer under this provision would thus be December 31, 2030.

H.R. 2286 states that on the 30th anniversary of the later of the date on which property is transferred to a non-grantor trust or a grantor trust that is not includible in the grantor's gross estate, or January 1, 2022, and on each 30th anniversary thereafter, the trust assets shall be taxed as if they had been transferred. Any property that has been held by a non-grantor trust or a grantor trust that is not includible in the grantor's gross estate on January 1, 2022, and that has been so held for at least 30 years, shall be taxed as if it were sold on January 1, 2022. H.R. 2286, Prop. IRC § 1261(c)(4).

Van Hollen states that with respect to trusts other than grantor trusts the assets of which are includible in the grantor's gross estate, any property held by the trust shall be treated as having been sold for its fair market value on the last day of the taxable year ending 21 years after the latest of (i) December 31, 2005; (ii) the date the trust was established; and (iii) the last date on which such property was treated as sold by reason of this rule. Van Hollen, Prop. IRC § 1261(b)(2)(A).

5. Exceptions to Recognition

All of the proposals include several exceptions to the general rule that a gift or death is treated as a constructive sale.

a) Marital Exception

The Biden proposal states that transfers by a decedent to a U.S. spouse would carry over the basis of the decedent and no gain would be recognized. Capital gain on property transferred to a U.S. spouse would be recognized on the spouse's death or earlier if the spouse disposes of the asset. There does not appear to be a secondary marital exception if the spouse remarries. Also, there is no provision for exempt marital gifts to a QDOT when the donor's spouse is not a U.S. citizen.

H.R. 2286 provides an exception for transfers to a surviving spouse who is a U.S. citizen. H.R. 2286 Prop. IRC § 1261(b)(1). In addition, a qualifying spousal trust is not subject to the recognition rules applicable to trusts generally. A qualifying spousal trust is a qualified domestic trust under IRC § 2056A, of which the transferor's spouse is the sole current income beneficiary and the transferor, during his or her lifetime, or such spouse or surviving spouse has a power of appointment over the entire trust. H.R. 2286 Prop. IRC § 1261(c)(5).

Van Hollen contains a much more detailed marital exception. Under that bill, there is no constructive sale treatment for any transfer to a spouse or surviving spouse of the transferor, or to a QTIP trust. Van Hollen, Prop. IRC §§ 1261(c)(2)(A) and 1261(c)(2)(C). Property transferred to a spouse or QTIP trust will be treated as sold by the spouse or surviving spouse on the date on which it is disposed of by the spouse or surviving spouse or, if earlier, the date of such spouse's death. Van Hollen, Prop. IRC § 1261(c)(2)(B). The Van Hollen discussion draft denies the marital exception for a transfer to a spouse who is not a U.S. citizen or a long-term resident. A long-term resident is defined, for this purpose, as an individual who is not a U.S. citizen, who is a permanent resident of the United States for the taxable year in which the transfer occurs and in at least 8 of the 15 taxable years preceding the taxable year in which the transfer occurs. Van Hollen, Prop. IRC § 1261(c)(2)(D). Van Hollen does not provide an exception for a gift to a QDOT.

b) Charitable Exception

The Biden proposal states that transfers by a decedent to charity would not generate a taxable capital gain. The transfer of appreciated assets to a split-interest trust would generate a taxable capital gain, with an exclusion allowed for the charity's share of the gain based on the relative value of the charity's interest in the trust under estate and gift tax rules.

H.R. 2286 exempts from the recognition rules transfers to charity described in Section 170(c). H.R. 2286, Prop. IRC § 1261(b)(3).

Van Hollen also exempts from the recognition rules transfers to or for the use of a charity described in Section 170(c). Van Hollen, Prop. IRC § 1261(c)(3)(A). Van Hollen explicitly states that property set aside for the use of a charity is not subject to the dynasty trust rules discussed above. Van

Hollen, Prop. IRC § 1261(c)(3)(B). In valuing what part of a trust is held for the use of a charity, rules similar to Section 2702 will apply. Van Hollen, Prop. IRC § 1261(c)(3)(C). A gift of an interest in property for the benefit of a charity is not eligible for this exception unless the interest is a remainder interest, a guaranteed annuity, or a unitrust interest. Van Hollen, Prop. IRC § 1261(c)(3)(D). The dynasty trust rules discussed above do not apply to qualified disability trusts (defined in Section 642(b)(2)(ii)) or cemetery perpetual care trusts (defined in Section 642(i).

c) Tangible Personal Property Exception

The Biden proposal states that the transfer of tangible personal property such as household furnishings and personal effects (excluding collectibles) would not be a recognition event.

H.R. 2286 exempts transfers of tangible personal property that are not: (a) held in connection with a trade or business; (b) held for investment; or (c) a collectible. For this purpose, a collectible is defined with reference to Section 408(m), which precludes holding collectibles in an IRA, and thus includes any work of art, any rug or antique, any metal or gem, any stamp or coin, any alcoholic beverage, or any other tangible personal property specified by the Secretary for this purpose. H.R. 2286, Prop. IRC § 1261(b)(2). Thus, transfers of non-collectible personal effects would not be subject to the new tax on death or gifts. Under Prop. Reg. § 1.408-10(b), 49 Fed. Reg. 2794 (Jan. 23, 1984), the taxable items of tangible personal property would also include any musical instrument or historical objects (documents, clothes, etc.).

Van Hollen exempts transfers of tangible personal property that are not: (a) held in connection with a trade or business; (b) held for the production of income; or (c) a collectible. For this purpose, a collectible is defined with reference to Section 408(m). Van Hollen, Prop. IRC § 1261(c)(1). The difference between the two bills appears to be only that H.R. 2286 refers to assets held for investment, while Van Hollen refers to assets held for the production of income.

Note. The phrase in H.R. 2286 appears to be broader than that in Van Hollen, because assets can be held for investment without the generation of income if they are held expressly for appreciation, while assets held to produce income are almost definitionally also held for investment.

d) $250,000 Residential Gain Exemption

The Biden proposal states that the $250,000 per-person exclusion under current law for capital gain on a principal residence would apply to transfers of “all residences” by gift or at death and would be portable to the decedent’s surviving spouse. Thus, the exclusion would be $500,000 per couple.

e) Small Business Stock Exemption

The Biden proposal states that the exclusion under current Section 1202 for capital gain on certain small business stock would apply to gifts and transfers at death.

6. Grantor Trusts

The Biden proposal states that the deemed owner of a wholly-revocable grantor trust would recognize gain on the unrealized appreciation in any asset distributed from the trust to any person other than the deemed owner or his or her U.S. spouse, other than a distribution made in discharge of an obligation of the deemed owner. All of the unrealized appreciation on assets of a revocable trust would be realized at the deemed owner's death or if the trust otherwise becomes irrevocable. The Biden proposal makes no other special provisions for grantor trusts that are not wholly-revocable by the deemed owner.

H.R. 2286 states that assets held by a grantor trust that is included in the grantor's gross estate are treated as sold on (i) the date of the grantor's death or, if earlier, (ii) the date they are distributed to someone other than the grantor. A similar rule applies with respect to trusts deemed owned by a third-party under Section 678. H.R. 2286, Prop. IRC § 1261(c)(1).

Van Hollen states that a transfer to a grantor trust deemed owned by "the transferor" is not treated as a sale for fair market value. Van Hollen, Prop. IRC § 1261(b)(1)(A). Property held in a grantor trust is treated as transferred by the grantor in a sale for fair market value, however, on the date that: (i) the grantor ceases to be treated as the deemed owner; (ii) the property is distributed to any person other than the grantor; or (iii) the property would no longer be includible in the grantor's gross estate. Property in a grantor trust is also treated as having been sold for its fair market value on the date of the grantor's death. Van Hollen, Prop. IRC § 1261(b)(1)(B).

Note. The House and Senate bills have similar treatment of property held in a grantor trust that would not be includible in the grantor's gross estate, but H.R. 2286 provides for similar treatment for trusts deemed owned by a third-party under Section 678. Thus, under H.R. 2286, a grantor's transfer to a BDIT or BDOT should not itself be treated as a sale of the transferred assets for their fair market value, but under Van Hollen, it would be so taxable. The Biden proposal does not appear to make special provisions for trusts that are wholly taxable to someone other than the grantor under Section 678,

7. Trust Modification or Decanting

H.R. 2286 provides that the modification of the beneficiaries of a trust or the transfer or distribution of trust assets (including distribution to another trust) shall be treated as a taxable disposition under these rules, "unless the Secretary determines that any such transfer or modification is of a type which does not have the potential for tax avoidance." H.R. 2286, Prop. IRC § 1261(c)(3).

Neither the Biden proposal nor Van Hollen has a comparable provision.

8. Step-Up in Basis for Gifts where Gain Recognized

The Biden proposal states that the basis of property received from a decedent would continue to be its fair market value at the decedent's death. The basis of property received from a donor would be its fair market value at the time of the gift. The donee's basis in property received by lifetime gift would be the donor's basis, to the extent that the unrealized gain on that property counted against the donor's $1 million exclusion from recognition.

Both the House and Senate bills state that property acquired by gift after December 31, 2021 will take a basis equal to the fair market value of the property at the time of the gift. Prop. IRC § 1015(a)(1).

9. Annual Exclusion Gifts

H.R. 2286 provides that no gain is recognized on transfers to an individual that are not taxable gifts because of the gift tax annual exclusion. Prop. IRC § 1261(d).

Van Hollen has no similar provision, but it provides a $100,000 lifetime exemption from taxation as a sale for fair market value for transfers during the transferor's lifetime. Van Hollen, Prop. IRC § 1391(d).

The Biden proposal has no similar provision.

10. Information Reporting

The Biden proposal states that the gain would be reported on the Federal gift or estate tax return or on a separate capital gains return.

H.R. 2286 provides a new Section 6050Z, "Returns Relating to Certain Gifts and Bequests," which will require that a donor or the executor for a decedent shall be required to report to the Secretary and to each transferee the name and taxpayer ID number of the transferee, a description of the transferred property, and the fair market value of the transferred property. This will apply to any gift, other than one of a covered security (defined with reference to Section 6045(g)(3), on which the broker is already required to report), to which new Section 1261 will apply, and to any transfer at death (other than a transfer of a covered security) which is includible in gross income under Section 1261. There are exceptions for gifts that are not subject to new Section 1261 because they are under the annual exclusion, and to transfers at death that are under the $1,000,000 exclusion.

Van Hollen provides a new Section 6048A, "Information With Respect to Certain Domestic Trusts," which will require the trustee of any trust the aggregate value of the assets of which is more than $1,000,000 on the last day of the taxable year, or the gross income for the taxable year of which exceeds $20,000, shall be required to provide the Secretary with (a) a full and complete accounting of all activities and operations of the trust for the taxable year; (b) the name and taxpayer ID number of the trustee, the grantor, and each beneficiary of the trust, and such other information as the Secretary requires. Van Hollen, Prop. IRC § 6048A.

11. Extension of the Time to Pay Certain Capital Gains at Death

The Biden proposal states that the payment of tax on the appreciation of certain family-owned and -operated businesses would not be due until the interest in the business is sold or the business ceases to be family-owned and operated. A 15-year fixed-rate payment plan would be allowed for the capital gains tax on appreciated assets transferred at death, other than liquid assets such as publicly traded financial assets and other than businesses for which the deferral election is made. The IRS could require security at any time when there is a reasonable need for security to continue this deferral.

H.R. 2286 provides that a taxpayer may elect to pay any capital gain recognized on a transfer at death of an eligible asset (an asset other than actively-traded personal property (see Section 1092(d)(1)), under Section 1261 can be paid in 2 or more (but not more than 7) equal annual installments. H.R. 2286, Prop. IRC § 6168(a)(1). The election must be made not later than the time the return reporting the tax on the gain is due. H.R. 2286, Prop. IRC § 6168(a)(2). The interest rate on the deferred tax shall be 45% of the annual rate for underpayments of income taxes under Section 6601.

Van Hollen provides that a taxpayer may elect to pay any tax on a capital gain recognized on account of the transfer of an eligible asset (an asset other than actively-traded personal property (see Section 1092(d)(1)), on a transfer at death under Section 1261, can be paid in 2 or more (but not more than 10) equal annual installments. Van Hollen, Prop. IRC § 6168(a)(1). The first installment shall be paid on or before the date selected in the election, which is not more than 5 years after the date on which the tax is otherwise due. Van Hollen, Prop. IRC § 6168(a)(2). Interest is due during this 5-year deferral period. Van Hollen, Prop. IRC § 6168(f)(1). The election must be made not later than the time the return of tax reporting the gain is due. Van Hollen, Prop. IRC § 6168(d). The interest rate on the deferred tax shall be 45% of the annual rate for underpayments of income taxes under Section 6601. Van Hollen provides for an acceleration of the deferred tax if the eligible asset is distributed, sole, exchanged or otherwise disposed of or nonrecourse indebtedness is secured in whole or in part by a portion of such eligible asset. Van Hollen, Prop. IRC § 6168(g)(1). Similarly, any late payment of interest or principal must be paid upon notice from the Secretary, unless the payment is made within 6 months of the original due date. If the payment is made within 6 months, there will be a penalty equal to 5% of the amount of the payment. Van Hollen, Prop. IRC § 6168(g)(2). A special lien is imposed under new Section 6324C, “Special Lien for Taxes Deferred Under Section 6168.” Van Hollen, Prop. IRC § 6324(c).

12. Waiver of Penalty for Underpayment of Estimated Tax

The Biden proposal states that provision will be made for waiver of the penalty for underpayment of estimated tax with respect to capital gains at death.

Van Hollen provides that a taxpayer who dies during the taxable year shall not be liable for an estimated tax underpayment penalty if the source of the underpayment was the tax under Section 1261. Van Hollen, Prop. IRC § 6354(e)(3)(C).

H.R. 2286 has no comparable provision.

13. Appraisal Costs

The Biden proposal states that donors and estates of decedents could deduct the full cost of appraisals of appreciated assets, though it does not state whether these costs would be income tax deductions, estate tax deductions, or both.

Van Hollen permits the deduction of the costs of any appraisal of property that is deemed to have been sold under Section 1261. Van Hollen, IRC § 199B. This is not treated as a miscellaneous itemized deduction.

H.R. 2286 has no comparable provision.

14. Effective Date

The Biden proposal would be effective for gains on property transferred by gift, and on property owned at death by decedents dying, after December 31, 2021, and on certain property owned by trusts, partnerships, and other non-corporate entities on January 1, 2022.

Note. The Biden proposal would also tax capital gains and qualified dividends of taxpayers with adjusted gross income of more than $1,000,000 at the same rates as ordinary income – 37% (40.8% including the net investment income tax). A separate proposal would increase the top ordinary individual income tax rate to 39.6% (43.4% including the net investment income tax). The $1,000,000 figure would be indexed for inflation after 2022. These rules would apply to gains required to be recognized after the "date of announcement." The "date of announcement" will be either the date on which the Green Book was released (May 28, 2021) or the date on which the White House published on its website a fact sheet relating to these proposals (April 28, 2021).

All of the provisions of H.R. 2286 will apply to gifts made after and transfers at death with respect to decedents dying after December 31, 2021.

All provisions of Van Hollen shall apply to gifts made after and transfers at death with respect to decedents dying after December 31, 2020.

Note. There are several unclear points in these proposals, which is to be expected with proposals that have, in one case, not been drafted and in the other two cases not yet been reviewed by the tax-writing committees (and, with regard to the Senate proposal, formally introduced). For example, new Section 1261 in the House and Senate bills states that the property transferred by gift shall be "treated as sold for its fair market value." This strongly suggests that every gift of a life insurance policy would be a transfer for valuable consideration causing the proceeds to be taxable as ordinary income. This is not likely intended, but the statutes need to be clarified on this issue.

It is also unclear how these statutes would apply to retirement benefits. Any deemed sale within a qualified plan or IRA would present no problem, because the entity is tax-deferred. Furthermore, qualified plan interests are required to be nonassignable. Interests in an IRA, however, are not subject to the nonassignability requirement, and it is unclear how an assignment of an interest in an IRA would be taxed under new Section 1261.

The income tax on gains under these proposals at a decedent's death should be deductible as a claim against the estate for estate tax purposes under Section 2053. This does not, of course, prevent imposition of both the estate tax and income tax on the same assets at a decedent's death. Such imposition could be avoided only by making one of the taxes creditable against the other. A deduction only allows an effective reduction in the total combined rate.

The various statements by the sponsors of the House and Senate bills and the Green Book refer consistently to taxing capital gains at death or on a gift. The proposals are not, however, limited to capital gains. A gift of or the transfer at an individual's death of property that is not a capital asset, such as property held for sale to customers in the ordinary course of business, would produce ordinary taxable income, rather than capital gains.

These proposals would effect two major changes on a client's estate plan. First, they would substantially increase the total taxes paid on estates over $1,000,000. Second, they would create a serious need for additional liquid assets in an estate, even with the proposed provisions for deferred payment of the income taxes. This may, in turn, encourage far more clients to own more life insurance than they currently own.

I. Foreign Bank Account Reporting Act. 31 U.S.C. § 5314

1. Treasury Will Treat Foreign Virtual Currency Accounts as Subject to FBAR. FinCEN Notice 2020-2 (Dec. 31, 2020). https://www.fincen. gov/sites/default/files/shared/NoticeVirtual%20Currency%20Reporting%20on%20the%20FBAR%20123020.pdf

Treasury's Financial Crimes Enforcement Network announced that it will propose FBAR regulations treating virtual currency accounts as reportable under the FBAR rules.

2. How to Prove "Willful" Failure to File FBAR

a) Willfulness Shown by Concealing Foreign Trusts, Except Where it Helped the Taxpayer to Reveal Them. United States v. Rum, 995 F.3d 882, 2021 WL 1589153 (11th Cir. Apr. 23, 2021), aff'g 2019 WL 5188325 (M.D. Fl. Sept. 29, 2019) (slip copy), rept. of master adopted, 2019 WL 3943250, 124 A.F.T.R.2d 2019-5389 (Aug. 2, 2019) (slip copy)

Said Rum is a naturalized U.S. citizen opened a Swiss bank account with UBS in order to conceal money from potential judgment creditors. The account was a numbered, rather than a named account, and Said elected to have his mail held at UBS, rather than sent to his U.S. address. UBS charged a fee to retain his mail and all retained mail was deemed to have been duly received by him. Rum gave inconsistent statements on why he failed to return the money to the U.S. earlier and he admitted that he went to Switzerland several times to meet with bank officers at UBS and obtain the best tax return on his investments. UBS informed Said in 2002 that earnings from U.S. securities had to be reported to the IRS but Said directed UBS not to invest in U.S. securities. He also signed a document stating that he was liable for U.S. tax on the earnings of the account. Said prepared some of his own income tax returns and answered "no" to whether he had a foreign bank account. This statement was made under penalties of perjury. When Said hired a tax return preparer, he did not tell him about the foreign accounts. Said never filed FBARs, and when he was audited for the 2006 tax year, he told the agent that he had closed his UBS account but failed to tell her that he opened the new one another foreign bank. The agent imposed additional taxes, but no FBAR penalties. After discussions with the agent, Said filed a late 2009 FBAR in 2010. In a second examination of Said's 2005, 2007, 2008, 2009, and 2010 tax years, the revenue agent asserted substantial deficiencies and civil fraud penalties. She also approved a non-willful FBAR penalty, rather than a willful FBAR penalty, because the prior revenue agent had not raised the FBAR issue in 2005. When the agent realized that the prior agent's actions were immaterial, she recommended raising the penalty to a willful nonfiling penalty of 50% of the account balance at the time of the violation.

The U.S. District Court for the Middle District of Florida (Judge Scriven), approved and adopted the analysis of a magistrate (Mag. Porcelli), which had found that: (a) the $100,000 limitation on penalties for willful nonfiling contained in 31 C.F.R. § 1010.820(g)(2) was superseded by the legislative change in the Code section being interpreted by that regulation; (b) there was no genuine issue of material fact over willfulness, in light of the actions of the taxpayer to conceal the foreign accounts from his creditors and from the IRS; and (3) the IRS had not acted in bad faith or arbitrarily and capriciously by assessing the maximum possible penalty. On the issue of willfulness, the magistrate noted that the case law consistently treats recklessness, including the intentional avoidance of information about the legal requirements, as a form of willfulness, and that the taxpayer's actions here met that standard. On the issue of whether the IRS acted arbitrarily and capriciously, the magistrate noted that the Internal Revenue Manual directs that the maximum penalty apply where the account exceeds $1 million in value at the time of the violation. 2A I.R.M. Abr. & Ann. § 4.26.16-2. The I.R.M. allows a reduced penalty if the taxpayer meets certain mitigation factors, including that the IRS not have sustained a fraud penalty. The magistrate stated that the civil fraud penalty sustained in this case was appropriate because the taxpayer provided several implausible and inconsistent explanations of his behavior, he admitted that "he was very active with communicating investment strategies to UBS" and read financial papers because "he wanted to ensure he was getting the best return on his investment with UBS," and he even stated that he opened the foreign accounts to conceal money from potential judgment creditors, though he was inconsistent in his identification of those creditors. Among the facts tending to show willfulness, the court noted that Said reported the account when applying for a mortgage, to demonstrate his financial strength, but did not report it when applying for financial aid for his children's college expenses or when filing his tax returns.

The Court of Appeals for the Eleventh Circuit, in a *per curiam* opinion, held that (a) the District Court correctly declined to give the actions of the IRS a review *de novo*, but rather sustained the actions of the government unless they were arbitrary and capricious; (b) the IRS did not display a failure to follow its own internal procedures sufficient to warrant a departure from the arbitrary and capricious standard of review; (c) the district court correctly stated that willfulness includes recklessness (citing *Bedrosian v. United States*, 912 F.3d 144, 152 (3d Cir. 2018); *United States v. Horowitz*, 978 F.3d 80, 89 (4th Cir. 2020); and *Norman v. United States*, 942 F.3d 1111, 1115 (Fed. Cir. 2019)); (d) the taxpayer's admitted actions demonstrated a pattern of failing to report income and a knowing effort to avoid knowledge of FBAR requirements, which together amounted to willfulness and justified the lower court's grant of a summary judgment; (e) the revenue agent's manager had the reasonable discretion to change the penalty from non-willful to willful; and (f) the maximum penalty for a willful FBAR violation may exceed $100,000 because of the statutory language under section 5321(a)(5)(C), despite the retention of the $100,000 limit in the regulations.

b) Willfulness Does Not Require Actual Knowledge of Filing Obligation. *Kimble v. United States*, 991 F.3d 1238, 2021 WL 1081395 (Fed. Cir. March 22, 2021), *aff'g* 141 Fed. Cl. 373, 2018 WL 6816546, 122 A.F.T.R.2d 2018-7109 (Fed. Cl., 2018)

Alice Kimble is a U.S. citizen whose parents opened an investment account at the Union Bank of Switzerland (UBS) around or before 1980, on which they named Alice as a joint owner. Alice claims that her father opened the account in secret from fear of being persecuted in the United States, as some of his family had been persecuted in Germany during the Holocaust. Alice's husband, Michael Kimble, himself an investment adviser, advised Alice's father regarding the UBS account and advised Alice after her father's death. In order to maintain the utmost secrecy, Alice signed agreements to maintain the account as a numbered account only and to retain all correspondence about the account at the bank. Michael prepared the couple's joint income tax returns which did not report any of the income from the UBS account or disclose its existence. After the couple divorced in 2000, Alice hired a CPA to prepare her returns. The CPA did not ask about the account and Alice did not disclose it, so it remained undisclosed and unreported on Alice's tax returns. Alice claimed to have learned that she had an obligation to disclose the account after reading an article in the New York Times in 2008, and she retained counsel to advise her. In 2009, UBS entered into a deferred prosecution agreement with the United States that required it to unmask its numbered accounts held by U.S. citizen clients. Also in 2009, Alice was accepted into the Offshore Voluntary Disclosure Program (OVDP), but in 2013, after years of negotiations, Alice withdrew from the OVDP and declined to pay any penalty. The IRS audited Alice's tax returns and assessed a willful non-filing FBAR penalty of $697,299, representing 50% of the account. Alice paid the penalty and sued for a refund in the Court of Federal Claims.

The Court of Federal Claims (Judge Braden) granted summary judgment for the government, finding that Alice had willfully avoided the FBAR requirements because she never disclosed the account to her accountant, she did not inquire about any need to report foreign income, she indicated on her tax returns that she had no foreign accounts, and she did not review her tax returns but signed that she had reviewed them and that they were correct under penalty of perjury. The court held that these actions constituted a "reckless disregard" for the legal duty to disclose foreign bank accounts and that it amounted to "willful" failure to file FBAR. The court also held that the IRS did not abuse its discretion in setting a 50% penalty and that the taxpayer had waived any Eighth Amendment arguments by failing to plead them.

On appeal, the Court of Appeals for the Federal Circuit (Judge Hughes) affirmed. The court rejected the taxpayer's claim that one cannot commit a willful violation unless one actually knows of the obligation to file FBAR. The court stated that wilfullness also includes recklessness. *Norman v. United States*, 942 F.3d 1111, 1115 (Fed. Cir. 2019). Here, recklessness was established by the fact that she knew of the account and took several steps to keep it a secret, that she did not review her own income tax returns and still signed them under penalty of perjury declaring that she had no foreign accounts. "In other words, Ms. Kimble had a secret foreign account, she had constructive knowledge of the requirement to disclose that account, and she falsely represented that she had no such accounts." *Kimble v. United States*, 2021 WL 1081395 at *3 (Fed. Cir. March 22, 2021). The court also held that the assessment of a 50% penalty was within the limits of the statute and that the regulations that still reflect a $100,000 cap are no longer applicable. Furthermore, imposing such a substantial penalty was within the discretion of the IRS and within the mitigation guidelines established by Treasury for such cases, because the taxpayer had very few ties to Switzerland apart from the investment account, she managed the account actively, albeit with the assistance of her husband, and she was the sole beneficiary of the account.

c) Nearly $1 Million Willful FBAR Penalty Imposed for Recklessness *United States v. Horowitz*, 978 F.3d 80, 2020 WL 6140674 (4th Cir. Oct. 20, 2020), *reh'g denied* (4th Cir. Dec. 18, 2020), *aff'g* 361 F.Supp 3d 511, 2019 WL 265107, 123 A.F.T.R. 2d 2019-500 (D. Md. 2019)

Peter and Susan Horowitz established a Swiss bank account that ultimately was held at Finter Bank Zürich. The account grew to over $2 million. The Horowitzes did not disclose the accounts to the CPA who prepared their income tax returns and did not pay tax on the income from the account. They also answered "no" to the question on the 1040 about whether they held any foreign accounts or trusts. For some years, the Horowitzes participated in the Treasury's Offshore Voluntary Disclosure Program, but then they elected out of the program. The government assessed willful FBAR penalties against the Horowitzes, in the amount of $247,030 each for 2007 and $247,030 each for 2008. The parties filed cross-motions for summary judgment.

The U.S. District Court for Maryland (Judge Grimm) held primarily for the government, finding no genuine dispute of material fact as to the willfulness of the Horowitzes' failure to report, noting that they acted with a reckless disregard for the FBAR filing requirements. In particular, the court pointed to the fact that the tax returns signed by the Horowitzes "included a question of whether they had foreign accounts, followed by a cross-reference" to the FBAR filing requirement. It also found significant that, by their own account, the Horowitzes had discussed their tax liabilities for the foreign accounts with friends but never discussed them with their accountants.

The Fourth Circuit (Judge Niemeyer) affirmed, relying on the same analysis used by the District Court. The court held that the District Court correctly found that the Horowitzes had acted willfully as a matter of law, because the Horowitzes admitted that they (1) "never bothered" to ask their tax-return preparers whether they had to report the Swiss bank accounts; and (2) signed their tax returns stating that they had no foreign accounts without reading them with any care. This conduct, the court held, objectively establishes recklessness, which objectively establishes willfulness. Citing *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47 at 57, 127 S.Ct. 2201 at 2208, 167 L.Ed.2d 1045 (2007); and *United States v. Williams*, 489 F.App'x 655, 658–59 (4th Cir. 2012). The court noted that, by their own account, the Horowitzes knew that they were holding nearly $2 million in a foreign bank account and earning interest income on that account, which they never reported. The Horowitzes also knew that the salary income they earned abroad was reportable to the IRS and that they had to pay

U.S. taxes on it. In addition, they recognized that interest income was taxable income under American law, at least when earned in a domestic bank account. "With this compound knowledge — that interest income was taxable income and that foreign income was taxable in the United States — the Horowitzes could hardly conclude reasonably that the interest income from their Swiss accounts was not subject to taxes." 2020 WL 6140674 at *7. Also, it was undisputed that the foreign bank was set up as a numbered account with "hold mail" service, which the bank knew "would and did assist U.S. clients in concealing assets and income from the IRS." 2020 WL 6140674 at *8. The court also found that incorrectly completing their federal income tax returns and stating that they had no foreign accounts under penalty of perjury strongly evidenced recklessness.

d) More District Courts Adopt the *Bedrosian* FBAR Recklessness Standard

(1) District Court Adopts *Bedrosian*, Despite Lack of Appellate Precedent. *United States v. Goldsmith*, 2021 WL 2138520 (S.D. Ca. May 27, 2021)

Robert Goldsmith inherited from his mother a Swiss account that had first been opened by his father. He traveled to Switzerland and transferred the accounts to a numbered account. Before closing the account in 2012, the bank sent him a letter stating his and his wife's U.S. tax reporting requirements. On audit, the IRS assessed more than $300,000 in penalties and interest for willful failing to file FBAR.

The District Court for the Southern District of California (Judge) held that Robert had willfully failed to file FBARs for his Swiss bank account from 2008 to 2010 and that he was liable for more than $300,000 in penalties and interest. The Ninth Circuit has not yet expressly adopted the approach taken in the Third Circuit's decision in *Bedrosian v. United States*, 912 F.3d 144 (3d Cir. 2018), but the District Court did so in this case. Under *Bedrosian*, recklessness constitutes willfulness, and reckless requires a showing that Robert should have known that there was a grave risk of failing to meet a filing requirement, and that he could have easily learned of the requirement. The court noted that three other U.S. District Courts in the Ninth Circuit had already followed *Bedrosian* in FBAR cases. *United States v. Zimmerman*, 2020 WL 6065333 (C.D. Cal. Sept. 16, 2020); *United States v. Bohanec*, 263 F. Supp. 3d 881 (C.D. Cal. 2016); and *Jones v. United States*, 2020 WL 2803353 (C.D. Cal. 2020). The court also held that the government had identified enough of Robert's actions to establish recklessness and, therefore, willfulness. In particular, the court noted that Robert had: (a) signed several qualified intermediary forms acknowledging his ownership; (b) actively managed the account through direction given to his bank on strategy; (c) withdrawn funds during his travels to Europe; (d) maintained the fund as a numbered account;

(e) held the fund under a hold-mail order; (f) failed to disclose the account to his tax return preparer, even when the preparer asked directly about ownership of any foreign accounts; (g) stated on his federal income tax returns, under penalty of perjury, that he had no foreign accounts; and (h) not paid income taxes on the income generated by the foreign account.

Note. Robert argued that the tax return preparer questionnaire that denied the existence of a foreign account was actually completed by his wife, but the court stated that this did not excuse his keeping this information from his tax return preparer.

(2) District Court Follows Appeals Court. *United States v. Kronowitz,* 2021 WL 2251954 (S.D. Fla. June 4, 2021)

Kenneth Kronowitz, a CPA who had prepared tax returns for 59 years, opened financial accounts in the Cayman Islands and Switzerland. The government contended that Kenneth opened the accounts to hide assets to protect his gains on his real estate investments from future creditor claims, including those of some known potential creditors. He failed to file FBAR for these accounts from 2005 to 2010, and the IRS assessed a willful non-filing penalty of $663,771.

The U.S. District Court for the Southern District of Florida (Judge Bloom) applied the standard for recklessness adopted by the Eleventh Circuit in *United States v. Rum*, 995 F.3d 882, 2021 WL 1589153 (11th Cir. Apr. 23, 2021). Under this standard, first applied in *Bedrosian v.United States*, 912 F.3d 144 (3d Cir. 2018), recklessness constitutes willfulness, and reckless requires a showing that the individual should have known that there was a grave risk of failing to meet a filing requirement, and that the individual could have easily learned of the requirement. The court noted that (a) Kenneth took continuing professional education courses on tax shelters, foreign taxation, offshore trusts, asset protection, and estate planning, but then stated that did not recall that FBAR was ever mentioned; (b) on his personal income tax returns for 2005 – 2010, Kenneth indicated under penalties of perjury that he had no foreign accounts, though he did report the income from those foreign accounts; (c) Kenneth claimed not to have read the instructions to Schedule B, yet he filed 30 to 40 income tax returns a year for nearly 60 years. The court did not believe Kenneth when he said that he did not know about FBAR until he hired an attorney during the IRS audit in 2011. In particular, the court stressed that Kenneth was reckless in the conduct of his investments generally and in his filing requirements in particular. He neither conducted independent research nor consulted with a tax advisor with experience in international matters to determine his filing requirements.

(3) District Court Adopts *Bedrosian,* Despite Lack of Precedent from Appeals Court. *United States v. DeMauro,* 483 F.Supp.3d 68, 2020 WL 5757466, 126 A.F.T.R. 2d 2020-6230 (D.N.H. Aug. 28, 2020), *mot. to revise rejected,* 2021 WL 1979484 (D.N.H. May 18, 2021)

Annette DeMauro's second husband had used the threat of extensive litigation supported by his great wealth to extract a favorable property settlement. In 2000 — the same year she finalized her divorce — Annette opened a numbered Swiss bank account with UBS AG. Annette testified that she opened the foreign bank account to "protect" her money from her ex-husband, whose wealth and contacts made him a threat. She also instructed UBS to hold onto any correspondence with her until she claimed it, and authorized UBS to destroy unclaimed correspondence after three years. Annette did not seek advice from an attorney or financial advisor about opening the foreign account. She funded her Swiss account with substantial sums received from the sale of property she had received in her second divorce. In 2004, Annette filed an income tax return in which she checked "no" to the question on Part III of Schedule B about whether she had a financial interest or signature authority over a financial account in a foreign country. Annette later changed Swiss banks and ultimately moved her account to Oberbank in the Czech Republic. At trial, Annette conceded that from 2002 through 2009, she asked no one whether the income earned on her foreign accounts was taxable in the U.S. or whether she should file a federal tax return. After an examination, Treasury assessed a $274,695.72 willful nonfiling FBAR penalty for each of the three years 2007 – 2009.

After a two-day bench trial, the U.S. District Court for New Hampshire (Judge Laplante) granted summary judgment to the government on the issue of willful FBAR nonfiling. The court applied *Bedrosian*, and rejected a evidence of recklessness the fact that Annette took steps to conceal her account and to hide it when under examination, because it believed that she did so only to hide her assets and the paper trail for her accounts from her ex-husband. Citing *United States v. Aversa*, 984 F.2d 493 (1st Cir. 1993), *cert. granted, judgment vacated sub nom. Donovan v. United States*, 510 U.S. 1069 (1994). On the other hand, the court held that Annette acted recklessly in failing to seek advice on whether the $3.5 million she placed in her foreign account was taxable or reportable, given the relatively large sum of money in her bank accounts.

The court later rejected a motion by Annette amend the verdict and judgment against her, finding no clear error in its previous ruling despite a contention of justifiable professional reliance. Annette noted that she set up her foreign account to protect her assets while she was going through a contentious divorce and that she informed her accountant of the account's existence. The court noted it was within the prerogative of the court to assess the credibility of the witnesses, and that it had not believed that Annette had told her CPA of the accounts and that the CPA had been unaware of the FBAR requirements. The court also noted it did not believe that Annette had informed her advisers that she earned interest income on her foreign accounts. The court also stated that it had not previously relied solely on Annette's failure to report the foreign income from these accounts, noting that she had taken several actions to conceal the accounts, including using a numbered pseudonymous accounts, withholding paper correspondence, and concealing money transfers.

Note. The government also assessed over $78,000 in penalties under Section 6651(f) for intentionally failing to file timely income tax returns. The court also held that the United States failed to prove by clear and convincing evidence that Annette's failure to file timely income tax returns was intentional.

(4) District Court Adopts *Bedrosian,* Despite Lack of Precedent from Appeals Court. *United States v. Gentges,* ___ F.Supp.3d ___, 2021 WL 1222764 (S.D.N.Y. March 31, 2021)

Heinz Gentges is a U.S. citizen who owned two Swiss bank accounts at UBS. Both accounts were numbered and Heinz signed documents for both stating that he wanted to avoid disclosure of his identity to the IRS, and so prohibited the acquisition of additional US securities in those accounts and required that all mail regarding the accounts be retained at the bank. The balance on both accounts was over $10,000 and Heinz was required to file FBAR in 2007. 31 U.S.C. § 5314(a); 31 C.F.R. §§ 103.24, 103.27, *amended and recodified at* 31 C.F.R. § 1010.350 (2011). Heinz and his wife had earlier formed various trusts for estate planning purposes, transferring the ownership of their U.S. assets to the trusts. They did not, however, transfer the UBS accounts to these trusts. Heinz also did not disclose the existence of the UBS accounts to the attorney he consulted in forming the trusts, nor did he seek any advice about the UBS accounts from this attorney, Heinz's CPA, or anyone else. Heinz failed to file FBAR in 2007 and, in 2016, the IRS assessed FBAR willful non-filing penalties of $903,853, which was 50% of the account balances in 2007. Heinz failed to pay the penalties and the government sued to collect them.

The U.S. District Court for the Southern District of New York (Judge Karas) granted summary judgment for the government. The court noted that term "willful" is not defined in the statute or regulations, and that the Second Circuit has not yet addressed its meaning for FBAR purposes. *United States v. Bernstein*, 486 F.Supp.3d 639, 2020 WL 5517315, at *4 (E.D.N.Y. Sept. 14, 2020). Nonetheless, the court followed the opinions of the three circuits that have considered this issue (the Third, Fourth, and Federal Circuits), and stated that "willful" in this context means either knowing or reckless violations of the FBAR requirement. See *Bedrosian v. United States*, 912 F.3d 144, 152 (3d Cir.

2018); *United States v. Horowitz*, 978 F.3d 80 (4th Cir. 2020); and *Norman v. United States*, 942 F.3d 1111 (Fed. Cir. 2019). The court concluded that Heinz's actions were reckless, based on the facts that: (a) Heinz had the same tax preparer for many years and trusted him greatly, yet he never disclosed the existence of the foreign account to this tax return preparer; (b) Heinz lacked expertise in tax matters, but he never consulted any tax experts regarding the proper reporting of these accounts, thereby negating the importance of his lack of actual knowledge of the FBAR rules; (c) the accounts were large enough that they could not be merely overlooked; (d) Heinz stated on his 2007 tax return under penalties of perjury that he had no financial interest in any foreign bank accounts, despite his claims that he had not reviewed the returns in detail; and (e) Heinz did not review the returns in detail before signing them. The court agreed with the other courts that have viewed a false statement on one's income tax return as sufficient alone to establish willful failure to file and distinguished the cases where courts have viewed this only as *prima facie* evidence of willfulness. See *United States v. Clemons*, 2019 WL 7482218 (M.D. Fla. 2019); *United States v. Flume*, 2018 WL 4378161 (S.D. Tex. 2018); *United States v. de Forrest*, 463 F. Supp. 3d 1150 (D. Nev. 2020). The court stated that, on summary judgment, courts may—and regularly do—impute constructive knowledge to defendants based on documents those defendants have signed. Citing *United States v. Horowitz*, 361 F. Supp. 3d 511, 529 (D. Md. 2019), ***aff'd***, 978 F.3d 80 (4th Cir. 2020); *United States v. Rum*, 2019 WL 5188325 (M.D. Fla. 2019) (slip copy), *app. filed* (11th Cir. 2019); and *Kimble v. United States*, 141 Fed. Cl. 373, 2018 WL 6816546, 122 A.F.T.R.2d 2018-7109 (Fed. Cl., 2018, *aff'd* 2021 WL 1081395 (Fed. Cir. March 22, 2021).

Note. The court did find that the IRS had incorrectly calculated the penalties and ordered it to redetermine the correct penalty. The IRS assessed one penalty for $679,365 based on one of the numbered accounts (the 4959 Account), and another penalty for $224,488 based on the other numbered account (the 4337 Account). The court held that the IRS improperly calculated the penalty assessed with respect to the 4337 Account, basing the penalty on 50% of the balance on the date that the FBAR should have been filed (June 30, 2008), when the only information that the IRS had was the balance on December 31, 2007. This, the court held, was impermissible, citing *United States v. Schwarzbaum*, 2020 WL 2526500, 125 A.F.T.R.2d 2020-2109 (S.D. Fl. 2020) (slip copy), *app. filed*, 2020 WL 2526500 (11th Cir. Oct. 23, 2020); and *Jones v. United States*, 2020 WL 2803353, 125 A.F.T.R. 2d 2020-2067 (C.D. Calif. 2020) (slip copy).

(5) District Court Adopts *Bedrosian*, Following Precedent from Appeals Court. *United States v. Collins*, 2021 WL 456962, 127 A.F.T.R.2d 2021-854 (W.D. Pa. Feb. 8, 2021) (slip copy)

Richard Collins was a financially sophisticated taxpayer who held foreign financial accounts. He approved tax returns that denied existence of the accounts and he never filed FBARs. He also tried to keep his foreign accounts secret in the United States. He tried to avoid receiving mail from his brokerages when he was in the United States. In 2013, Richard filed FBAR for 2007 and 2008, reporting his accounts with HSBC (in Canada), Le Credit Lyonnais (in France) and UBS (in Switzerland). Those accounts totaled nearly $886,000 in 2007 and over $900,000 in 2008. In 2015, the IRS proposed $300,000 of willful FBAR penalties for the 2007 and 2008 filings, based on the maximum account balances in those two years. This was mitigated by more than 50% from the maximum possible impositions, after considering the facts and circumstances of Richard's case. Richard still contested the penalties.

The United States District Court for the Western District of Pennsylvania (Judge Bissoon) sustained the penalties. The court applied the *Bedrosian* standard and held that Richard failed to report his interests in foreign financial accounts, that his failure was willful, and that the accounts were large enough to require FBAR filings. The court held that the evidence revealed Richard had conducted a decades-long course of actions, omission and *scienter*, that supported the proposed penalties.

Note. The court also held that (a) the FBAR penalties were neither an abuse of discretion nor were they the result of arbitrary or capricious actions or contrary to law; (b) the $100,000 ceiling on the willful nonfiling penalty no longer applied; and (c) the penalties were not unconstitutionally excessive under the Eighth Amendment.

(6) District Court Adopts Bedrosian on Remand from Appeals Court. Bedrosian v. United States, 2020 WL 7129303, 126 A.F.T.R. 2d 2020-7067 (E.D. Pa. Dec. 4, 2020), on rem'd from 912 F.3d 144 (3d Cir. 2018)

Arthur Bedrosian, a successful businessman, opened a savings account with UBS in Switzerland so that he could make purchases while traveling abroad for work instead of relying on traveler's checks. Arthur informed his accountant that he maintained a bank account in Switzerland and the accountant told him that he had been breaking the law every year by not reporting the Swiss account to the IRS, but that his estate could deal with the consequences after his death. Arthur continued not reporting his UBS account. In 2005, Arthur borrowed 750,000 Swiss Francs and opened a UBS investment account. Arthur then hired a new accountant who prepared Arthur's 2007 income tax return including a statement that Arthur owned a foreign bank account. The new accountant also prepared a FBAR for Arthur for the smaller of Arthur's two UBS accounts. Arthur testified that he did not remember discussing his Swiss bank accounts with his new accountant and that he did not know how the accountant knew to acknowledge the existence of a foreign bank account on the tax return or to prepare the FBAR. Arthur signed the 2007 tax return and FBAR without reviewing them. Arthur then became more aware of the seriousness of not reporting foreign accounts to the IRS and hired legal counsel to correct the inaccuracies on his prior tax filings. The IRS audited Arthur's returns and assessed a $975,789 penalty for "willful" failure to disclose the larger UBS account. Arthur paid 1% of the penalty assessed and filed a complaint in the District Court seeking to recover his $9,757.89 payment as an unlawful exaction. The Government answered and filed a counterclaim for the allegedly full penalty amount of $1,07,345 (including interest and a late-payment penalty).

The District Court (Judge Bayleson), after a one-day bench trial, held that the Government had failed to establish Arthur's failure to disclose his $2 million UBS account was "willful." *Bedrosian v. United States*, 2017 WL 4946433 (E.D. Pa. 2017) ("*Bedrosian I*").

On appeal, the Third Circuit reversed and remanded the case for reconsideration of whether Arthur's failure to file FBAR was willful. *Bedrosian v. United States*, 912 F.3d 144 (3d Cir. 2018) ("*Bedrosian II*"). The court held that the willfulness in the FBAR context means the same thing as willfulness in other civil contexts, but that the District Court did not sufficiently consider all the relevant facts in reaching its conclusion that Arthur had not acted willfully. The Third Circuit stated that willfulness requires either a knowing or reckless failure to file and that recklessness occurs when a taxpayer engages in conduct "entailing an unjustifiably high risk of harm that is either known or so obvious that it should be known." *Bedrosian II*, 912 F.3d at 153.

On remand, the District Court (Judge Bayleson) held that Arthur had acted willfully. The court cited the facts that: (a) Arthur's cooperation with the Government, which tended to negate willfulness, began only after he was exposed as having hidden foreign accounts; (b) shortly after filing the 2007 FBAR, Arthur sent two letters to UBS directing closure of both accounts, even though only one of these accounts had been disclosed on his FBAR; Arthur moved the larger account to a different Swiss bank; (c) After Arthur read an article in The Wall Street Journal about the federal government tracing mail coming into the United States, he put his Swiss accounts on a "mail hold," for which he paid an additional fee; (d) Arthur was aware of the significant amount of money held in his foreign bank accounts; (e) Arthur's accountant may have known of the larger account from at one of his meetings with a UBS representative; (f) Arthur was a sophisticated businessman; and (g) Arthur's first accountant told him that he was breaking the law by not reporting the UBS accounts. The court recognized that it had not originally considered whether Arthur ought to have known that there was a grave risk that an accurate FBAR was not being filed and whether he was in a position to find out for certain very easily. The court discussed and followed the position of the Fourth Circuit in

Horowitz v. United States, that if a taxpayer were not aware of the FBAR reporting requirement, based on their knowledge of taxes on interest income, it did not make sense for them to conclude that their foreign accounts would not be taxed. Here, Arthur knew about the FBAR requirement because his prior accountant told him about it. Also like the taxpayers in, Arthur used "hold mail" service, and had an account with too large a balance to overlook it. The court also noted that, like the taxpayers in Horowitz, Arthur did not review his tax returns but still signed them under penalty of perjury, claiming not to have the larger foreign account.

e) $5.4 Million in Willful FBAR Penalty Sustained by Showing of Intentional Recklessness. *United States v. Estate of Danielsen through Snowalter*, 2020 WL 6163101, 126 A.F.T.R. 2d 2020-6366 (M.D. Fl. Oct. 6, 2020)

Dean Danielsen created a foreign foundation (a *stiftung*) after he was sued, to provide asset protection. Dean controlled the foundation. The foundation opened two foreign accounts (one in Liechtenstein and one in Canada), the value of which grew to over $10.8 million. Dean failed to file FBAR for the two accounts. Treasury assessed $5,466,892 in penalties for willful failure to file FBAR and then sued to collect the penalties.

The Magistrate Judge for the U.S. District Court for the Middle District of Florida (Mag. Judge Mizell) sustained the penalties, finding "reckless or careless disregard of that statutory duty." 2020 WL 6163101 at *3. The court agreed that the failure to file was willful, noting particularly that: (a) Dean was a naturalized United States citizen who was the beneficial owner of and had a financial interest in two foreign bank accounts, the aggregate monthly balance of which always exceeded $10,000; (b) Dean filed FBARs in 1994 and 1995 for other foreign financial accounts, demonstrating that he knew he was required to file FBAR; and (c) Dean checked "no" on his federal income tax return when asked if he had a foreign bank account.

3. Ninth Circuit Joins Three District Courts and Holds $10,000 Penalty for Non-Willful Failure to File FBAR is Computed Per Year, Not Per Account. *United States v. Boyd*, 991 F.3d 1077, 2021 WL 1113531 (9th Cir. March 24, 2021), *rev'g and rem'g* 2019 WL 1976472, 123 A.F.T.R.2d 2019-1651 (C.D. Cal. 2019)

Jane Boyd was an American citizen who had a financial interest in fourteen financial accounts in the United Kingdom with an aggregate balance in excess of $10,000. The amounts in these accounts significantly increased between 2009 and 2011 after her father died in 2009 and she deposited her inheritance. Jane received interest and dividends from these accounts and did not report the interest and dividends on her 2010 federal income tax return or disclose the accounts to the IRS. In 2012, Jane asked to participate in the IRS's Offshore Voluntary Disclosure Program—a program that allows taxpayers to voluntarily report undisclosed offshore financial accounts in exchange for predictable and uniform penalties. After the IRS accepted Jane into the program, she submitted a correct, but late, 2010 FBAR listing her fourteen foreign accounts and amended her 2010 tax return to include the interest and dividends from these accounts. Jane was later granted permission by the IRS to opt out of the program, and the IRS conducted a full audit of the taxpayer's income tax return for 2010. The IRS assessed a penalty for non-willful non-filing of FBAR, charging her with one violation for each account she failed to timely report for calendar year 2010. The IRS assessed a total penalty of $47,279. The government sued to obtain a judgment against the taxpayer.

The U.S. District Court for the Central Discount of California (Judge Fitzgerald) held for the government and the taxpayer appealed.

The Ninth Circuit, by a two-to-one majority, held that the IRS must calculate the penalty for non-willful non-filing of FBAR on a per-FBAR basis, adopting the same analysis used by three of the four District Courts that have reviewed the issue. The majority opinion (Judge Bennett) explained that the regulations require that a taxpayer file an FBAR containing certain information, and that it be filed timely. 31 C.F.R. § 1010.350(a). The court stated that, because the taxpayer's late FBAR was correct, she could be held liable only for a non-willful failure-to-file penalty and only for the one year for which she filed her FBAR late. The government argued that the amount of the penalty can be assessed on a per-account basis, based on the statutory scheme as a whole. The court disagreed. It reviewed statutes and regulations regarding the FBAR penalties, noting that 31 U.S.C. § 5321(a)(5) states merely that the penalties for non-willful violations shall not exceed $10,000. The court noted that the regulations require the filing of an FBAR form "with respect to foreign financial accounts exceeding $10,000" during the prior calendar year. 31 C.F.R. §§ 1010.350(a), 1010.306(c). For willful FBAR violations involving "a failure to report the existence of an account . . . ," the maximum penalty that is the greater of $100,000 or 50% of "the balance in the account at the time of the violation." 31 U.S.C. §§ 5321(a)(5)(C), 5321(a)(5)(D)(ii). The court stated that Congress clearly knows how to attach penalties on an account-specific basis, and yet it did not do so with respect to the non-willful violation penalties. The court also stated that the language of the reasonable cause exception, which applies only to non-willful non-filing penalties, was helpful in interpreting the statute. The court noted that the reasonable cause penalty applies where "the amount of the transaction or the balance in the account at the time of the transaction was properly reported." 31 U.S.C. § 5321(a)(5)(B)(ii). Again, the court stated that the inclusion of explicit per-account language in the reasonable cause exception suggests that the omission of such language in the general non-willful non-filing penalty provisions must have been intentional.

Judge Ikuta dissented. She believed that a more natural reading of the relevant statutes supported the government's position, not that of the majority. The dissent notes that the regulations require that "[e]ach United States person having a ... financial account in a foreign country [1] shall report such relationship to the Commissioner . . . for each year in which such relationship exists *and* [2] shall provide such information as shall be specified in a reporting form prescribed under 31 U.S.C. 5314 to be filed by such persons." 31 C.F.R. § 1010.350(a) (emphasis added in the dissent). The dissent read this as creating a legal obligation to report each account and a separate and independent obligation to file a reporting form. The dissent also noted that the regulations require that the "reports required to be filed . . . shall be filed on forms prescribed by the Secretary." This, the dissent stressed, distinguishes the reports required to be filed and the forms on which they are filed. Thus, as the penalties are for failure to file the report, they should not be calculated based on how many forms were not filed but, rather, on how may accounts were not reported.

Note 1. See also *United States v. Kaufman*, 2021 WL 83478, 127 A.F.T.R.2d 2021-502 (D. Cn. Jan. 11, 2021) (slip copy) (FBARs not filed for between 12 and 17 accounts in each of three years; penalty is either $30,000 or $144,000); *United States v. Giraldi*, 2021 WL 1016215, 127 A.F.T.R. 2d 2021-1217 (D.N.J., March 16, 2021) (slip copy) (FBARs not filed for four accounts in each of four years; penalty is either $40,000 or $160,000);; *United States v. Bittner*, 469 F. Supp. 3d 709, 2020 WL 3498082, 126 A.F.T.R. 2d 2020-5051 (E.D. Tex. June 28, 2020), *app. filed*, 2020 WL 3498082 (5th Cir. Sept. 18, 2020) (FBARs not filed for between 51 and 61 accounts in each of five years; penalty is either $50,000 or nearly $3,000,000). Only the district court in *United States v Boyd* has held for the government, that the penalty is calculated per account as well as per year. The Ninth Circuit has now reversed the district court's decision in *Boyd* and held that the penalty for non-willful non-filing is calculated on a per-FBAR basis.

There is good reason to favor the majority reason, apart from the intricacies of statutory construction. First, in some circumstances the Government's proposed rule would impose more penalties on some non-willful violators than on similarly situated willful violators. Assume, for example, that T1 and T2 are U.S. citizens. Each separately maintains $100,000 evenly across twenty (20) foreign financial accounts. Each fails to file an FBAR form for Taxable Year. T1's failure is non-willful and T2's failure is willful. Under the Government's position, T1 would be subject to a maximum penalty for non-willful non-filing of $200,000 (20 accounts × $10,000 penalty). T2, however, would be subject to a maximum willful non-filing penalty of $100,000 (the greater of $100,000 or 50% of account balances). *Kaufman*, 2021 WL 83478 at *10 and *Giraldi*, 2021 WL 1016215 at *6 (providing similar examples).

Second, even when dealing only with non-willful non-filing penalties, the government's analysis can impose vastly different penalties on taxpayers who are situated in what is fundamentally the same position. Assume, for example, T1 and T2 are U.S. citizens and each maintain $5 million across multiple foreign financial accounts in a single calendar year. T1 has five (5) accounts that each hold $1 million. T2 has fifty (50) accounts that each hold $100,000. Under the Government's approach, if both individuals non-willfully fail to file FBAR forms for the same tax year, the maximum penalty for T1 would be $50,000 (5 accounts × $10,000 penalty), while the maximum penalty for T2 would be $500,000 (50 accounts × $10,000 penalty). *Bittner*, 469 F. Supp. 3d at 721 and *Giraldi*, 2021 WL 1016215 at *7 (providing similar examples).

At present, the IRS has won only in one district court, whose opinion was reversed on appeal, and in the opinion of a dissenting appellate judge. The taxpayer has won in three district courts and in the view of the majority of the Tenth Circuit. While other circuits are yet to be heard from, one can hope that logic prevails and the government ultimately is forced to concede that the majority of the Tenth Circuit in *Boyd* is correct.

Note 2. The court in *Kaufman* also granted the government a summary judgment that Zvi had no reasonable cause, because he repeatedly failed to tell his CPA about the foreign accounts. The court did not find any justification from the fact that Zvi had during this period suffered a heart attack and head trauma. The court stated that the facts were similar to those in *United States v. Agrawal*, 2019 WL 6702114 (E.D. Wis., 2019); *United States v. Ott*, 2019 WL 3714491 (E.D. Mich. Aug. 7, 2019); *Jarnagin v. United States*, 134 Fed. Cl. 368 (2017); and *Moore v. United States*, 2015 WL 1510007 (W.D. Wash., 2015), in which the account owner knew that he had or controlled many foreign bank accounts, but made no effort to determine that he had an obligation to file FBAR. Merely retaining an American CPA is not itself enough.

4. $100,000 Cap on Willful FBAR Penalties Rejected

a) Second Circuit Rejects Regulations' $100,000 Cap on FBAR Willful Nonfiling Penalty, with a Dissenting Opinion. *United States v. Kahn,* 5 F.4th 167, 2021 WL 2931305 (2nd Cir. July 13, 2021), *aff'g* 2019 WL 8587295 (E.D.N.Y. 2019)

Harold Kahn failed to file for the 2008 year to report two bank accounts held by him at Credit Suisse, in Switzerland. Each account held over $100,000 and the aggregate value in the two Credit Suisse accounts was $8,529,456, as of June 30, 2009. The IRS assessed a $4,264,728 willful penalty -- 50% of the aggregate account balance on the date FBAR was required to be filed. Thereafter, Harold died and his sons, Jeffrey and Joel Kahn, were named personal representatives of his estate. The estate paid the tax and sued for a refund.

The U.S. District Court for the Eastern District of New York (Judge Matsumoto) granted the government summary judgment, holding that the $100,000 statutory cap on the penalty for willful nonfiling of FBAR had been repealed before the return in this case was required to be filed, and that the regulations that still contained this cap were no longer valid, because they conflicted with the statute. The taxpayer appealed.

The United States Court of Appeals for the Second Circuit (Judge Kearse) affirmed. The court explained that a $100,000 cap was enacted in 1986 and the regulations applying it were promulgated in 1987. 31 U.S.C. § 5321(a)(5)(B)(ii)(I)-(II) (1988); 31 C.F.R. § 1010.820(g). The statutory cap was eliminated in 2004. 31 U.S.C. § 5321(a)(5)(C)(i). The regulations, however, were left unchanged. The IRS argued that revisions in the regulations were unnecessary because the statute was "self-executing." *Internal Revenue*

Manual, 4.26.16.4.5.1--FBAR Willfulness Penalty (July 1, 2008). The estate argued that the regulation states that the Secretary "*may* assess" the penalty for a willful failure to file FBAR, but that the regulation leaves the Secretary free to impose a $100,000 limitation on what it desires to assess. The court held that the regulation was clearly inconsistent with the plain language of the amended statute, and thus presently unenforceable. The court noted that the regulation tracked precisely the language of the statute which has now been repealed, and that the statute does not authorize the Secretary to set its own limitation on the penalties for such violations. Thus, the regulation cannot be enforced as presently written. The Secretary has discretion in any case to impose a lesser penalty, but it cannot create its own cap on the maximum penalty that can be imposed to replace one that Congress has repealed. Citing *Norman v. United States*, 942 F.3d 1111, 1117-18 (Fed. Cir. 2019); *United States v. Horowitz*, 978 F.3d 80, 90-91 (4th Cir. 2020), discussed below; and *United States v. Rum*, 995 F.3d 882, 892 (11th Cir. 2021), discussed below.

Judge Menashi dissented, because "an agency must abide by its own regulations." *Fort Stewart Schs. v. Fed. Lab. Rels. Auth.*, 495 U.S. 641, 654, 110 S.Ct. 2043, 109 L.Ed.2d 659 (1990). He agreed with the taxpayer that the statute does not require that the Treasury impose penalties greater than $100,000, and that this leaves Treasury free to decline to do so. "The current regulation therefore does not conflict with the governing statute and the Secretary must adhere to that regulation as long as it remains in effect." 2021 WL 2931305 at *8.

Note. The dissent's argument was rejected by the majority, which explained that, while Treasury has the discretion to impose a smaller penalty in any case, it does not have the discretion to create a cap on penalties lower than that created by the statute. Furthermore, even if Treasury could do so, there is no reason to believe that it intended to do so when it did not modify the existing regulation after the statutory change. As the Supreme Court has noted, "[T]he existence of a parroting regulation," *i.e.*, one that "merely … paraphrase[s] the statutory language" rather than introducing a provision formulated in reliance on agency "expertise and experience," "does not change the fact that the question here is not the meaning of the regulation but the *meaning of the statute*." *Gonzales v. Oregon*, 546 U.S. 243, 257, 126 S.Ct. 904, 163 L.Ed.2d 748 (2006) (emphasis added in opinion).

b) *Per Curiam* Eleventh Circuit Rejects Regulations' $100,000 Cap on FBAR Willful Nonfiling Penalty. *United States v. Rum*, 995 F.3d 882, 2021 WL 1589153 (11th Cir. Apr. 23, 2021), *aff'g* 2019 WL 5188325 (M.D. Fl. Sept. 29, 2019) (slip copy), *rept. of master adopted*, 2019 WL 3943250, 124 A.F.T.R.2d 2019-5389 (Aug. 2, 2019) (slip copy)

Said Rum failed to file a timely FBAR with respect to a substantial Swiss bank account. The failure was determined to be willful (see discussion above).

The U.S. District Court for the Middle District of Florida (Judge Scriven), approved and adopted the analysis of a magistrate (Mag. Porcelli), which had found that the failure to file was willful, and that the $100,000 limitation on penalties for willful nonfiling contained in 31 C.F.R. § 1010.820(g)(2) was superseded by the legislative change in the Code section being interpreted by that regulation. The taxpayer appealed

The Court of Appeals for the Eleventh Circuit, in a *per curiam* opinion, held that the maximum penalty for a willful FBAR violation may exceed $100,000 because of the statutory language under section 5321(a)(5)(C), despite the retention of the $100,000 limit in the regulations.

c) Federal Circuit Rejects Regulations' $100,000 Cap on FBAR Willful Non-filing Penalty. *Kimble v. United States*, 991 F.3d 1238, 2021 WL 1081395 (Fed. Cir. March 22, 2021), *aff'g* 141 Fed. Cl. 373, 2018 WL 6816546, 122 A.F.T.R.2d 2018-7109 (Fed. Cl., 2018)

Alice Kimble is a U.S. citizen whose parents opened an investment account at the Union Bank of Switzerland (UBS) around or before 1980, on which they named Alice as a joint owner. Alice failed to file FBAR and, on examination, the IRS assessed a willful non-filing FBAR penalty of $697,299, representing 50% of the account. Alice paid the penalty and sued for a refund in the Court of Federal Claims.

The Court of Federal Claims (Judge Braden) granted summary judgment for the government, finding that Alice had willfully avoided the FBAR requirements (see discussion above) and that the $100,000 cap in the regulations was not enforceable.

On appeal, the Court of Appeals for the Federal Circuit (Judge Hughes) affirmed. The court held in part that the assessment of a 50% penalty was within the limits of the statute and that the regulations that still reflect a $100,000 cap are no longer applicable.

d) Unanimous Fourth Circuit Refuses to Enforce $100,000 Limit. *United States v. Horowitz*, 978 F.3d 80, 2020 WL 6140674 (4th Cir. Oct. 20, 2020), *aff'g* 361 F.Supp 3d 511, 2019 WL 265107, 123 A.F.T.R. 2d 2019-500 (D. Md. 2019)

Peter and Susan Horowitz established a Swiss bank account that ultimately was held at Finter Bank Zürich. The account grew to over $2 million. The Horowitzes did not disclose the accounts to the CPA who prepared their income tax returns and did not pay tax on the income from the account. They also answered "no" to the question on the 1040 about whether they held any foreign accounts or trusts. For some years, the Horowitzes participated in the Treasury's Offshore Voluntary Disclosure Program, but then they elected out of the program. The government assessed willful FBAR penalties against the Horowitzes, in the amount of $247,030 each for 2007 and $247,030 each for 2008. The parties filed cross-motions for summary judgment.

The U.S. District Court for Maryland (Judge Grimm) held primarily for the government, finding that the $100,000 limitation on willful penalties no longer applied, because Congress had statutorily changed the law and the regulations and IRS Manual provisions to the contrary were no longer valid.

The Fourth Circuit (Judge Niemeyer) affirmed, relying on the same analysis used by the District Court. The court agreed with the vast majority of courts that the $100,000 limitation on FBAR penalties for willfulness no longer applied.

e) Massachusetts District Court Refuses to Enforce $100,000 Limit. *United States v. Toth*, 2020 WL 5549111, 126 A.F.T.R.2d 2020-6065 (D. Mass. Sept. 15, 2020) (slip copy), *app. filed* (1st Cir. Jan. 11, 2021)

Monica Toth was a U.S. citizen and resident who, in 1999, opened a Swiss account at UBS. On advice of her father and brother, Monica kept the account a secret. Monica had control and legal authority over the account and in 2007, had an account balance of approximately $4.3 million. She did not file a 2007 FBAR. On her 2007 federal income tax return, Monica checked the box saying that she had no foreign bank accounts. The government assessed a $2,173,703 penalty which, with interest and late fees, was now over $3 million. The government brought suit and sought summary judgment.

The U.S. District Court for Massachusetts (Judge Burroughs) granted the summary judgment. The court first rejected the contention that the $100,000 cap that had originally been statutorily imposed on penalties for willful nonfiling of FBAR no longer applies. The court explained that FBAR was part of the Bank Secrecy Act of 1970 (Pub. L. No. 91-508, 91st Cong., 2d Sess. (1970), 84 Stat. 1114) and the Money Laundering Control Act of 1986 (Pub. L. No. 99-570, 99th Cong., 2d Sess. (1986), 100 Stat. 3207). The law initially provided a $100,000 cap on the penalty for willful violations, and Treasury promulgated regulations reflecting this cap. In 2004, Congress changed the civil penalties for willful failure to file an FBAR to the greater of $100,000 or 50% of the balance of the account at the time of the violation. Pub L. No. 108-357, § 821, 108th Cong., 2d Sess. (2004), 118 Stat. 1418, 1586; 31 U.S.C. § 5321(a)(5)(C). Treasury never amended its regulations to reflect the new limit. The court, following the vast majority of other courts, held that merely not changing the old regulation did not create a lower ceiling, because Treasury lacked the power to do so. The court then held that the facts supported a finding of willfulness and applied the standard set by the Federal Circuit in *Norman v. United States*, 942 F.3d 1111, 1116 (Fed. Cir. 2019).

Note. See also similar holding in *United States v. Collins*, 2021 WL 456962, 127 A.F.T.R.2d 2021-854 (W.D. Pa. Feb. 8, 2021) (slip copy); *United States v. Kahn*, 2019 WL 8587295 (E.D. N.Y. 2019) (slip copy); *Kimble v. United States*, 141 Fed.Cl. 373, 122 A.F.T.R.2d 2018-7109 (Fed. Cl. 2018); *United States v. Schoenfeld*, 396 F.Supp.3d 1064, 2019 WL 2603341, 123 A.F.T.R.2d 2019-2334 (M.D. Fla. June 25, 2019); and *United States v. Rum*, 2019 WL 5188325 (M.D. Fla. 2019) (slip copy), *aff'd* (11th Cir. 2019). The *Schoenfeld* stated that while "Congress did not establish specific reporting requirements in the BSA, leaving that to the Secretary, it *did* establish, in § 5321, specific parameters for civil penalties, providing what the maximum penalty for willful violations 'shall' be." Citing *United States v. Park*, 2019 WL 2248544, at *8.

Two district courts, however, have held that the regulations do create a cap on the FBAR penalty for willful failure to file. *United States v. Wahdan*, 325 F. Supp. 3d 1136, 2018 WL 3454973, 122 A.F.T.R.2d 2018-5208 (D. Colo. 2018); and *United States v. Colliot*, 2018 WL 2271381, 121 A.F.T.R.2d 2018-1834 (W.D. Tex. 2018) (slip copy). Obviously, a variety of appellate opinions may be forthcoming on this issue, which should either be dispositive or lead to one or more requests for certiorari.

5. FBAR Penalties Are Not Taxes and Flora Full-Payment Rule Does Not Apply to Refund Suit. *Mendu v. United States*, 153 Fed. Cl. 357, 2021 WL 1291674, 127 A.F.T.R. 2d 2021-1560 (Fed. Cl. Apr. 7, 2021)

Raghuveer Mendu, a U.S. citizen and founder of an investment banking firm involved in the Indian venture capital business, had control over three foreign financial accounts for which he failed to file timely FBAR. The IRS assessed a $752,920 penalty for willful failure to file FBAR. 31 U.SC. § 5321(a)(5). Raghuveer paid $1,000 of the penalty and sued for a refund in the U.S. Court of Federal Claims. The government moved to dismiss, arguing that Raghuveer must pay the entire penalty in order to bring a suit for a refund. *Flora v. United States*, 357 U.S. 63 (1958) (*Flora I*) and 362 U.S. 145, 177 (1960) (*Flora II*).

The Court of Federal Claims (Judge Roumel) held that the FBAR penalty is not itself an "internal revenue tax," and that claims for refund of FBAR penalties fall outside of the *Flora* full payment rule. The *Flora* "full payment rule" requires that a plaintiff pay the full tax amount before bringing a suit for refund of "any internal-revenue tax." The court held that the FBAR penalties are not an "internal revenue tax" because they are not imposed under the Internal Revenue Code, (Title 26, U.S.C.), but instead under the general Treasury authorities over money and finance, (Title 31 U.S.C.). The court also noted that because FBAR penalties are not under Title 26, they are not subject to the various statutory cross-references that equate "penalties" with "taxes. The court stated that the *Flora* fully-payment rule was established because permitting partial payment in tax-refund suits could "seriously impair the government's ability to collect taxes." *Flora II*, 362 U.S. at 164, 176 n.41 & n.43, but that there were no administrative collection procedures for FBAR penalties with which this suit would interfere.

Note. The court also rejected the government's reliance on footnote dictum from *Bedrosian v. United States*, 912 F.3d 144 (3rd Cir. 2018). *Bedrosian* also involved a small partial payment of an FBAR penalty, and the Third Circuit concluded that the FBAR statute is "part of the machinery for the collection of federal taxes," and thus an internal revenue law. In a footnote, however, the Third

Circuit stated that it was "inclined to believe" that an account holder must "pay the full [FBAR] penalty before filing suit," but that it would leave "a definitive holding on this issue for another day." *Bedrosian*, 912 F.3d at 149-50, n.1. That footnote stated that the Third Circuit was "inclined to believe" that an account holder must "pay the full [FBAR] penalty before filing suit," but that the court would leave "a definitive holding on this issue for another day." *Bedrosian*, 912 F.3d at 149-50, n.1. The Court of Federal Claims noted that it was not bound by dictum from another circuit, that the dictum was not supported by substantial analysis, and that it was based upon several assumptions with which the Court of Federal Claims disagreed. Specifically, the court noted that the *Bedrosian* footnote relied on a statement by then-judge Neil Gorsuch's in his concurring opinion in *Wyodak Res. Dev. Corp. v. United States*, 637 F.3d 1127 (10th Cir. 2011), that "internal-revenue laws" are defined by their function and not their placement in the U.S. Code. That opinion, however, stated that the courts should look at whether the levy in question was properly understood to be a tax rather than a regulatory fee, based on the statute's announced purpose, the Constitutional power under which it was enacted, and its consistent use of the term "fee" as opposed to "tax." Applying these tests, the court found that the FBAR penalties were not an internal revenue tax. The Court of Federal Claims also noted that the *Bedrosian* footnote relied on *Whistleblower 21276-13W v. Comm'r*, 147 T.C. 121, 130 n.13 (2016), which stated that not all taxes are contained in the Internal Revenue Code. The court stated that *Whistleblower 21276-13W* was not an FBAR case and actually *stated that* FBAR civil penalties "are not among the tax-related penalties enumerated in chapter 68, and they are not 'assessed, collected, and paid in the same manner as taxes.'" *Whistleblower 21276-13W* at 95. See also *Williams v. Comm'r*, 131 T.C. 54, 56-57 (T.C. 2008) (Tax Court lacks jurisdiction over FBAR civil penalties, because they are authorized in Title 31 ('Money and Finance') of the United States Code, not Title 26 (the Internal Revenue Code)).

6. It Ain't Exactly Duress – Taxpayer Cannot Escape Closing Agreement Because It Was Entered into Due to Fear of Incurring Large Tax Penalties if Taxpayer Lost in Court. *Harrison v. IRS*, 2021 WL 930266, 127 A.F.T.R. 2d 2021-1164 (D.D.C. March 11, 2021) (slip copy)

Robert Harrison and Julianne Sprinkle, a married couple, maintained a Swiss bank account with approximately $850,000. They failed to file FBAR for the account. After returning the U.S. in early 2014, they entered into the IRS's OVDP program and disclosed the account, which had reached a peak value of approximately $1.2 million in 2007. When the Streamlined Procedures were announced shortly thereafter, the taxpayers sought to transition to the Streamlined Procedures' more favorable penalty structure under the Transition Rules. They submitted the required self-certification of non-willfulness and were informed by an IRS officer that they qualified for the lower penalties under the Transition Rules. In 2017, however, the IRS officer informed the couple that the Central Review Committee had denied their request for transitional treatment and they would need to choose whether to remain in the OVDP and execute a closing agreement or proceed to a traditional audit. The taxpayers ultimately decided against going through the typical examination process because they believed that "they would face such extreme penalties that they would lose all their financial assets." 2021 WL 930266 at *3. They instead executed a Closing Agreement and paid $510,943.44 —the 27.5% miscellaneous offshore penalty plus the back taxes, interest, and other penalties owed. Two years later, the taxpayers changed their mind and sued for a refund of their payment. Among other allegations, they claimed that they signed the Closing Agreement under the duress of the possible loss of all of their assets.

The U.S. District Court for the District of Columbia (Judge Cooper) held that the taxpayers could not withdraw from the agreement just because the IRS told them what penalties they might be subject to if they contested their liability; such statements do not constitute legal duress. The court explained that, for federal purposes, duress occurs "[i]f a party's manifestation of assent is induced by an improper threat by the other party that leaves the victim no reasonable alternative, the contract is voidable by the victim." *Restatement (Second) of Contracts* § 175(1). The court stated that merely informing the taxpayers and their lawyer that they risked substantial penalties if they did not sign the Closing Agreement is insufficient for a claim of duress. Accurately informing a party of the legal risks resulting from non-settlement does not keep the party from exercising free will and judgment.

Note. The court also rejected the taxpayers' arguments that (a) the Transition Rules were promulgated without notice and comment rulemaking in violation of Section 706(2)(D) of the Administrative Procedure Act; (b) the application of the Transition Rules here was "arbitrary, capricious, an abuse of discretion, and otherwise contrary to law" under APA Section 706(2)(A); and (c) the purported absence of various procedural protections in the Transition Rules violates the Due Process Clause of the Fifth Amendment.

7. High Willful FBAR Penalties are Not Unconstitutionally Excessive

a) $3 Million FBAR Penalty Not Unconstitutionally Excessive and Taxpayer Had Financial Interest in Swiss Accounts. *Landa v. United States,* 153 Fed.Cl. 585, 2021 WL 1526511, 127 A.F.T.R.2d 2021-1682 (April 19, 2021)

Leon Landa, a U.S. citizen who had emigrated to the United States from Ukraine. Leon's grandfather deposited money into two Swiss bank accounts during World War II. Leon's father located the two accounts in 1980 and Leon became aware of them. Leon's father gave him, his brother, and his mother power of attorney on the accounts. The Landa family has a wholesale supply company to the jewelry and diamond industry, and Leon and his father traveled annually to Zurich for a jeweler's convention and to monitor the accounts. In 2008, Leon moved the two accounts to a new bank, BSI, because it did not do business in the United States or report to the IRS. Leon identified himself as the sole account holder. Leon signed a document that stated: "I do not authorise disclosure of my name. I am aware that the Bank will not invest in US securities on my account." Starting in 2010, Leon visited Switzerland yearly to monitor the BSI account. Leon directed BSI to hold mail at the bank so he would not receive mail about the account in the United States, and he signed a held-mail receipt directing BSI to destroy 142 pages of correspondence dated between September 15, 2009, and March 23, 2011. Leon withdrew funds from the BSI account on various occasions. Leon filed his 2009 Federal income tax return with a tax return preparer, to whom he did not reveal the Swiss accounts. He answered the question about the existence of foreign accounts in the negative, under penalty of perjury. Leon filed a late 2009 FBAR. The IRS audited Leon's family and Leon contended that he held the accounts as trustee for his other family members. The IRS assessed a $3,173,464 willful FBAR penalty against Leon – 50% of the BSI account balance. Leon paid the penalty and sued for a refund.

The Court of Federal Claims (Judge Hertling) held that: (a) Leon had a financial interest in the foreign account and he was not merely a trustee of funds held for the benefit of others; (b) his failure to file was willful and (c) the $3 million FBAR penalty was not an unconstitutionally excessive fine. Leon argued that the Swiss legal rules did not necessarily treat him as the owner of record, but the court stated that the Swiss rules are irrelevant to the U.S. tax treatment of the account, and that Leon had a sufficient financial interest in the account under the US. rules to be required to file FBAR. The court also found insufficient evidence of the existence of Leon's ownership in solely a fiduciary capacity, noting that Leon had admitted that he considered establishing a formal trust but had decided not to do so. Besides which, Leon was the owner of record of the account which, even if there were a trust, would have required that he file FBAR. The court noted that Leon had waived the right to dispute the willfulness of his failure to file because he did not raise this issue in his complaint, but even if he had, his actions supported a finding of reckless disregard of the FBAR rules, which constitutes willful failure to file. Finally, the court held that the penalty was not an "excessive fine" under the Eighth Amendment to the U.S. Constitution, because the FBAR penalty is not punitive in nature, but rather seeks to recover the damages caused to the U.S. by the failure to file. Citing *United States v. Bajakajian*, 524 U.S. 321, 328 (1998) *United States v. Toth*, 2020 WL 5549111, 126 A.F.T.R.2d 2020-6065 (D. Mass. Sept. 15, 2020) (slip copy), *app. filed* (1st Cir. Jan. 11, 2021); *United States v. Est. of Schoenfeld*, 344 F. Supp. 3d 1354, 1369-70 (M.D. Fla. 2018).

b) $3 Million FBAR Penalty is Not Unconstitutionally Excessive. *United States v. Toth*, 2020 WL 5549111, 126 A.F.T.R.2d 2020-6065 (D. Mass. Sept. 15, 2020) (slip copy), *app. filed* (1st Cir. Jan. 11, 2021)

Monica Toth was a U.S. citizen and resident who, in 1999, opened a Swiss account at UBS. On advice of her father and brother, Monica kept the account a secret. Monica had control and legal authority over the account and in 2007, had an account balance of approximately $4.3 million. She did not file a 2007 FBAR. On her 2007 federal income tax return, Monica checked the box saying that she had no foreign bank accounts. The government assessed a penalty which, with interest and late fees, was now over $3 million. The government brought suit and sought summary judgment.

The U.S. District Court for Massachusetts (Judge Burroughs) granted the summary judgment. The court held that the facts supported a finding of willfulness and applied the standard set by the Federal Circuit in *Norman v. United States*, 942 F.3d 1111, 1116 (Fed. Cir. 2019). The court noted that the factual basis for the government's claim of willfulness was not contested, and so summary judgment was appropriate. The court held that the $3 million penalty did not violate the Eighth Amendment to the U.S. Constitution's prohibition against excessive fines. The court relied on *United States v. Bajakajian*, 524 U.S. 321 (1998), which held that the Eighth Amendment applies only to penalties that are punitive in nature, and tax penalties have traditionally been held to be remedial for Eighth Amendment purposes. It also held that the penalty did not violate the Fifth Amendment's Due Process Clause, because the Due Process requirement is not violated by federally-imposed fines and damages.

c) $13 Million FBAR Penalty is Not Unconstitutionally Excessive. *United States v. Schwarzbaum*, 2020 WL 2526500, 125 A.F.T.R.2d 2020-2109 (S.D. Fl. 2020) (slip copy), *app. filed*, 2020 WL 2526500 (11th Cir. Oct. 23, 2020)

Isac Schwarzbaum was a U.S. taxpayer who opened Swiss bank accounts with gifts and bequests from his father, a German national living in Switzerland. Some of the accounts were directly transferred to Isac, who kept a large Swiss account received from his father invested in the same manner that his father had, managed by the same bankers and based upon his father's instructions. Isac personally filed a FBAR for one of his Swiss accounts with his 2007 income tax return, as well as a Form 3520 reporting a $5 million gift from his father. In 2010, Isac disclosed his foreign accounts to his US accountant but opted out of OVDI. The IRS assessed nearly $14 million of willful FBAR penalties, mitigated from an initial assessment of $36 million.

The U.S. District Court (Judge Bloom) held that the $13 million penalty was not unconstitutionally excessive under the Eighth Amendment, because the FBAR penalty was remedial, rather than punitive. The Eighth Amendment applies only to penalties that are punitive in nature, and tax penalties have traditionally been held to be remedial for Eighth Amendment purposes. The court also noted that the statute in question is entitled "Civil penalties", suggesting that Congress did not intend that it be punitive in nature.

Note 1. See similar holdings in *United States v. Collins*, 2021 WL 456962 (W.D. Pa. Feb. 8, 2021) (slip copy); *United States v. Garrity*, 2019 WL 1004584, 123 A.F.T.R. 2d 2019-941 (D.Conn. 2019) (slip copy), *app. withdrawn* 2019 WL 3384830 (2nd Cir., July 23, 2019); *Moore v. United States*, 2015 WL 1510007, 115 A.F.T.R. 2d 2015-1375 (W.D. Wash. 2015) (calculating the penalty in this manner produced a high penalty but did not violate the Eighth Amendment; court assumed without analysis that civil FBAR penalties are "fines" under the Eighth Amendment, but that they are invalid only if they are "grossly disproportional to the gravity of the defendant's offense").

8. Obligation to File FBAR is Not Satisfied by Claim of Fifth Amendment; Failure to File was Willful. ***United States v. Bernstein*****, 486 F.Supp.3d 639, 2020 WL 5517315, 126 A.F.T.R. 2d 2020-6053 (E.D. N.Y. Sept. 13, 2020)**

Daniel and Yana Bernstein had two Swiss bank accounts with a combined value of approximately $1 million. The Bernsteins had directed that there be no telephone or mail communications between them and the bank regarding the account, nor should any account statements be sent to them. The Bernsteins never told their accountant about the accounts. Their tax attorney noted that, because the taxpayers had not filed FBAR, they should file one for the 2010 tax year in which they would invoke their privilege against self-incrimination under the Fifth Amendment. The attorney prepared an addendum to the FBAR describing the basis for the privilege in which the Bernsteins offered to make more detailed disclosures if they received use immunity from criminal prosecution. The IRS asserted $262,288.50 willful failure to file penalty against each of the Bernsteins.

The District Court for the Eastern District of New York (Judge Cogan) granted summary judgment to the government. The Bernsteins cited *Cheek v. United States*, 498 U.S. 192 (1991), which held that a determination of willfulness in a tax fraud case involving an individual who prepared his own tax return and did his own tax research was subjective, turning on what the taxpayer actually believed was required of him; the correctness of that belief was not at issue. The court held that *Cheek* did not apply in this case because *Cheek* involved a criminal violation, whereas this case involved a civil fine. Citing *Bedrosian v. United States*, 912 F.3d 144 (3d Cir. 2018); and *Lefcourt v. United States*, 125 F.3d 79 (2d Cir. 1997). The court concluded that no reasonable jury could only find that the taxpayers willfully failed to comply with the statute, even without drawing any adverse inference from their assertion of their Fifth Amendment privilege.

Note. See also *United States v. Collins*, 2021 WL 456962 (W.D. Pa. Feb. 8, 2021) (slip copy).

9. Taxes Win Over Death -- Liability for FBAR Penalties Survives Taxpayer's Death

a) In Close Call, District Court Refuses to Hold that Nonwillful FBAR Nonfiling Penalties Do Not Survive Death of Accountholder. ***United States v. Gill*****, 2021 WL 2682533 (S.D. Tex. June 30, 2021) (slip copy)**

Jagmail S. Gill was a U.S. citizen who filed 2005-2010 U.S. income tax returns not reporting his foreign-source income and who failed to file FBAR for those years for 25 foreign accounts with balances ranging from $7.6 million to $18.1

million. Most of the accounts were controlled by Jagmail, but some were controlled by his wife, Amarjit. The government asserted non-willful FBAR failure to file penalties of nearly $800,000. Jagmail did not pay the assessments and the government filed suit. After suit was filed, Jagmail died of a suspected case of COVID-19 and Amarjit was named personal representative of his estate. The estate moved to dismiss arguing that a claim for nonwillful nonfiling of FBAR cannot survive the death of the accountholder.

The U.S. District Court for the Southern District of Texas (Judge Miller) denied the motion, finding that, while the law was unsettled, the plaintiff had not established that the claim did not survive death of the accountholder. The court explained that 28 U.S.C. § 2404 states that a civil action for damages filed by the government before a defendant's death survives that death, but that this statute applies only to claims that are remedial, rather than penal. The Fifth Circuit looks to three factors to determine whether a statute is penal or remedial: (1) was the purpose of the statute to redress individual wrongs or more general wrongs to the public; (2) does recovery under the statute runs to the harmed individual or to the public; and (3) is the recovery authorized by the statute wholly disproportionate to the harm suffered. *In re Wood*, 643 F.2d 188, 190 (5th Cir. 1980); *Malvino v. Delluniversita*, 840 F.3d 223, 229 (5th Cir. 2016). Other courts examining the treatment of FBAR penalties have applied a longer set of factors described in *Hudson v. United States*, 522 U.S. 93, 118 S. Ct. 488 (1997), including: (1) does the sanction involve an affirmative disability or restraint; (2) has the statute historically been regarded as a punishment; (3) does the statute come into play only on a finding of scienter; (4) does the statute's operation promote the traditional aims of punishment—retribution and deterrence; (5) is the behavior to which the statute applies already a crime; (6) is there an alternative purpose connected to the statute that may rationally be assignable for it; and (7) does it appear excessive in relation to the alternative purpose assigned. *United States v. Green*, 457 F. Supp. 3d 1262, 1269 (S.D. Fla. 2020); *United States v. Wolin*, 489 F. Supp. 3d 21, 28 (E.D.N.Y. 2020); *United States v. Estate of Schoenfeld*, 344 F. Supp. 3d 1354, 1370 (M.D. Fla. 2018). The government noted that every court that has taken up the issue found that the penalties survive death because they are more remedial than penal, but the court chose to examine the penalties itself, rather than to be swayed by the views of other courts. It found that the matter was less clear, particularly as no other court had considered the treatment of nonwillful nonfiling penalties. The court looked at the Supreme Court's opinion in *United States v. Bajakajian*, 524 U.S. 321 (1998), which held that a punitive forfeiture is invalid only if it is "grossly disproportional to the gravity of the defendant's offense." The court noted, however, that *Bajakajian* involved a forfeiture which differed from the FBAR nonwillful nonfiling penalty because it could be imposed on an innocent owner of unreported currency. The Supreme Court in *Bajakajian* noted that the Government's loss would not be remedied by confiscating the money, in this case, the Government asserts required to conduct the examination of the Gills' accounts for failure to file

FBAR would be directly compensated, to some extent, by the penalties. Examing the Hudson factors, the court noted that non-willful violations differed from willful violations with respect to scienter and whether the penalty was excessive in relation to its remedial purpose. The scienter factor weighed against finding the penalty as penal because the penalty did not require knowledge of wrongdoing. As the analysis was nearly a toss-up, the court held that the moving party had failed to meet its burden of proof.

b) FBAR Willful Nonfiling Penalties Survive Death. *United States v. Wolin*, 489 F.Supp.3d 21, 2020 WL 6481477, 126 A.F.T.R. 2d 2020-6348 (E.D.N.Y. Sept. 28, 2020), *app. filed,* (2nd Cir. Oct. 29, 2020), *app. withdrawn* (2nd Cir. Dec. 11, 2020)

The United States brought suit against the fiduciary of the Estate of Leo Ziegel and against his two daughters, who inherited Leo's beneficial interests in a foreign trust and a Swiss bank account. Leo had hired Auctoriana Anstalt to establish a Lichtenstein Stiftung (foundation) and to open a bank account with UBS. Documents support the fact that Leo was the real owner of the account and he met with the UBS employees and exercised control and received benefits from the accounts. Leo failed to file FBAR and did not even advise his accountants who prepared his 2008 income tax returns that the accounts existed. Leo died in 2014, and the government assessed a claim against Leo's estate for $1.4 million in penalties for willful nonfiling of FBAR. The executor and the beneficiaries moved to dismiss, arguing that the claim for FBAR willful nonfiling penalties did not survive Leo's death.

The U.S. District Court for the Eastern District of New York (Judge Mauskopf) denied the motion. The court stated that the question was controlled by *Estate of Kahr v. Comm'r*, 414 F.2d 621 (2d Cir. 1969), which held that a claim for tax fraud survived the taxpayer's death. The court also discussed and followed *United States v. Estate of Schoenfeld*, 344 F. Supp. 3d 1354, 1375-76 (M.D. Fla. 2018), and *United States v. Park,* 389 F. Supp. 3d 561, 575 (N.D. Ill. 2019), both of which held that an FBAR claim survived the taxpayer's death.

10. Courts Disagree on Whether Merely Signing a False Income Tax Return Establishes Willful Failure to File FBAR

a) Nearly $1 Million in FBAR Penalties Imposed with Taxpayers' Having Signed False Income Tax Returns as *Prima Facie* Evidence of Willfulness. *United States v. Horowitz*, 978 F.3d 80, 2020 WL 6140674 (4th Cir. Oct. 20, 2020), *aff'g* 361 F.Supp 3d 511, 2019 WL 265107, 123 A.F.T.R. 2d 2019-500 (D. Md. 2019)*, reh'g denied* (4th Cir. Dec. 18, 2020)

Peter and Susan Horowitz established a Swiss bank account that ultimately was held at Finter Bank Zürich. The account grew to over $2 million. The Horowitzes did not disclose the accounts to the CPA who prepared their income tax returns and did not pay tax on the income from the account. They also answered "no" to the question on the 1040 about whether they held any foreign accounts or trusts. For some years, the Horowitzes participated in the Treasury's Offshore Voluntary Disclosure Program, but then they elected out of the program. The government assessed willful FBAR penalties against the Horowitzes, in the amount of $247,030 each for 2007 and $247,030 each for 2008. The parties filed cross-motions for summary judgment.

The U.S. District Court for Maryland (Judge Grimm) held primarily for the government, finding that there was no genuine dispute of material fact as to the willfulness of the Horowitzes' failure to report, noting that they acted with a reckless disregard for the FBAR filing requirements. They thus "declar[ed] under penalty of perjury that [they] had 'examined this return and accompanying schedules and statements' and that, to the best of [their] knowledge, the return was 'true, accurate, and complete.'" 361 F.Supp.3d 511 at 528-529. The court stated that "their] signature[s] [are] prima facie evidence that [they] knew the contents of the return," including the foreign accounts question and the cross-reference to "filing requirements, which put them "on inquiry notice of the FBAR requirement."

The Fourth Circuit (Judge Niemeyer) affirmed, relying on the same analysis used by the District Court. The court agreed that the taxpayers' failure to complete their federal income tax returns correctly and their statement under the penalties of perjury that they had no foreign accounts under penalty of perjury was *prima facie* evidence of recklessness.

b) Signing False Income Tax Return Proves Willfulness, Despite Lack of Actual Knowledge of the Obligation to File. *United States v. Gentges*, 2021 WL 1222764 (S.D.N.Y. March 31, 2021) (slip copy)

Heinz Gentges is a U.S. citizen who owned two Swiss bank accounts at UBS. Both accounts were numbered and Heinz signed documents for both stating that he wanted to avoid disclosure of his identity to the IRS, and so prohibited the acquisition of additional US securities in those accounts and required that all mail regarding the accounts be retained at the bank. The balance on both accounts was over $10,000 and Heinz was required to file FBAR in 2007. 31 U.S.C. § 5314(a); 31 C.F.R. §§ 103.24, 103.27, *amended and recodified at* 31 C.F.R. § 1010.350 (2011). Heinz failed to file FBAR in 2007 and, in 2016, the IRS assessed FBAR willful non-filing penalties of $903,853, which was 50% of the account balances in 2007. Heinz failed to pay the penalties and the government sued to collect them.

The U.S. District Court for the Southern District of New York (Judge Karas) granted summary judgment for the government. The court concluded that Heinz's actions were reckless, based primarily on the fact that Heinz stated on his 2007 tax return under penalties of perjury that he had no financial interest in any foreign bank accounts. The court rejected the argument that Heinz had not reviewed the returns in detail, which the court found to be reckless behavior in and of itself. The court agreed with the other courts that have viewed this as sufficient alone to establish willful failure to file and distinguished the cases where courts have viewed this only as prima facie evidence of willfulness. See *United States v. Clemons*, 2019 WL 7482218 (M.D. Fla. 2019); *United States v. Flume*, 2018 WL 4378161 (S.D. Tex. 2018); *United States v. de Forrest*, 463 F. Supp. 3d 1150 (D. Nev. 2020). The court stated that, on summary judgment, courts may—and regularly do—impute constructive knowledge to defendants based on documents those defendants have signed. Citing *United States v. Horowitz*, 361 F. Supp. 3d 511, 529 (D. Md. 2019), *aff'd*, 978 F.3d 80 (4th Cir. 2020); *United States v. Rum*, 2019 WL 5188325 (M.D. Fla. 2019) (slip copy), *aff'd*, 995 F.3d 882, 892 (11th Cir. 2021); and *Kimble v. United States*, 141 Fed. Cl. 373, 2018 WL 6816546, 122 A.F.T.R.2d 2018-7109 (Fed. Cl., 2018, *aff'd* 2021 WL 1081395 (Fed. Cir. March 22, 2021).

c) **Filing a False Income Tax Return is Only Rebuttable *Prima Facie* Evidence of Willful FBAR Nonfiling. *United States v. Schwarzbaum*, 2020 WL 1316232, 125 A.F.T.R. 2d 2020-1373 (S.D. Fl. 2020) (slip copy), *app. filed* (11th Cir. Oct. 23, 2020), *supplemental order by magistrate*, 9:18-cv-81147 (S.D. Fl. June 30, 2021)**

Isac Schwarzbaum was a U.S. taxpayer who opened Swiss bank accounts with gifts and bequests from his father, a German national living in Switzerland. A large Swiss account that Isac received directly from his father was kept invested in the same manner that his father had invested it, managed by the same bankers and based upon his father's instructions. Isac told his accountants about receiving gifts from his father but not about the foreign accounts, which he had been mis-told were not relevant absent U.S. contacts. In opening several of his Swiss accounts, Isac elected to have the banks retain his correspondence for a fee, assigned his accounts pseudonyms, and opted not to invest in U.S. stocks. Isac used his German passport, rather than his U.S. passport, when opening several of the accounts. The accountant's tax software defaulted to "no" on question 7a of Schedule B, asking "[a]t any time during [applicable tax year], did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?" Isac personally filed a FBAR for one of his Swiss accounts with his 2007 income tax return, as well as a Form 3520 reporting a $5 million gift from his father. In 2009, UBS informed Isac that an IRS treaty request required that he report his foreign accounts and explained to him the OVDI. The letter encouraged Isac to consult with a U.S. qualified tax advisor, but he instead consulted a Swiss counsel who incorrectly told him that the UBS letter did not apply in his situation. In 2010, Isac disclosed his foreign accounts to his U.S. accountant but opted out of OVDI. The IRS assessed nearly $14 million of willful FBAR penalties, mitigated from an initial assessment of $36 million.

The U.S. District Court (Judge Bloom) held that Isac was liable for a non-willful FBAR penalty for 2006 and willful FBAR penalties for 2007 – 2009, but that the IRS had incorrectly computed the willful non-filing penalties. The government argued that Isac's signature on the tax returns conclusively deemed him to have knowledge of the contents of the return, including the declaration that there were no foreign accounts. The district court rejected this analysis, stating that relying solely on constructive knowledge would render meaningless the distinction between non-willful and willful FBAR violations for which the statute clearly provides. The court found that the 2006 non-filing was not willful, because those foreign accounts were mere continuations of accounts created by Isac's father. The non-filing for 2007–2009, however, reflected recklessness or willful blindness. The court noted that Isac never hired anyone to translate the returns and explanations for him, even though he usually did not sign documents in English without knowing what they said. Also, Isac self-prepared his 2007 and 2009 FBARs and reviewed the instructions for the 2007 FBAR form, and so should have known of the FBAR requirements. The IRS calculated the willful non-filing FBAR penalty based on a worksheet provided by Isac, which looked at the highest aggregate balance in each account during each year, rather than the balance on each June 30, as required by the statute.

Note 1. The IRS will not usually assess more than one-half of the aggregate value of all foreign accounts, though agents have discretion to impose higher (or lower) penalties where appropriate. IRM 4.26.16.6.5.3. Willfulness, therefore, matters.

Several cases have found willfulness because the accountholder signed a U.S. income tax return under penalty of perjury falsely stating that he or she had no foreign bank accounts. *United States v. Doherty*, 233 F.3d 1275, 1282 n.10 (11th Cir. 2000); *Norman v. United States*, 942 F.3d 1111, 1116 (Fed. Cir. 2019); and *Jarnagin v. United States*, 134 Fed. Cl. 368, 378 (Fed. Cl. 2017). The judges in *Schwarzbaum, Horowitz, United States v. Flume*, 390 F.Supp.3d 847, 2019 WL 2807386 (S.D. Tex. 2019), and *United States v. Williams*, 2010 WL 3473311, at *1 (E.D. Va. 2010), *rev'd on other grounds*, 489 F. App'x 655 at 658 (4th Cir. 2012), however, stated that such a false statement is *prima facie* evidence of willfullness, but that it can be rebutted by other facts. One hopes that appeals of these cases will result in a settlement of this issue, preferably on the basis of *Williams*, *Horowitz*, *Flume* and *Schwarzbaum*, which appear to be the better analyses.

Note 2. After losing in District Court, the government noted that Isac had no significant U.S. assets and sought to compel him to repatriate $18.2 million in assets held in Swiss accounts. Isac argued that the government had no authority to do so because the Swiss assets were outside the jurisdiction of the court, but the Magistrate Judge held otherwise. The judge explained that as long as Isac was within the court's jurisdiction, it could compel him to repatriate assets that were not within its jurisdiction. See *United States v. McNulty*, 446 F. Supp. 90 (N.D. Cal. 1978) (ordering a defendant to repatriate lottery winnings collected in Ireland and deposited in a bank on the Island of Jersey).

J. Income Tax Procedures

1. Beneficiary of a Foreign Trust Who is also Its Deemed Owner is Subject to 35% Nonfiling Penalty, Rather than 5% Penalty. *Wilson v. United States*, 6 F.4th 432, 2021 WL 3177273 (2nd Cir. July 28, 2021), *rev'g* 2019 WL 6118013 (E.D.N.Y. 2019) (slip copy)

Joseph Wilson was the sole owner and beneficiary of a foreign trust that in 2007, distributed $9.2 million in assets to him. He was required by Section 6048 to file IRS Form 3520-A (Annual Information Return of Foreign Trust with a U.S. Owner) and IRS Form 3520 (Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts). He filed both forms late for 2007 and the IRS assessed under Section 6677(a) a penalty for failure to file the Form 3520, equal to 35% of the annual distributions ($3.1 million), rather than a penalty under Section 6677(b) equal to 5% of the trust fund. Joseph paid both penalties and filed claim for a refund of the 35% penalty, claiming that the lower penalty should have been imposed. He died and his daughter filed a suit for refund.

The U.S. District Court for the Eastern District of New York (Judge Cogan) granted summary judgment for the taxpayer, holding that the plain language of Section 6677(b) imposes the lower penalty on a deemed owner of a trust in lieu of the higher penalty imposed on beneficiaries. The 35% penalty is imposed by Section 6677(a), on trust beneficiaries, but Section 6677(b)(2) states that "subsection (a) shall be applied by substituting '5 percent' for '35 percent'" for returns required to be filed by the owner of a foreign trust. This, the court held, means that only one penalty can be imposed, and that if the beneficiary is also the trust owner, the lower penalty must control.

A unanimous Second Circuit (Judge Wesley), reviewing the lower court's summary judgment *de novo*, reversed. The court held that the plain language of Sections 6048 and 6677 clearly creates two separate filing requirements, one for trust owners and one for trust beneficiaries, and that nothing in the statute suggests that trust owners who are also beneficiaries need file only one form. Furthermore, while Section 6677(a) imposes a penalty of 35% of the "gross reportable amount" and Section 6677(b) says that, for deemed owners, the 35% figure shall be deemed to be 5% of the "gross reportable amount," the Code defines "gross reportable amount" differently for the two penalties. For beneficiaries, it is the gross amount of the distribution. IRC § 6677(c)(1). For trust owners, it is the gross value of the trust fund, without regard to the size or even existence of the distributions. IRC § 6677(c)(2). The court noted that while Section 6677(b) calculates the 5% penalty differently from the 35% penalty, it does not purport to modify the 35% penalty itself. The court also rejected as not determinative the fact that the instructions to

Form 3520 permit the filing owner not to state trust distributions if a Form 3520-A has been filed, but rather to attach the latter form's explanation of the distributions.

Note. The appeals court appears to be quite correct, but possibly for another reason. It is simply illogical to assume that a taxpayer who fails to file one required form will be subject to a higher penalty than a taxpayer who fails to file that form and another form. There can be no such reward for being doubly negligent.

The court did not address, furthermore, whether the IRS could assess both penalties in this case. As the court of appeals noted, these are two separate filing requirements and two separate penalties. If the grantor/beneficiary failed to file both returns in a timely fashion, it seems reasonable that both penalties could be imposed.

2. Government Lien Attaches to Property Held by Nominee Trust. *United States v. Steele*, 830 Fed.Appx. 250 (Mem), 2020 WL 7024540 (9th Cir. Nov. 30, 2020), aff'g 2019 WL 2411422 (D. Nev. 2019)

Spencer J. Steele owed the government for four years of personal income tax and the government sought to collect these amounts by levying on a house that was the sole asset of the Desert Lake Trust, an irrevocable trust created at the Spencer's request. Spencer lent the trust $422,000 that it used to buy the house. Spencer was neither the trustee nor a beneficiary of the trust, but he resided in the trust's property under a 99-year lease. The rent from the lease was the property's only income, and it was used to pay expenses relating to the property, including the repayment of the $422,000 loan from Spencer. The government moved for summary judgment that the trust was actually Spencer's nominee and, as such, its assets were liable for the payment of Spencer's overdue income taxes.

The U.S. District Court for Nevada (Judge Du) granted the summary judgment, finding that Spencer had provided no evidence to indicate that he did not owe the taxes in question. The court also held that the trust held the property as a mere nominee for Spencer's benefit. The court stated that Nevada law recognized the nominee trust concept, but that it did not enumerate the factors that one should consider to determine whether a trust is a nominee. Citing *Edelstein v. Bank of N.Y. Mellon*, 286 P.3d 249, 258-59 (Nev. 2012). The court then looked to the factors that federal courts have held determine whether a trust is a nominee, including: (1) the source of the funds used to purchase the property; (2) the taxpayer's continued use of the property without the payment of a fair rental value; (3) the taxpayer's continued payment of maintenance charges and real estate taxes; (4) the nominees' acquisition of the property without any consideration, or for inadequate consideration; (5) the taxpayer's acts of holding himself out as the owner of the property; (6) the transfer of the property in anticipation of suit or the incurrence of liabilities by the taxpayer; and (7) the relationship between the taxpayers and the nominee, that is, whether it is a close one, such as by blood or marriage. From these factors, the court concluded that Spencer maintained control over the property through the trust and that the trust was his nominee.

On appeal, the Ninth Circuit (Judges Scannlain and Trott) held that the district court correctly found that the government may impose tax liens against the trust property because the record demonstrates that the trust held bare title to the property as Spencer Steele's nominee. Citing *Fourth Inv. LP v. United States*, 720 F.3d 1058, 1066–67 (9th Cir. 2013). In particular, the court noted that (a) Spencer's attorney drafted the trust documents, which Spencer hoped would protect his assets from debt collectors; (b) Spencer paid for the trust's purchase of the home, and then paid the trust monthly rent to live in the home under a 99-year lease agreement; (c) the trust's only income was Spencer's rent payments and so the trust "repaid" Spencer for the borrowed funds by re-routing his own money back to him; (d) the trust did nothing with its income other than make monthly loan repayments to Spencer, pay for the home's taxes, insurance, and maintenance, and cover the trust's own administrative expenses; and (e) Spencer used the home as his personal residence.

Judge Smith dissented, believing that the trial court did not adequately examine Nevada law to determine whether the trust was a nominee. Moreover, he argued that the district court did not correctly evaluate the facts, as seen in the light most favorable to the taxpayer (as nonmoving party), and that had it done so, the court would not have granted summary judgment.

III. ESTATE TAXES

A. IRC § 2001. Legislative Estate Tax Repeal or Reform

1. Ways and Means Proposals for Budget Reconciliation Act

The Senate has passed a budget resolution under the reconciliation procedures, so that the bill to implement it need receive only a simple majority vote in the Senate. The Build Better Back Act is currently before the House Committee on Ways and Means, which has been marking-up this legislation.

The democratic members of the Ways and Means Committee have proposed certain tax changes to raise approximately $3 trillion to offset the costs of the programs included in this bill. These proposals were only introduced on September 12, 2021, and changes should be expected from the whole committee, the House of Representatives, the Senate Finance Committee, the Senate, and if it gets that far, a Conference Committee.

a) Lower Applicable Exclusion Amount and GST Exemption

The TCJA doubled the estate and gift tax exemption. With inflation, it is now $11,700,000 for unmarried individuals and $23,400,000 for married individuals. This increase provision is currently scheduled to expire on December 31, 2025. The proposal would move the expiration date to December 31, 2021. This would also reduce the GST exemption accordingly, since it is tied to the estate tax applicable exclusion amount. These changes would apply to estates of decedents dying and gifts made after December 31, 2021. Projected revenue raised - $50 billion.

b) Increased Special Use Valuation Limit

This proposal would increase from $750,000 to $11,700,000 the maximum amount that an estate can be reduced by special use valuation under Section 2032A for farm and closely-held business real estate. These changes would apply to respect to estates of individuals dying after and to gifts after December 31, 2021.

c) Estate and Gift Taxation of Grantor Trusts

The proposal would make the estate and gift tax rules more like the income tax rules with respect to grantor trusts. This provision, which applies only to future trusts and future transfers, would include the assets of a grantor trust in the grantor's gross estate for estate tax purposes. It would also treat the termination of grantor trust status during the grantor's lifetime or the distribution of assets from the trust to someone other than the grantor or the grantor's spouse as a taxable gift by the grantor. This provision also taxes a sale from a grantor trust to its owner the same way as a normal sale of assets. This provision would be effective for trusts created on or after the date of enactment, and to any portion of a trust created before the date of enactment attributable to contributions after the date of enactment. Projected revenue raised - $7 billion.

Note. This is a very broad proposal. It imposes a gift tax on the grantor when the grantor trust status ends, so it would eliminate the utility of such conventional planning vehicles as Qualified Personal Residence Trusts (QPRTs), Grantor Retained Annuity Trusts (GRATs), and Inter Vivos Charitable Lead Grantor Trusts. It would also cause the assets of most Irrevocable Life Insurance Trusts (ILITs) to be included in the insured grantor's gross estate, because virtually all such trusts are grantor trusts based solely on the fact that trust income may be used to pay premiums on the policies owned by the trust.

This problem cannot necessarily be solved prohibiting the trustee from using income to pay premiums. In PLR 8839008, the IRS distinguished fiduciary accounting income from gross or taxable income and stated that Section 677(a)(3) refers to the latter. In that ruling, the trustee of an ILIT was prohibited from using income to pay premiums. The trustee paid them from fiduciary accounting principal, but the IRS stated that, because the premiums were greater than the trust's taxable income, the trustee was deemed to have used the income to pay the premiums, and the grantor was taxable on that income. Thus, unless clarified, this provision could eliminate the primary benefits of the irrevocable life insurance trust. This would be particularly problematic because the increased estate tax rates and reduced basic exclusion amount would create greater liquidity demands on a decedent's taxable estate, and ILITs have traditionally been the primary vehicle for meeting these liquidity demands.

Perhaps the best solution in such a situation would be to create an ILIT, prohibit the use of income to pay premiums, and then: (i) fund the trust and keep the money in a non-interest bearing account for future use paying premiums; (ii) have the grantor pay the premiums directly to the insurer; or (iii) have the grantor give money to the trustee and have the trustee immediately pay the premiums (possibly keeping the money in a non-interest bearing account during the Crummey withdrawal period).

d) Valuation Discounts

The proposal would change the estate and gift tax valuation rules to ignore discounts from partial ownership or lack of control of an asset in determining its value, to the extent that the entity includes assets that are not used in the conduct of an active trade or business. Thus, the value of passive assets held by a partnership, LLC, or corporation that are not used in the active conduct of the business would be valued without a discount, as if owned directly by the entity owners. Because this provision is limited to passive assets, it should not affect family farms and businesses. There is also a look-through rule that treats the nonbusiness assets of another entity as held by the parent entity, if the parent holds at least a 10% interest in the subsidiary entity. This provision would be effective for transfers on or after the date of enactment. Projected revenue raised - $20 billion.

e) Charitable Gifts

The proposal would take steps to eliminate the charitable contribution deduction for abusive syndicated conservation easement transactions, in which the property is held for less than three years and the deduction exceeds 2.5 times the basis of the property. These provisions would apply to contributions made after December 31, 2021. Projected revenue raised $11 billion.

2. Obama Wealth Transfer Tax Proposals

President Joe Biden has not yet released a comprehensive tax reform proposal that includes changes in the wealth transfer taxes, but he has a history from his Obama Administration years of supporting several specific changes in the wealth transfer tax rules. See Dept. of Treas., *General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals* (Feb. 2016); also Pratt & Brown, *Estate Planning During an Election Year: Will It Be 2012 All Over Again?* 94 Fl. Bar J. 4-45 (Jan/Feb 2020).

a) Wealth Transfer Tax Rates and Exemptions

The President has made no suggestions regarding the wealth transfer taxes, but he seems likely to espouse the 2016 proposals that the Obama administration made to revise these rules. These changes would include return the estate, gift, and GST rates and exemptions to $3,500,000 -- their 2009 levels and imposing a top estate and gift tax rate of at least 45%. Indexing could also be eliminated.

b) Inclusion of Grantor Trust Assets in Grantor's Gross Estate

The Obama Administration's 2017 budget would include in a grantor's gross estate any assets held by a grantor trust deemed owned by the deceased grantor on the date of death and treat distributions from such grantor trusts made during the grantor's lifetime as completed taxable gifts. Under this proposal, the gross estate of a person deemed to own a trust under the grantor trust rules will include that portion of the trust attributable to a sale, exchange, or "comparable transaction" between the grantor and the trust, if that transaction was disregarded for income tax purposes. The grantor's gross estate would also include any income, appreciation and reinvestments attributable to such portion of the trust, less the amount of the consideration received by the person in that transaction. These amounts would also be subject to gift tax at any time during the deemed owner's life when his or her treatment as a deemed owner of the trust ends and will be treated as a gift by the deemed owner to the extent any distribution is made to another person (except in discharge of the deemed owner's obligation to the distributee) during the life of the deemed owner. The proposals would reduce the amount subject to transfer tax by any portion of that amount that was treated as a prior taxable gift by the deemed owner. The transfer tax imposed by this proposal would be payable from the trust, rather than by the grantor directly.

The proposal stated that it would not change the treatment of any trust that is already includable in the grantor's gross estate, such as a GRIT, a GRAT, a QPRT, or a revocable trust. Similarly, it would not apply to any trust having the exclusive purpose of paying deferred compensation under a nonqualified deferred compensation plan if the assets of such trust are available to satisfy claims of general creditors of the grantor. The proposal also would not apply to any trust that is a grantor trust solely because its income may be used to pay premiums on insurance policies on the life of the grantor or the grantor's spouse.

Note. This was designed to eliminate the utility of installment sales to a grantor trust, but it might also apply to a substitution of grantor trust assets for assets of an equivalent value under Section 675(4)(C). This proposal also raises questions about what constitutes a transaction "comparable" to a sale or exchange -- is a loan a comparable transaction? The breadth of the exclusion from these rules for trusts the assets of which are already includible in the decedent's gross estate is also uncertain. The assets of most GRATs are included in the gross estate of a grantor who dies during the annuity term, but the regulations under Section 2036(a) provide a formula for determining the portion of the trust assets that are included, and where there is very substantial appreciation, perhaps coupled with much higher interest rates than were prevalent when the GRAT was created, some portion of the trust assets may not otherwise be includible in the deceased grantor's gross estate.

It is also noteworthy that the 2017 General Explanations refer to the "deemed owner" of the trust, rather than the grantor. It is apparent that these rules would apply to beneficiaries who are deemed to own a trust under Section 678(a), as well as grantors who are deemed to own the trust under Section 671.

The proposal would exclude from its operation a trust that is a grantor trust solely because its income may be used to pay premiums on insurance policies on the life of the grantor or the grantor's spouse. This appears to be designed to exclude from the operation of these rules irrevocable life insurance trusts, which often do buy policies from the insured grantor to avoid the three-year rule of Section 2035(a). Many irrevocable life insurance trusts now also include other grantor trust powers, including particularly a right to reacquire trust assets by substituting assets of equivalent value. The IRS approved this technique in Rev. Rul. 2011-28, 2011-49 I.R.B. 830. Read literally, the proposal would not exclude from its operation irrevocable life insurance trusts that give the grantor the right to substitute assets, rendering many such trusts relatively useless as estate planning devices.

The proposal authorizes Treasury to create regulatory exceptions, and while the regulatory process is not quick, it does involve comments and participation by practice groups, such as the ABA, the AICPA, and the ACTEC, and it often creates the type of practical and technically correct exceptions that would be needed to make such a provision operate in a reasonable manner.

c) Expand Requirement that Basis Be Tied to Transfer Tax Values

The Obama Administration proposed two more changes in the consistent reporting requirements. It would have expanded the property subject to the consistency requirement imposed under Section 1014(f) to include: (a) property qualifying for the estate tax marital deduction, provided a return is required to be filed under Section 6018, even though that property does not increase the estate's federal estate tax liability; and (b) property transferred by gift, if the gift must be reported on a federal gift tax return.

d) Elimination of Crummey Powers

The Obama Administration proposed eliminating the present interest requirement for gifts that qualify for the gift tax annual exclusion, and instead, define a new category of annual exclusion transfers (without regard to the existence of withdrawal or put rights), on which it would impose an annual limit of $50,000 per donor. Thus, a donor's transfers in the new category in a single year above $50,000 would be taxable, even if the total gifts to each individual donee did not exceed $15,000.

The new category would include transfers in trust (other than to a trust described in Section 2642(c)(2)), transfers of interests in passthrough entities, transfers of interests subject to a prohibition on sale, and other transfers of property that, without regard to withdrawal, put, or other such rights in the donee, cannot immediately be liquidated by the donee.

Note. This would expand and liberalize lifetime gifts for donors of moderate donative objectives. If you want to give away no more than $50,000 a year in partnership interests or gifts in trust, one would not need to worry about special withdrawal rights. One could make $15,000 gifts of cash or other assets (other than interests in passthrough entities, interests subject to a prohibition on sale, and property that cannot immediately be liquidated by the donee) to other donees, without limitation or worry about present interests.

e) Limit Dynasty Trusts to 90 Years

The Obama Administration proposed that the allocation of GST exemption to a transfer protect that transfer from GST tax for no more than 90 years. The Treasury explanation stated that, on the 90th anniversary of the creation of a trust, the GST exemption allocated to the trust would terminate and the inclusion ratio would move to one. Contributions to a trust from different donors are deemed to be held in separate trusts under Section 2654(b), and each such separate trust would be subject to the same 90-year rule, measured from the date of the first contribution by the grantor of that separate trust. The special rule for pour-over trusts under Section 2653(b)(2) would continue to apply to pour-over trusts and to trusts created under a decanting authority, and for purposes of this rule, such trusts will be deemed to have the same creation date as the initial trust, with one exception.

If trust property is distributed to a trust for a beneficiary of the initial trust during the initial 90-year period, and the distributee trust is as described in Section 2642(c)(2), the inclusion ratio of the distributee trust will not be changed to one, because of the distribution from the initial trust, by reason of this rule. This exception is intended to permit an incapacitated beneficiary's distribution to continue to be held in trust without incurring GST tax on distributions to the beneficiary if that trust is to be used for the sole benefit of that beneficiary and any trust balance remaining on the beneficiary's death will be included in the beneficiary's gross estate for Federal estate tax purposes.

The other rules of Section 2653 also would continue to apply and would be relevant in determining when a taxable distribution or taxable termination occurs after the 90th anniversary of the trust. An express grant of regulatory authority would be included to facilitate the implementation and administration of this provision.

This proposal would apply to trusts created after enactment, and to the portion of a pre-existing trust attributable to additions to such a trust made after that date (subject to rules substantially similar to the grandfather rules currently in effect for additions to trusts created prior to the effective date of the GST tax).

f) Limit/Eliminate GRATs

The Obama Administration proposed to limit the utility of grantor retained annuity trusts (GRATs) in several ways. (a) it proposed eliminating the use of short-term GRATs by requiring that all GRATs last for at least 10 years, and by imposing a maximum term of the grantor's life expectancy plus 10 years; (b) it proposed that all GRATs have a minimum remainder interest equal to the greater of 25% of the value of the transferred assets or $500,000 (but not more than the value of the contributed assets); (c) it would preclude the use of GRATs with decreasing annuity payments. This is necessary to protect the required minimum term, but it also eliminates a good planning technique by which GRATs made very large payments in the first year and smaller payments in the second year, setting the stage for a more aggressive rolling schedule; (d) it would prohibit a grantor from engaging in a tax-free exchange of any asset held by the GRAT. This would prevent the use of a substitution power, as described in Section 675(4)(C), to exchange volatile assets that have grown substantially in value while held by the GRAT, for assets with a more stable value.

g) Limiting Use of Health Education Exemption Trusts (HEETs) to Avoid GST Tax

Section 2503(e) states that direct payments (without limit) to the provider of medical care or tuition of a donee are not taxable gifts, and Section 2611(b)(1) states that "any transfer which, if made during the donor's life, would not be treated as a taxable gift by reason of section 2503(e)" is not a generation-skipping transfer, even if made to a skip-person. A Health and Education Exclusion Trust, or HEET, is a trust that provides for the medical expenses and tuition of multiple generations of descendants, free from imposition of the GST tax. The initial funding of a HEET is subject to gift tax, because the unlimited gift tax exclusion does not apply to transfers in trust, and the trust must give some bona fide beneficial interest to a charity or other nonskip-person beneficiary, to avoid having a GST tax imposed on the creation of the trust under the direct skip rules.

The Obama Administration's 2017 budget proposal would "clarify" that the Section 2611(b)(1) exclusion, like the Section 2503(e) exclusion, applies only to a direct payment by a donor to the provider of medical care or to the school in payment of tuition, and not to trust distributions, even if the distributions are made for those same purposes. Therefore, the proposal would render HEETs useless as devices to avoid the GST tax.

The proposal would apply to trusts created after the introduction of the bill proposing this change, and to transfers after that date made to trusts that are otherwise protected by the effective date rules. This proposal is projected to lose money over the next ten years, probably because without the GST tax incentive to create HEETs, taxpayers will not create them and will not pay gift tax or use applicable exclusion amount to create them.

Note. There appears to be no constitutional reason why these changes could not be retroactive to the beginning of the year in which it was enacted or, possibly, even earlier. See *United States v. Carlton*, 512 U.S. 26, 114 S. Ct. 2018, 2019, 129 L. Ed. 2d 22, 25 (1994); *Kitt v. United States*, 277 F.3d 1330 (Fed. Cir. 2001), *modified*, 288 F.3d 1355 (Fed. Cir. 2002); *NationsBank v. United States*, 269 F.3d 1332 (Fed. Cir. 2001), *cert. denied*, 537 U.S. 813 (2002); *Quarty v. United States*, 170 F.3d 961 (9th Cir. 1999); *U.S. Bank, N.A. v. United States*, 74 F. Supp. 2d 934, 935 (D. Neb. 1999). Politically, however, there is often substantial objection to a significant change in the tax law (other than the level of tax rates) being made retroactive, though often that objection is less if the changes are effective only from the date the legislation was first introduced.

3. Sen. Warren Proposes Substantial Estate, Gift and GST Tax Increases and Reforms to Pay for Housing Assistance. S. 1368, 117th Cong., 1st Sess. (April 26, 2021); H.R. 2768, 117th Cong., 1st Sess. (April 21, 2021)

Senator Elizabeth Warren (D-Mass.) has introduced S. 1368, the American Housing and Economic Mobility Act of 2021, a bill designed to make housing more affordable for many persons. To finance this expenditure, Sen. Warren proposes a series of estate, gift, and GST tax changes. At present, this bill has six co-sponsors, all of whom are or caucus with Democrats. An identical bill was introduced in the House of Representatives by Rep. Emanuel Cleaver (D-MO), and this bill has at this writing 13 co-sponsors, all of whom are Democrats.

a) Reduced Exemptions

These bills would reduce the basic exclusion amount (and, thereby, the GST exemption and gift tax lifetime exemption) to $3,500,000. Indexing of this exemption would be eliminated. There is no stated effective date for this change.

b) Increased Rates

These bills would very substantially increase the estate and gift tax rates to 55% on estates (or transfers) not over $13 million, 60% on estates (or transfers) over $13 million but not over $93 million, and 65% on estates (or transfers) over $93 million. They would also impose a 10% surtax on estates over

$1 billion and increase the GST tax rate to 65%. Again, there is no stated effective date for these changes.

c) GRATs

These bills would (i) require that all GRATs have a minimum term of 10 years, (ii) prevent decreases in the GRAT annuity rate during the first 10 years of the grantor's reserved annuity term, and (iii) require that the GRAT have a remainder worth at least 10% of the value of the assets transferred to the trust. These changes would apply to transfers made after the date of enactment of the act.

d) Including Grantor Trust Assets in the Deemed Owner's Gross Estate

These bills would include the value of assets held by a trust deemed owned by the grantor (under Sections 671-677 or 679), or by a third-party (under Section 678), in the deemed owner's gross estate at his or her death. Assets distributed to one or more of the beneficiaries during the deemed owner's lifetime would be treated as a taxable gift (presumably by the deemed owner, though the bill doers not specifically so state). Assets of a trust that ceases to be deemed owned by the deemed owner during his or her lifetime will also be treated as given to the trust beneficiaries. These rules would not apply to a trust that is already otherwise includible in the deemed owner's gross estate, nor would it apply to any other type of trust that the Secretary deems not to have a significant transfer tax avoidance purposes. Taxes imposed under this rule would be the obligation of the trustee. These changes would apply to trusts created on or after the date of enactment, and to any portion of a trust established before the date of enactment that are attributable to contributions made after the date of enactment. They also apply to any portion of a trust established before the date of enactment to the extent those assets have already been distributed to trust beneficiaries.

Note. These rules would apply both to grantor trusts and to trusts deemed owned by someone other than the grantor under Section 678, such as the typical beneficiary defective irrevocable trust (BDIT). If a person is deemed to own only a portion of a trust, these rules apply only to that portion. A special rule, however, states that a person other than the grantor who is the deemed owner of a trust under Section 678, is treated as the owner of the trust for purposes of estate tax inclusion only to the extent that he or she engages in a "sale, exchange, or comparable transaction" with the trust that is disregarded for income tax purposes. This will include not only the assets so transferred to the trust, but any accumulated income and appreciation in the value of those assets.

There is no exclusion for irrevocable life insurance trusts, virtually all of which are grantor trusts under Section 677(a)(3), because trust income may be "applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse." This problem cannot necessarily be solved prohibiting the trustee from using income to pay premiums. In PLR 8839008, the IRS distinguished fiduciary accounting income from gross or taxable income, and stated that Section 677(a)(3) refers to the latter. In that ruling, the trustee of an ILIT was prohibited from using income to pay premiums. The trustee paid them from fiduciary accounting principal, but the IRS stated that, because the premiums were greater than the trust's taxable income, the trustee was deemed to have used the income to pay the premiums, and the grantor was taxable on that income. Thus, unless clarified, this provision could eliminate the primary benefits of the irrevocable life insurance trust. This would be particularly problematic because the increased estate tax rates and reduced basic exclusion amount would create greater liquidity demands on a decedent's taxable estate, and ILITs have traditionally been the primary vehicle for meeting these liquidity demands. Perhaps the best solution in such a situation would be to create an ILIT, prohibit the use of income to pay premiums, and then: (i) fund the trust and keep the money in a non-interest bearing account for future use paying premiums; (ii) have the grantor pay the premiums directly to the insurer; or (iii) have the grantor give money to the trustee and have the trustee immediately pay the premiums (possibly keeping the money in a non-interest bearing account during the Crummey withdrawal period).

e) Dynasty Trusts

These bills would apply a GST inclusion ratio of 1, despite any application of the GST exemption, to any trusts other than a "qualifying trust." A trust would be a qualifying trust if it requires that the trust terminate not more than 50 years after its creation. A trust created before the date of enactment would be a qualifying trust for the first 50 years after the date of enactment. Where trust portions are treated as separate shares for GST tax purposes (Section 2654(b)(1)), each separate trust will be treated as having been created on the date of the first transfer to that trust under the separate share rules. Where a generation-skipping transfer involves property transferred from one trust to another, the date of the creation of the transferee trust will be the earlier of the date that trust was created. This provision would apply beginning with the date of enactment.

Note. This focuses on when the trust is required to terminate. A new dynasty trust, even if set according to the common law rule against perpetuities (lives in being plus 21 years) would have a GST inclusion ratio of 1, regardless of the donor's GST exemption. To get a GST exemption, you would have to provide expressly for the trust to terminate after 50 years.

f) The Annual Gift Tax Exclusion

These bills would impose an annual per donor limitation on annual exclusion gifts for certain transfers of two times the maximum annual exclusion. These transfers include transfers in trust, transfers of an interest in a passthrough entity, transfers of an interest subject to a prohibition on sale, or transfers that create no present interest, ignoring any withdrawal powers. These changes would apply to transfers after the date of enactment.

Note. These changes would not eliminate indexing of the annual exclusion, so it would remain (currently) $15,000 per donee. Presumably, you could use up the $20,000 limit for certain gifts to family members and then make outright gifts to use up the rest of your $15,000 annual exclusion. For example, if Donor gives gifts in trust for the benefit of four children, the annual exclusion available would be $30,000. Presumably, however, Donor could make an additional $30,000 in outright gifts to these same children, and still be within the annual exclusion.

4. Sen. Sanders and Rep. Gomez Propose Major Changes in Wealth Transfer Taxation. S. 994, 107th Cong., 1st Sess. (March 25, 2021); and H.R. 2576, 116th Cong., 1st Sess. (April 15, 2021)

Sen. Bernie Sanders (I-Vt.) and Rep. Jimmy Gomez (D-Cal.) introduced the "For the 99.5 Percent Act," which would reduce estate, gift, and generation-skipping transfer gift tax exemptions and exclusions, raise tax rates, and eliminate the tax benefits afforded by numerous estate planning techniques.

a) Rates and Exemptions

These bills would reduce the estate and GST exemptions to $3,500,000 with respect to estates of individuals dying after, to transfers made after December 31, 2021. It would not eliminate indexing of this figure. It would reduce the basic exclusion amount for gift tax purposes to $1,000,000, with respect to gifts made after December 31, 2021. It appears, though it is unclear, that the gift tax exemption would also be indexed for inflation.

Section 2 of these bills would also change the estate and gift tax rates to the following structure, raising the top rates to \ 45% on transfers of $3.5 million to $10 million, 50% on transfers of over $10 million and not over $50 million, 55% on transfers of over $50 million and not over $1 billion, and 65% on transfers of more than $1 billion, with respect to estates of individuals dying after and gifts made after December 31, 2021. The bill would also set the GST rate at a flat 77% -- the highest estate tax rate.

b) Increased Special Use Valuation Limit

These bills would increase from $750,000 to $3,000,000 the maximum amount that an estate can be reduced by special use valuation under Section 2032A for farm and closely-held business real estate. These changes would apply to respect to estates of individuals dying after and to gifts after December 31, 2021.

c) Estate Tax Rules for Conservation Easements

These bills would increase from $500,000 to $2,000,000 the estate tax deduction under Section 2031(c) for land subject to certain conservation easements. It would also permit a reduction of up to 60% of the gross estate, rather than 40% under current law. These changes would apply to respect to estates of individuals dying after and to gifts after December 31, 2021.

d) No Basis Step-Up for Property in a Grantor Trust

These bills would provide that property held in a trust of which the transferor is deemed to be the owner under the grantor trust rules, the assets of which are not included in the deceased grantor's gross estate for federal estate tax purposes, would not be eligible for a basis adjustment at the grantor's death under Section 1014. These changes would apply to respect to transfers after the date of enactment. This effective date suggests, however, that a contrary rule allowing a basis adjustment for such assets ought to apply with respect to transfers before the date of enactment.

e) Valuation Discounts

These bills would eliminate valuation discounts for nonbusiness assets held by an entity and eliminate lack-of-control discounts where the transferor, the transferee, and members of the family of the transferor and transferee control the business. These changes would apply to transfers after the date of enactment.

The elimination of valuation discounts is a relatively complex provision. First, the bill would require that, whenever one transfers an interest in a non-actively traded entity, the value of the entity's nonbusiness assets is determined as if they had been transferred outright, outside of the entity, with no valuation discounts. The interest is then valued as if the business had not held the nonbusiness assets. For this purpose, nonbusiness assets are any assets not used in the active conduct of a trade or business. With certain exceptions, passive assets, such as cash, cash equivalents, or debt or equity interests in another entity, are not treated as used in the active conduct of a trade or business. These bills would make exceptions for certain assets, such as) inventory or assets held for sale to customers in the ordinary course of a trade or business, depreciable business assets, and certain other assets enumerated in the bill. Passive assets can also be treated as used in the active conduct of a trade or business if they are real property used in a trade or business in which the taxpayer materially participates. Assets that are part of the reasonable working capital needs of a trade or business are treated as being used in the active conduct of the trade or business.

A look-through rule states that if a nonbusiness asset consists of a 10% interest in another entity, then the taxpayer is treated as holding 10% of the underlying assets of that other entity.

The Sanders-Gomez bills also state that for estate and gift tax purposes, no minority discount is available for interests in an entity that is not actively traded, if the transferor and the transferee and members of the families of either (as defined in the special use valuation rules of Section 2032A(e)(2), control or have a majority interest in the entity.

f) GRATs

These bills would require that a GRAT does not create a guaranteed annuity interest unless: (i) it has term that is at least 10-year, but not more than the grantor's life expectancy plus ten years; (ii) the annuity amounts do not decrease during the reserved annuity term; and (iii) the remainder interest has a value not less than the greater of 25% of the fair market value of the property in the trust or $500,000 (but not more than the fair market value of the trust property). These changes would apply to transfers after the date of enactment.

g) Grantor Trusts

These bills would require that the assets of a grantor trust: (i) be deemed to be includible in the deemed owner's gross estate for estate tax purposes; (ii) to the extent distributed to beneficiaries other than the grantor during the grantor's lifetime, will be treated as taxable gifts by the grantor; and (iii) the termination of grantor trust status during the grantor's lifetime will be treated as a gift of the remaining trust assets (to the extent deemed owned by the grantor). These rules will apply to whatever portion of a trust the grantor is deemed to own under the grantor trust rules, and to any portion of a trust deemed owned by someone other than the grantor under Section 678, if the deemed owner engages in a sale, exchange, or comparable transaction with the trust that is disregarded for income tax purposes. These rules would not, however, apply to a grantor trust or trust portion otherwise included in the grantor's gross estate.

These bills would also provide that any tax imposed on the assets of a grantor trust under these rules shall itself be a liability of the trust.

This section of the Sanders-Gomez bills applies to trusts created on or after the date of enactment, and to trust portions established before the date of enactment to the extent attributable to a contribution made on or after the date of enactment. It also applies to whatever portion of a trust deemed owned by someone other than the grantor under Section 678, if the deemed owner engages in a sale, exchange, or comparable transaction with the trust that is disregarded for income tax purposes.

Note. Unlike the 2017 proposals made by the Obama administration, these bills contain no express exclusion for irrevocable life insurance trusts (ILITs). Virtually all ILITs are grantor trusts under Section 677(a)(3), because trust income may be "applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse." This problem appears not to be resolvable by a trust provision prohibiting the use of income for this purpose and requiring that all premiums be paid from principal. In PLR 8839008, the IRS distinguished fiduciary accounting income from gross or taxable income and stated that Section 677(a)(3) refers to the latter. In that ruling, the trustee of an ILIT was prohibited from using income to pay premiums. The trustee paid them from fiduciary accounting principal, but the IRS stated that, because the premiums were greater than the trust's taxable income, the trustee was deemed to have used the income to pay the premiums, and the grantor was taxable on that income. Thus, unless clarified, this provision could eliminate the primary benefits of the irrevocable life insurance trust. This would be particularly problematic because the increased estate tax rates and reduced basic exclusion amount would create greater liquidity demands on a decedent's taxable estate, and ILITs have traditionally been the primary vehicle for meeting these liquidity demands. Perhaps the best solution in such a situation would be to create an ILIT, prohibit the use of income to pay premiums, and then: (i) fund the trust and keep the money in a non-interest bearing account for future use paying premiums; (ii) have the grantor pay the premiums directly to the insurer; or (iii) have the grantor give money to the trustee and have the trustee immediately pay the premiums (possibly keeping the money in a non-interest bearing account during the Crummey withdrawal period).

h) Limitation on GST Exemption

These bills would eliminate the GST exemption for transfers to a generation-skipping trust whose termination date is 50 years or more from the date of its creation, with respect to transfers after the date of enactment. A generation-skipping trust created before the date of the enactment would be deemed to be a qualifying trust for a period of 50 years after the date of the enactment.

Note. This focuses on when the trust is required to terminate. A new dynasty trust, even if set according to the common law rule against perpetuities (lives in being plus 21 years) would have a GST inclusion ratio of 1, regardless of the donor's GST exemption. To get a GST exemption, you would have to provide expressly for the trust to terminate after 50 years.

i) Gift Tax Annual Exclusion

These bills would preserve the $10,000 gift tax annual exclusion for the first transfers made by a taxpayer during the taxable year, but impose a $20,000 annual limit to all transfers: (i) made in trust; (ii) of an interest in a passthrough entity; (iii) of an interest subject to a prohibition on sale; and (iv) of property that, without regard to withdrawal, put, or other such rights in the donee, cannot immediately be liquidated by the donee. These changes would eliminate the use of Crummey withdrawal powers to create a present interest for annual exclusion purposes. These changes would apply with respect to all transfers made after the date of enactment.

Note. These changes do not eliminate indexing of the annual exclusion, so it would remain (currently) $15,000 per donee. Presumably, you could use up the $30,000 limit (2 x $15,000) for gifts to family members in trust, and then make outright gifts to use up the rest of your $15,000 annual exclusion. For example, if Donor gives gifts in trust for the benefit of four children, the annual exclusion available would be $30,000. Presumably, however, Donor could make an additional $30,000 in outright gifts to these same children, and still be within the annual exclusion.

Note. The Sanders bill has five co-sponsors, all of whom are Democrats, including Sheldon Whitehouse (D-RI), who is a member of the Senate Finance Committee. The Gomez bill has 36 co-sponsors, all of whom are Democrats.

5. Senate Bill Would Halve Estate, Gift, and GST Tax Rates. S. 1627, 117th Cong., 1st Sess. (May 13, 2021)

A bill was introduced in the Senate by Sens. Tom Cotton (R-Ark.), John Boozman (R-Ark.), and Joni Ernst (R-Iowa), to reduce the top estate, gift, and GST tax rates to 20%, effective for gifts, estates, and generation-skipping transfers made after December 31, 2020. This bill has two co-sponsors (both Republicans).

Note. An identical bill was introduced in the House of Representatives in 2020, sponsored by Rep. Jody Arrington (R-Texas). H.R. 5652, 116th Cong., 2d Sess. (Jan. 17, 2020). This bill has no co-sponsors. Both of these bills also exempt the bills from the budgetary effects of the tax reduction from the Pay-As-You-Go (PAYGO) rules established by the Statutory Pay-As-You-Go Act of 2010 and the congressional budget resolution.

6. Republicans Restart Attempt to Repeal the Estate Tax. S. 617, 117th Cong., 1st Sess. (March 9, 2021); H.R. 1712, 117th Cong., 1st Sess. (March 9, 2021)

The Death Tax Repeal Act of 2021, introduced by Senator John Thune, R-S.D., a member of the Senate Finance Committee, would repeal the estate and generation-skipping transfer taxes and modify gift tax computation. The act would be effective from the date of enactment. An identical bill, H.R. 1712, was introduced in the House of Representatives by Rep. Jason Smith (R-Mo.).

a) QDOTS

Despite the repeal of the estate and GST taxes, the estate tax would continue to apply to distributions from a qualified domestic trust made after the date of enactment with respect to the surviving spouse of a decedent who dies before the date of enactment.

b) Gift Tax

The gift tax would be preserved as a separate and independent transfer tax, imposed at rates from 18% on transfers not over $10,000 to 35% on transfers over $500,000, taking into the aggregate of account all taxable gifts made after 1976.

- A transfer shall be treated as a taxable gift for these purposes unless the transfer is made to a trust that is a wholly-owned grantor trust with respect to the grantor or his or her spouse.

- The lifetime gift tax exemption will $10,000,000 adjusted for inflation after 2-16 and rounded to the nearest multiple of $10,000.

c) Transition Rule

A transition rule would, for purposes of basis and the calculation of the gift tax, treats gifts made in the year of enactment as two separate gifts – one made in the calendar year ending with the date of enactment and the other made in the year beginning on the date after the date of enactment.

Note. S. 617 has 35 co-sponsors, all of whom are Republicans. H.R. 1712 has 147 co-sponsors, one of whom is a Democrat and the others of whom are all Republicans.

See also H.R. 822, 117th Cong., 1st Sess. (Feb. 4, 2021), which would simply repeal the federal estate tax effective for estates of decedents dying after December 31, 2020. This bill was introduced by Rep. Robert E. Latta (R-Ohio), and it has four co-sponsors, all of whom are Republicans.

7. Senate Bill Would Make TCJA 2017 Changes Permanent. S.126, 117th Cong., 1st Sess. (Jan. 28, 2021)

Senator Ted Cruz (R-Tx) introduced S. 126, which would make permanent all of the individual provisions of the 2017 Tax Cuts and Jobs Act. Those provisions, including the increased estate tax applicable exclusion amount and lifetime gift tax exemption amount and GST exemption, will otherwise expire on December 31, 2025. This bill has three co-sponsors, all of whom are Republicans.

B. IRC § 2010. Unified Credit & Portability

1. Basic Exclusion Amount Adjusted for Inflation. Rev. Proc. 2020-45 § 3.41, 2020-46 I.R.B. 1016 (Nov. 9, 2020)

The IRS announced that the basic exclusion amount for will be $11,700,000 and the unified credit for 2021 will be $4,625,800.

2. Executor Can Make Late Election of Portability if Estate is Under the Filing Threshold. PLRs 202134015 (Aug. 27, 2021); 202134014 (Aug. 27, 2021); 202134011 (Aug. 27, 2021); 202134009 (Aug. 27, 2021); 202134008 (Aug. 27, 2021); 202134002 (Aug. 27, 2021); 202134001 (Aug. 27, 2021); 202133009 (Aug. 20, 2021); 202133002 (Aug. 20, 2021); 202121003 (May 28, 2021); 202120002 (May 21, 2021); 202120007 (May 21, 2021); 202115001 (April 16, 2021); 202108007 (Feb. 26, 2021); 202107003 (Feb. 19, 2021); 202046006 (Nov. 13, 2020)

In each ruling, D died survived by Spouse. The Form 706 for D's estate was due on Date 2, but the estate did not file a timely return to make the portability election. The estate discovered its failure to elect portability after the due date for making the election. The value of D's gross estate is less than the basic exclusion amount in the year of D's death, including taxable gifts made during his lifetime. The IRS noted that Reg. § 20.2010-2 states that an estate that elects portability will be considered, for estate tax purposes to be required to file a return under Section 6018(a), so that the due date of the return required to elect portability is 9 months after the decedent's date of death or the last day of the period covered by an extension (if an extension of time for filing has been obtained). Reg. § 301.9100-1(c) provides that the IRS may grant a reasonable extension of time to make a regulatory election, if the taxpayer provides evidence to establish to the satisfaction of the IRS that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government. Accordingly, Reg. § 301.9100-3 provides that a request for relief will be granted if the taxpayer establishes to the satisfaction of the IRS: (a) that the taxpayer acted reasonably and in good faith, and (b) that granting relief will not prejudice the interests of the government. Reg. § 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer and the tax professional failed to make, or advise the taxpayer to make, the election.

Note. For portability elections, the IRS appears not to require that the executor have relied on a professional who made an error, though it is useful to note where this has occurred. In most rulings, the executor merely states that they did not file the return on time and that the return was below the filing threshold. It is unclear how long the IRS will remain so lenient.

Also, these rulings do not permit a late portability election when the estate is over the filing threshold, even if no estate tax was owed due to the marital, charitable, or other deductions. Section 9100 relief will not currently be allowed in such cases.

Rev. Proc. 2017-34, 2017-26 I.R.B. 1282 (June 26, 2017) permits taxpayers to file a late estate tax return to elect portability, if:

- the personal representative files a complete and properly prepared estate tax return (Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return), by the second annual anniversary of the decedent's death;
- the executor states at the top of the form that the return is "FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A)";
- the decedent was survived by a spouse;
- the decedent died after December 31, 2010;
- the decedent was a U.S. citizen or resident on the date of death;
- the executor is not otherwise required to file an estate tax return because the gross estate is less than the filing threshold under Section 6018(a); and
- the executor did not file a timely estate tax return.

This new procedure cannot be used for estates that are above the filing threshold, even if no tax was due because of the marital or charitable deduction. An executor who fails to file under this procedure within the first two years after the date of death can still request relief by filing a private letter ruling request.

C. IRC §§ 2031, 2032, 2032A, 2033 and 7520. Valuation

1. Tax Court Values Intangibles Owned by Michael Jackson's Estate. *Estate of Michael J. Jackson v. Comm'r*, T.C. Memo. 2021-48 (May 3, 2021)

Pop icon Michael Jackson died in June 2009, holding an impressive assortment of tangible and intangible assets, including his large estate, Neverland, his costumes, and his interests in two entities that acquired and exploited various music, including the Beatles' archive, materials written by Jackson, and materials from other artists. The executors settled with the IRS regarding the valuation of tangible assets and some intangible assets, but could not reach an accord with the government respecting three assets: (a) Jackson's image and likeness; (b) his interest in New Horizon Trust II, through which he held an interest in Sony/ATV Music Publishing, LLC, which published music of various other artists, including the Beatles; and (c) his interest in New Horizon Trust III, the major asset of which was Mijac Music, a music-publishing catalog company that owned the copyrights to compositions that Jackson wrote or cowrote, and some compositions by other songwriters. The executors valued the entire estate at $7.2 million; the IRS valued it at $1.125 billion. The estate assessed a $505 million deficiency and $197 million in penalties.

The Tax Court (Judge Holmes) generally sided with the estate's valuations on two of the three assets. At trial, the estate valued the right to exploit Jackson's likeness and image at $3.1 million, based on capitalizing its projected revenue stream. (On the estate tax return, the estate valued these rights at $2,105.) The IRS valued these rights at $161.3 million. The battling experts agreed to value the asset based on the present discounted value of its future revenue stream, but the experts disagreed both on the proper discount rate and the projected revenue stream. (The IRS expert's views suffered by the fact that he committed perjury during his testimony before the court, claiming that he had never worked for the IRS before when, in fact, he had done so and the taxpayer's counsel clearly established it. Nonetheless, the court refused to strike the testimony of the IRS expert in its entirety.) The Tax Court described the IRS expert's valuation as a fantasy that failed to consider adequately Jackson's very poor personal reputation at his death. The court valued the right to Jackson's image and likeness at $4.2 million. The estate valued NHT II as zero, noting that the trust's liabilities exceeded the value of its assets; the IRS expert valued it at $206.3 million. Seven years after Jackson's death, the estate sold this interest to Sony for $750 million. The court agreed with the estate that NHT II had liabilities exceeding its assets on the date of death, and that the price paid was attributable to circumstances that changed after Jackson's death. The estate fared worse in valuing its interest in NHT III. The court stated that Mijac was the most difficult asset to value because its income derives from five different groups of songs, and each group produces income from three different sources. At trial, the estate valued NHT III at $2.3 million and the IRS valued it at $114.3 million. The Tax Court valued it at $107.3 million. The court refused to impose penalties, because the estate had correctly valued NHT II and had reasonable cause for its other valuations.

Note 1. This appears to be the first Tax Court case examining how to value the right to a decedent's image and likeness. If you represent famous people, this may be an issue of special importance.

Note 2. The Tax Court refused to use tax-affecting for the revenue stream from which it valued the various assets, stating that merely because it was not at all certain that the hypothetical buyer of these assets would be a C corporation that would take its potential taxes on the distribution of earnings into account in determining the sales price. The court discussed and distinguished *Estate of Jones v. Comm'r*, T.C. Memo. 2019-101, at *41-*42, in which tax affecting was allowed for a sale by a pass-through entity, noting that in *Jones* both parties agreed that a hypothetical buyer and seller would take into account the form of business entity in determining the fair market value of a limited-partnership interest. The court stated that "the Estate has failed to persuade us that a C corporation would be the hypothetical buyer of any of the three contested assets." T.C. Memo. 2021-48 at *81.

Note 3. Jackson's estate was represented by the California firm of which IRS Commissioner Charles Rettig was a member. Mr. Rettig withdrew as counsel for the estate while his nomination was awaiting confirmation, though they did not agree on either the discount rate or the future revenue stream.

2. Section 2032A Limitation Adjusted for Inflation. Rev. Proc. 2020-45 § 3.42, 2020-46 I.R.B. 1016 (Nov. 9, 2020)

An estate can reduce the estate tax value of qualifying real property used in a farm or business and valued under Section 2032A, by up to $1,190,00 for estates of decedents dying in 2021.

3. IRS Provides Interest Rates for Valuing Farmland in Decedent Estates. Rev. Rul. 2020-18, 2019-35 I.R.B. 668 (Aug. 26, 2019)

The IRS published a list of the average annual effective interest rates on new loans under the Farm Credit System, and the states within each Farm Credit System Bank Territory. These figures are used under Section 2032A(e)(7)(A)(ii) to compute the special use value of real property used as a farm for which a special use valuation election is made. The 2019 interest rates for the five Farm Credit System Bank Chartered Territories 5.27% for AgFirst FCB, 4.68% for AgriBank FCB, 4.37% for CoBank, and 5% for Texas. The ruling also includes a list of the states in each of the Farm Credit System Bank Chartered territories.

D. IRC §§ 2036 - 2038. Transfers with Retained Beneficial Enjoyment or Retained Control over Beneficial Enjoyment

1. Some Favorable Estate Tax Treatment of Intergenerational Split-Dollar Life Insurance Upheld, Along with Some Unfavorable Tax Treatment. *Estate of Morrissette v. Comm'r*, T.C. Memo. 2021-60 (May 13, 2021)

Clara M. Morrissette's revocable trust held her shares in the family's corporation, Interstate Group Holdings, Inc. (IGH), which owned and operated Interstate Van Lines. Clara was the initial trustee, but her three sons were added as co-trustees when she reached an advanced age and her health deteriorated. In 2006, the revocable trust was amended to permit the trustee to enter into an intergenerational split-dollar life insurance arrangement under which it paid the premiums on policies of insurance on the lives of Clara's children, with the policies owned by dynasty trusts for her children and their descendants. The revocable trust, the three dynasty trusts, Clara's brothers-in-law, and some other trusts entered into a buy-sell agreement, under which, on the death of any of the three sons, the remaining sons and their dynasty trusts would buy the deceased's IGH stock. To fund the buy-sell agreement, each of dynasty trust bought a universal life insurance policy on the life of each other son. The revocable trust entered split-dollar insurance agreements with three dynasty trusts. The revocable trust contributed $29.9 million to the three dynasty trusts to enable them to buy universal life insurance policies on each of the sons. The revocable trust would receive a portion of the death benefit from each policy equal to the greater of the cash surrender value of the policy or the aggregate premium payments on that policy. Each dynasty trust would receive the balance of the death benefit, which would be available to fund the purchase of the stock owned by or for the benefit of the deceased. The split-dollar agreements included a recital that the parties intended that the agreements be taxed under the economic benefit regime, rather than the loan regime, and that the only economic benefit provided to the dynasty trusts was current life insurance protection. The dynasty trusts executed collateral assignments of the policies to the revocable trust to secure their obligations under the split-dollar agreements. None of the trusts had the right to borrow against a policy held under this agreement. Clara reported gifts to the trusts for the 2006–2009 tax years using the economic benefit regime. After Clara's death, the IRS determined a gift tax deficiency and penalty against the estate, treating the entire $29.9 million as a gift in 2006. The estate challenged the deficiency in the Tax Court and sought partial summary judgment regarding whether the split-dollar agreements were governed by the economic benefit regime.

The Tax Court (Judge Goeke) granted the partial summary judgment, holding that (1) the agreements in this case were clearly split-dollar life insurance agreements because the revocable trust paid part of the premiums and was entitled to recover, at a minimum, all of those premiums paid, and because this recovery would be made from, or at least was secured by, the proceeds of the policies; (2) the dynasty trusts owned the policy but, under the regulations, the economic benefit regime applied because the agreement was donative in nature and the only economic benefit provided under the agreement to the donee was the current life insurance protection. Reg. § 1.61-22(c)(1)(ii)(A)(2); see also TD 9092, § 5, 2003-2 CB 1055, 1062; (3) the value of the economic benefits provided to the nonowner for a taxable year under the agreement is equal to the sum of the cost of current life insurance protection, the amount of cash value to which the nonowner has current access during the year, and any economic benefits not otherwise described that are provided to the nonowner. Reg. § 1.61-22(d)(2). *Estate of Morrissette v. Comm'r*, 146 T.C. 171 (2016) *(Morrissette I).*

In a second opinion, the Tax Court (Judge Goeke), the IRS sought to include the $30 million in premium payments or the $32.6 million in cash surrender value in Clara's gross estate under Sections 2036 and 2038, as well as including the revocable trust's rights under the split-dollar agreement. The IRS argued that the revocable trust, through the split-dollar agreement, had retained rights in the transferred funds includible under Sections 2036 and 2038. The Tax Court applied the same analysis in *Morrissette II* that it had applied in *Estate of Powell v. Comm'r*, 148 T.C. 392 (2017), that the bona fide sale exception requires both (1) a legitimate and significant nontax purpose and (2) adequate and full consideration for money or money's worth. The court stated that Section 2036 and 2038 adopt a broader definition of "sale," that includes transactions that are not commonly categorized as sales; they require only a voluntary act of transferring property in exchange for something. *Estate of Bongard v. Comm'r*, 124 T.C. 95, 113 (2005); *Estate of Stone v. Comm'r*, T.C. Memo. 2003-309. Here, the revocable trust voluntarily and in good faith transferred money to the dynasty trusts in exchange for a right to repayment, which is a sale for this purpose. The court then held that the transfer of premiums had a legitimate and significant nontax motive for entering into the split-dollar agreement. Assuring the control and succession of an active closely-held business is a legitimate nontax purpose, Clara sought to maintain control over the company and to pass that control on to her sons and future generations, and the split-dollar agreements were instrumental in accomplishing these objectives. Citing *Estate of Bigelow v. Comm'r*, 503 F.3d 955, 972 (9th Cir. 2007), *aff'g* T.C. Memo. 2005-65; *Estate of Strangi v. Comm'r*, 417 F.3d at 481; *Estate of Reynolds v. Comm'r*, 55 T.C. 172, 194 (1970). The court acknowledged that the split-dollar agreements were also part of an estate tax saving strategy, but the existence of a tax motivation does not negate the existence of a legitimate nontax motive. One son "who made most decisions relating to the split-dollar agreements, credibly testified that he would have engaged in the split-dollar agreements even if they had not provided any estate tax saving because of the nontax financial benefits that they provided." T.C. Memo. 2021-60 at *78. The court held that the revocable trust had received adequate and full consideration in money or money's worth for its premium payments, but that, unlike the question of fair market value, the adequacy of consideration is not defined on the basis of a willing buyer and willing seller and is not judged from the perspective of hypothetical persons. *Kimbell v. United States*, 371 F.3d 257, 266 (5th Cir. 2004). Adequacy of consideration requires that the consideration be similar to that which two unrelated persons would provide after negotiating at arm's length. *Estate of Bongard*, 124 T.C. at 122-123. The key is whether the exchange is an informed trade, and investors may desire an asset for features other than its fair market value, such as "management expertise, security or preservation of assets, and capital appreciation." *Estate of Thompson v. Comm'r*, 382 F.3d 367, 381 (3rd Cir. 2004), *aff'g* T.C. Memo. 2002-246. Here, the split-dollar agreements provided financial benefits other than the ability to sell or collect immediately on the split-dollar rights, including repayment plus inside buildup, management succession, and efficiency and capital accumulation. The court noted that in this case, the estate tax saving was achieved not through execution of the split-dollar agreements alone, but rather through the undervaluation of the split-dollar rights. In exchange for $30 million, the dynasty trusts agreed to buy life insurance and repay the revocable trust and Clara still held the contract rights at the time of her death. However, she no longer had use of or access to the $30 million. Thus, the split-dollar agreements changed the nature of the revocable trust's relationship with the funds that it had transferred. The court also held that Section 2703(a) did not apply to this arrangement, in a very rare victory for the taxpayer under this section. The court held that the split-dollar agreements were part of a *bona fide* business arrangement, not a device to transfer property at less than adequate and full consideration, and that its terms were comparable to similar arrangements entered into at arm's length. The court found that the transaction was a bona fide business agreement because it furthered a business purpose. *Amlie v.*

Comm'r, T.C. Memo. 2006-76. Some facts indicated a testamentary purpose for the split-dollar agreements, but that the mutual termination restriction was not itself a device because the consideration received by the transferor was fair. See *Estate of True v. Comm'r*, T.C. Memo. 2001-167, *aff'd*, 390 F.3d 1210 (10th Cir. 2004). The taxpayer was less successful in sustaining a $7.5 million valuation for the decedent's rights under the split-dollar agreements. The parties' experts differed on both computation of the probability-adjusted expected values of the policies and the applicable discount rates, but mostly on the second. The court accepted the discount rates of 8.85% and 6.4% (different rates for different insurers) proposed by the government's expert, finding that they more accurately reflected the risk that the insurers would default on their payment obligations under the policies. More importantly, the court agreed with the government that the sons likely intended to terminate the split-dollar agreements on December 31, 2013 (when the statute of limitations on estate tax deficiencies regarding Clara's estate return expired), and that this should be deemed to be the maturity date of the policies, producing a fair market value of $27,857,709. The court noted that the revocable trust agreement provided that the split-dollar rights would be divided among the respective dynasty trusts that owned the underlying policies, which would give the dynasty trusts full control over the policy and allow them to terminate the agreements on December 31, 2013.

Note 1. The court also sustained a 40% gross valuation misstatement penalty with respect to the valuation of the split-dollar agreement rights held by Clara's estate. It rejected claims that the penalties were never approved by the agent's supervisors, as required under Section 6751(b). While the approval had been done without great formality, such formality is not required and the court found adequate evidence to sustain the penalty as having been approved. The court also held that the estate had not reasonably relied on the opinions of its valuation experts. Reliance on professional advice may provide a reasonable cause defense if, under all the circumstances, the reliance was reasonable and in good faith. *Neonatology Assocs., P.A. v. Comm'r*, 115 T.C. 43, 98-99 (2000), *aff'd*, 299 F.3d 221 (3d Cir. 2002). The court stated that the estate's $7.5 million appraisal was not reasonable and the sons should have realized it.

Note 2. *Morrissette II* suggests that intergenerational split-dollar life insurance arrangements may work, though only in certain specific situations. First, there must be a bona fide nontax purpose for the arrangement. There was none in *Cahill*, but the business succession issues in *Morrissette II* provided a clear and substantial nontax purpose. Once such a purpose exists, the co-existence of tax motivations may not be a problem.

Second, the planned disposition of the decedent's rights under the split-dollar agreement to the trusts for the insureds and their descendants proved problematic in *Morrissette II*. This was the basis by which the Tax Court valued the retained rights under the split-dollar agreements at a figure far in excess of the actuarial value that the taxpayer reported on the decedent's estate tax return. Had these rights be left to, for example, a common trust fund for the descendants of the deceased, rather than to separate trusts that owned the policies themselves, a different and more favorable result might have been achieved.

Third, Section 2703, while devastating in *Cahill*, was surmounted by the taxpayer in Morrissette II principally because of the existence of a clear and substantial nontax business purpose for the agreements. One would, of course, still would have to establish that the terms of the agreement are comparable to similar arrangements entered into by persons in an arms' length transaction, but it seems likely that this will be relatively easy to overcome if there is a substantial nontax business purpose for the agreements.

Fourth, the decedent's arguments in *Cahill* were weakened because the transaction was negotiated between the trustee of the revocable trust (the decedent's son and attorney-in-fact) and his cousin (the trustee of the MB Trust). The transaction would have had far more credibility were the trustees independent and unrelated to each other. Obviously, this increases the cost of the transaction, but it is a small price to pay to give the arrangement a far more bona fide appearance.

Fifth, the use of a third-party loan to pay the life insurance premiums is not inherently inappropriate or disqualifying, but the existence of sufficient personal assets to make these payments was cited favorably by the court in *Morrissette II*. Also, it is likely that the lender required that the decedent in *Cahill* have the right to terminate the agreement, at a minimum with the consent of the trustee of the MB Trust. Also, the existence of the loan raises the presumption that the donor anticipates getting the cash out of the policy not later than when the loan becomes due. Thus, it is better if the premiums are paid from assets already held by the expected decedent, or from money borrowed against assets other than the policy.

2. Assets of Family Limited Partnership Included in Decedent's Gross Estate Despite Pre-Death Sale to Third Parties; Other Aspects of Estate Plan and Administration Fail to Achieve Desired Results. *Estate of Moore v. Comm'r,* T.C. Memo. 2020-40 (April 7, 2020)

Howard Moore was elderly and had suffered a recent heart attack when he executed an estate plan designed by his attorney, including a Living Trust, a Charitable Lead Trust (CLT), a Children's Trust, a Management Trust, an Irrevocable Trust, and a Family Limited Partnership (FLP). The Management Trust was the general partner of the FLP and held a 1% general partnership interest. The other partners were the Living Trust (95% limited partnership interest) and each of Howard's four children (a 1% limited partnership interest). Howard transferred his farm to the Living Trust which promptly transferred 4/5 of the farm to the FLP. Five days later, Howard sold the farm for $16.5 million. After the sale Howard continued to live on the property and to operate the farm. The FLP also paid $2 million to the Living Trust to cover Howard's income taxes and various expenses. The CLT was funded from the Living Trust at Howard's death, and makes distributions to the Moore Foundation, which then makes payments to the Community Foundation for Southern Arizona, to be divided among several charities in accordance at the recommendations of the directors of the Moore Foundation. The Living Trust was required to pay the

CLT an amount of assets sufficient to provide a deduction that would minimize Howard's estate tax liability. The Children's Trust was funded at Howard's death from the Living Trust, in an amount equal to Howard's remaining applicable exclusion amount. Each child received an equal share in trust, though specific assets were allocated to some of the children's shares. The Irrevocable Trust made distributions to Howard's four children according to their needs with no requirement of equal distributions. The trustee of the Irrevocable Trust had to pay the Living Trust an amount equal to any portion of the Irrevocable Trust that was included in Howard's gross estate. After Howard's death, the FLP made transfers to the Irrevocable Trust for retransfer to the CLT. The FLP also paid $500,000 to each of the children, in exchange for a promissory note requiring repayment by a set date with interest accruing at the rate of 3.6%. None of the children made payments of principal or interest on the loans and the FLP made no effort to collect. The Living Trust transferred its entire FLP interest to the Irrevocable Trust for $500,000 cash and a $4.8 million note bearing 4.5% interest with a principal due date in five years. The parties stipulated that the cash downpayment of $500,000 was made with the gift to the Irrevocable Trust in the previous month. The Irrevocable Trust never made any interest or principal payments on the note. Howard died at age 89 and the Living Trust paid many of his final expenses. The Living Trust paid $475,000 to Howard's lawyer for the administration of the estate, in addition to his substantial fees for designing the estate plan. The IRS audited the estate and assessed a deficiency, arguing that the value of the farm should be includible in Howard's gross estate despite, the transfer of the Living Trust's FLP interest to the Irrevocable Trust did not remove that value from the gross estate, Howard's estate cannot deduct a $2 million debt to the FLP, future charitable contributions, or $475,000 in attorney's fees, and that Howard's transfers of $500,000 to each of his children were gifts, rather than loans.

The Tax Court (Judge Holmes) held for the government on all issues. The court held that the farm was includible in Howard's gross estate under Section 2036(a), finding that the FLP was not created by a *bona fide* sale for adequate and full consideration because Howard had no significant nontax purpose for creating the FLP. *Estate of Bongard v. Comm'r*, 124 T.C. 95, 112 (2005). The court rejected the argument that Howard formed the FLP to bring his family together so that they could learn how to manage the business without him. Howard sold the farm five days after he transferred 4/5 of it to the FLP, so there was no business for the family to run. Also, Howard knew a month before the sale closed that he would sell the farm. The only assets of the FLP were liquid assets managed by an investment adviser. After a start-up meeting, the family held no management meetings. The court rejected asset protection as a motive because there was no credible evidence of a legitimate concern with possible creditor claims. The court also noted that: (a) the FLP was created when Howard had significant health problems; (b) the FLP was created after Howard consulted a lawyer about planning to "save the millions of dollars of taxes;" and (c) there were no negotiations or bargaining among the partners when the FLP was created. The court held that Howard retained beneficial enjoyment of the farm by continuing to live on and operate the farm and using FLP assets to pay personal and estate expenses. Furthermore, Howard's children, who were in control of the FLP, did whatever he asked them to do, suggesting an implicit understanding. Following *Estate of Powell v. Comm'r*, 148 T.C. 392 (2017), the court stated that Section 2043(a) requires that the value of the assets transferred to the FLP to which Section 2036(a) applies, be reduced by the value of the FLP interest included in the gross estate under Section 2033, to prevent double counting. The court applied a complicated mathematical formula to determine the adjustment under Section 2043(a) and explained that it had to reflect the changes in value of the FLP assets and the FLP interests from the time the assets were transferred to the FLP, and the value of FLP assets used to pay debts and expenses of Howard. The FLP had paid $500,000 to each of the children, in exchange for a promissory note requiring repayment by a set date with interest accruing at the rate of 3.6%. Examining the payments, the court held that they were not loans because there was no *bona fide* indebtedness; there was no principal repayment, no fixed payment schedule, no interest payments, no evidence that the children had assets from which to repay the loans, and the loan was unsecured. The court also found that the $2 million paid by the FLP to the Living Trust, to pay Howard's income taxes and other expenses was not a bona fide loan, and thus must be taken into account in determining the gross estate offset under Section 2043.

Note. The court also held that the estate would not get additional charitable deductions for additional charitable lead payments caused by any increase in the value of Howard's estate as determined at audit and litigation. The court noted that the actual language of the Irrevocable Trust required the trustee to distribute to the CLT "an amount equal to the value of any asset *<u>of this trust</u>* which is includible in my gross estate for federal estate tax purposes" (emphasis added). The IRS and the court had increased the value of Howard's farm, which was not an asset of the Irrevocable Trust, thus not compelling an additional payment. The court also noted that there is no deduction for payment that depend on the actions of a fiduciary or beneficiary or other person, and that the charitable deductions must be ascertainable on a decedent's date of death. The court stated that whether additional payments would be made to the CLT depended on the actions of the IRS and the court and were not, therefore, ascertainable at Howard's death. The court rejected an analogy to the defined value gift cases. *Estate of Christiansen v. Comm'r*, 586 F.3d 1061 (8th Cir. 2009), *aff'g* 130 T.C. 1 (2008); and *Estate of Petter v. Comm'r*, 653 F.3d 1012 (9th Cir. 2011), *aff'g* T.C. Memo. 2009-280. The court stated that Howard's estate plan involved whether there would even be any transfer of property to the CLT, rather than the mandatory transfer of an asset of uncertain value. This analysis, however, logically would appear to preclude any type of formula marital or charitable bequest that was based on the facts as ultimately determined with respect to the estate. Thus, on appeal, this part of the opinion should be reversed.

The court also denied an estate tax deduction for the payments to Howard's attorney for his work on the estate because the estate provided no information on what precisely the attorney had done. The attorney could not detail what he had done, stating only that the fee was a set amount and that the work was continuing. This was a problem, because the reasonableness of an attorney's fees for services rendered to an estate always requires a careful consideration of what services were actually rendered. Furthermore, if the attorney's fees were not deductible, then the estate would have to offset them with part of its unified credit, leaving less credit to shelter from estate tax the bequests and devises to estate beneficiaries.

E. IRC § 2055. Charitable Deduction

Two Plus Two Equals Three – Deduction Value of Charitable Dispositions of Minority LLC Interest is Less than Gross Estate Value of Controlling Interest. *Estate of Warne v. Comm'r,* T.C. Memo. 2021-17 (Feb. 18, 2021)

Miriam Warne gave her sons and granddaughters minority interests in five LLCs that held real estate and ground leases on real estate. Miriam retained reduced but controlling interests in the LLCs at her death through her family trust, the assets of which were includible in her gross estate for estate tax purposes. At Miriam's death, the family trust left her children the remaining interests in most of the LLCs and left 25% of one LLC to a church and 75% of that same LLC to a family foundation. On examination, the IRS assessed deficiencies based on increasing the gift tax value of the gifts and the estate tax value of the remaining LLC interests. The IRS also insisted that the interests left to the two charities must both be discounted, even though Miriam's family trust held 100% of those interests at Miriam's death. The IRS reduced the charitable deduction by $4.2 million.

The Tax Court (Judge Buch) reviewed the professional appraisals presented by both the estate and the IRS, and found fault with both, determining for itself the correct valuation of the assets held by the LLCs and the discounts for lack of marketability and control reflected in the various transfers. The court valued the leased interests held by the LLCs interests in which were given to the sons and granddaughters and the interests in those same LLCs included in the decedent's gross estate at a figure higher than that reported by the donor but lower than that sought by the government, because: (a) the court favored the yield capitalization valuation approach over the direct capitalization approaches on leaseholds; (b) it valued the underlying fee simple interest on one of the leaseholds without consideration of risk when using comparable properties to value the interests; (c) it averaged the two appraisals valuations of certain comparable properties, which were relatively close; and (d) it adopted the estate's discount rate, which it found reasonable. The court selected a 4% discount for lack of control, because: (i) it court agreed with the estate that the discount for lack of control for the majority interests held by the family trust should be low, where the operating agreements granted the majority interest holder powers such as the ability to dissolve the LLCs unilaterally and to appoint and remove managers, citing *Estate of Jones v. Comm'r*, 116 T.C. 121, 135 (2001); *Estate of Streighthoff v. Comm;r*, T.C. Memo. 2018-178, at *4-*5, *23, *aff'd*, 954 F.3d 713 (5th Cir. 2020); (ii) it rejected the 2% discount proposed by the government's expert, because it was based on closed end mutual funds, which the court stated were too dissimilar from the LLCs in this case to be reliable; and (iii) it rejected the 5% to 8% discounts proposed by the estate's expert, because he did not provide the court with information regarding the size and makeup of the sample that he used to produce this discount range and because he selected a higher discount because of a concern about potential litigation, the existence of which was speculative. The court allowed a 5% discount for lack of marketability of the LLCs interests. The court noted that the estate's appraiser was more credible with additional metrics and a more thorough explanation of his process than that provided by the government's expert. For reasons not explained, the court believed that the discount should be at the lower end of the range suggested by the estate's appraiser. The most important issue addressed by the court, however, was whether there should be discounts for lack of control and marketability applied to the shares of the single-member LLC that were left to the two charities. The court discussed *Ahmanson Foundation v. United States*, 674 F.2d 761 (9th Cir. 1981), in which a decedent left the only voting share of the stock of a corporation to his son and all of the nonvoting shares to a charitable foundation, and the Ninth Circuit held that "[t]here is nothing in the statutes or in the case law that suggests that valuation of the gross estate should take into account that the assets will come to rest in several hands rather than one." *Ahmanson Foundation,* 674 F.2d at 768. The court there explained that the value of a 100% interest includible in the gross estate cannot be discounted for lack of control and may be slightly discounted for lack of marketability, but the value of the nonvoting stock had to bear a substantial discount for lack of control and lack of marketability. The court did not require that the valuation used to in the gross estate calculation be the same as that used in the calculation of a charitable deduction, because the latter "is subject to the principle that the testator may only be allowed a deduction for estate tax purposes for what is actually received by the charity--a principle required by the purpose of the charitable deduction." *Ahmanson Foundation,* 674 F.2d at 772. The Tax Court refused to adopt a different position merely because the entirety of the LLC in question was left to charities. The parties stipulated that a 27.385% discount was appropriate for the 25% interest and a 4% discount for the 75% interest.

Note. The principle that the value of an asset for purposes of measuring the gross estate need not reflect the testator's decision to leave the asset to more than one beneficiary, while its value for purposes of a deduction of a partial interest must reflect the effects of that division on the value received by the charity or spouse, is firmly established. See also *Estate of Chenowith v. Comm'r,* 88 T.C. 1577 (1987) (marital deduction valued at a premium for 51% block of the stock of a wholly-owned corporation, while nonmarital share valued at a discount for minority interest); and *Estate of DiSanto v. Comm'r,* T.C. Memo. 1999-421 (marital deduction valued at a discount where surviving spouse disclaimed part of a control block of stock, reducing the marital gift to a minority interest).

Ahmanson Foundation and *Estate of Warne,* however, raise a scary proposition. Assume that decedent dies with a $75 million estate all of which is a substantial controlling interest of an LLC. Assume, furthermore, that decedent leaves the entire estate equally to two charities, or equally to a spouse and a charity. The decedent's gross estate would be valued with little or no discounts for lack of marketability and control, but all of the deductions for the residuary gift would be calculated with a significant discount. If *Estate of Warne*'s 27.385% discount were applied and the decedent's entire $11.7 million applicable exclusion amount were available at death, a $3,491,800 estate tax would be due on an estate passing entirely to charity or to charity and a surviving spouse. This could be avoided by dividing the LLC into two identical entities during life, and then leaving one to each of the residuary beneficiaries. After death, it is unclear that any strategy would avoid this problem.

F. IRC § 2056. Marital Deduction

Religious Divorce and Israeli Marriage Constitute a Valid Marriage for Estate Tax Purpose. *Estate of Grossman v. Comm'r*, T.C. Memo. 2021-65 (May 27, 2021)

Semone Grossman and Hilda Matrick were both Jewish. They had married in New York in 1955 and had separated in 1965. In 1967, Semone obtained an *ex parte* divorce in Mexico, after which he married Katia in a civil ceremony in New Jersey. Katia was not Jewish. Semone separated from Katia in 1974, after which Hilda sued both Semone and Katia and obtained a judgment declaring that the Mexican divorce and Semone's marriage to Katia were both invalid under New York law and that Semone was still legally married to Hilda. Hilda and Semone did not reconcile or cohabit after that. In 1986, Semone became engaged to Ziona, who was Jewish, had been born and raised in Israel, and who held dual United States-Israeli citizenship. Semone did not obtain a civil divorce from Hilda, but he did go before a *Beth Din* (an orthodox rabbinical court) in New York and obtained a *get* (a religious divorce). Semone and Ziona then went to Israel and, upon presenting evidence of the *get* and were married in 1987. After they married, Semone and Ziona returned to New York and lived there for 27 years until Semone's death in 2014. They had two children, filed joint Federal income tax returns, and shared a home and finances. Semone and Ziona bought a burial plot in Israel (where Semone is now buried alongside Ziona's parents.) Semone and Ziona socialized with Hilda, who never challenged the validity of Semone and Ziona's marriage. Hilda filed her Federal income tax returns as a single individual and made no statutory claim against Semone's estate after his death. The executor of Semone's estate filed an estate tax return reporting a gross estate of $87 million and claiming a $79 million marital deduction for property left to Ziona. The IRS disallowed the deduction, contending that Semone had never been validly divorced from Hilda and, therefore, he had not been validly married to Ziona.

The Tax Court (Judge Toro) granted a summary judgment that Semone's marriage to Ziona was legally valid for estate tax purposes. The court explained that identifying a decedent's surviving spouse is a determined by State law. Citing *Estate of Goldwater v. Comm'r*, 64 T.C. 540, 550 (1975), *aff'd*, 539 F.2d 878 (2nd Cir. 1976); *Estate of Steffke v. Comm'r*, 64 T.C. 530, 534 (1975, *aff'd*, 538 F.2d 730 (7th Cir. 1976). Here, the decedent and both of the spouses in question reside in New York and the estate is being administered in New York, so the IRS contended that New York law was determinative. The estate argued that "place of celebration" test should apply regardless of New York law, but that result would be the same under New York law. The court did not have to consider the estate's alternate arguments on summary judgment, because even if he accepted the government's view that New York law applied, the estate would still win.

The court agreed with the estate that New York law would recognize Semone and Ziona's marriage under the place of celebration rule, because the *get* and foreign marriage were valid in Israel, where the marriage were celebrated. The court noted that New York has applied this principle consistently since at least 1881. *Van Voorhis v. Brintnall*, 86 N.Y. 18, 24 (1881). This court held that the marriage in question did not fall under either of the two narrow exceptions to the place of celebration rule: (a) it did not involve incest or polygamy coming within the prohibitions of natural law; and (b) it was not prohibited by positive law. The court rejected the IRS contention that Semone and Ziona's marriage was prohibited by natural law because it was bigamous, noting that under New York law, the question was whether the religious divorce and marriage were valid in Israel, the place of celebration. Israel clearly viewed Semone and Hilda as validly divorced and Semone as capable of remarrying, as demonstrated by Israel's acceptance of the letter from the *Beth Din* of America, the issuance of a *ketubah* (marriage contract) to Semone and Ziona, and the later issuance of a marriage certificate. Israeli law fully accepts religious divorces, even as New York does not. Since New York law requires the court to look to the law of the place of the marriage celebration, New York would not view this marriage as bigamous. Basically, the place of celebration rule means that since Semone and Ziona satisfied the divorce rules of Israel, where their marriage was celebrated, they effectively satisfied the rules of New York. Similarly, the court rejected the argument that Semone and Ziona's marriage violates New York positive law, in particular article I, section 9 of the New York Constitution, which provides that no "divorce [shall] be granted otherwise than by due judicial proceedings." The court noted that *Van Voorhis* and *Matter of May*, 305 N.Y. 486, 488 (1953) both held that this provision does not apply to marriages celebrated outside of the state.

Note 1. The court stressed that it was opining only on "the New York Court of Appeals' expected recognition of Semone and Ziona's marriage, celebrated in Israel, uncontested for many years by the previous spouse, and left undisturbed by the New York courts." T.C. Memo. 2021-65 at *39. The court avoided any broad pronouncements on how couples may or may not obtain valid divorces in New York. The court also noted that its conclusion was "buttressed by New York law's presumption in favor of the validity of a second marriage." *Grabois v. Jones*, 89 F.3d 97, 100 (2d Cir. 1996). Furthermore, the presumption of the validity of a second marriage is stronger where the person contesting the validity of the marriage is a stranger to the marital relationship, such as is the IRS.

Note 2. Because of effective date considerations, the court did not have to consider the application of Reg. § 301.7701-18(b)(2), which became effective in 2016 and requires that, in addition to being valid under the law of the place of celebration, a foreign marriage must also be recognizable under the laws of at least one State: "Two individuals who enter into a relationship denominated as marriage under the laws of a foreign jurisdiction are recognized as married for federal tax purposes if the relationship would be recognized as marriage under the laws of at least one state, possession, or territory of the United States, regardless of domicile." Id. The court did not need to consider these regulations in this case because the decedent died two years before the regulations became effective.

G. Estate Tax Procedures

1. IRS Will Charge $67 User Fee for an Estate Tax Closing Letter but Make Them Easier to Apply For. Prop. Reg. § 300.13, REG-114615, 85 Fed. Reg. 86871 (Dec. 31, 2020)

The IRS will charge a $67 user fee for an estate tax closing letter, beginning 30 days after the publication of the final regulations in the Federal Register. Treasury and the IRS do not state what procedure will be required to apply for a closing letter, but they state that they expect to create a simple one-step, web-based procedure for requesting and paying for closing letters.

Note. Traditionally, the IRS issued a closing letter automatically when an estate tax return was accepted or an audit terminated, but as a result of both IRS budget reductions and the large number of estate tax returns filed to elect portability, the IRS announced on its website that, for estate tax returns filed on or after June 1, 2015, it would issue a closing letter only upon a request. The IRS stated that the request for a closing letter could not be made until at least four months after the filing of the estate tax return. One must contact the IRS by telephone or fax (and, during the Covid 19 pandemic, only by fax) to request a closing letter. The IRS later explained that an estate tax transcript could be used to show that the IRS has accepted an estate tax return or closed an audit. Notice 2017-12, I.R.B. 2017-5 (Jan. 30, 2017). The IRS stated that a transcript could be requested online from four to six months after the estate tax return was filed. The IRS was aware that executors, probate courts, State tax departments, and others had come to rely on estate tax closing letters and the information in those letters for confirmation that the examination of the estate tax return by the IRS had been completed and the IRS file had been closed. These persons often did not find the transcript a satisfactory substitute for the closing letter.

2. Taxpayer Liable for Over $1 Million in Unpaid Estate and Gift Taxes; Court Orders Sale of Two Inherited Properties to Satisfy Deficiency. *United States v. Widtfeldt*, 824 Fed. Appx. 444, 2020 WL 5959904 (8th Cir. Oct. 8, 2020), *aff'g per curiam* 2019 WL 4450693, 124 A.F.T.R. 2d 2019-5936 (D. Neb. 2019) (slip copy)

James Widtfeldt received two parcels of real estate from his mother by gift two years before her death. James was executor of his mother's estate. Among the property included in his mother's estate was the two parcels of real property, valued $1.8 million on the date of death. The IRS found that James' mother had not filed a gift tax return and the estate had not filed an estate tax return for these transfers, and that taxes, interest, and penalties were appropriate. James sued in the Tax Court and, after filing several pleadings described as frivolous and asserting arguments described as nonsensical, the Tax Court granted the IRS's motion to dismiss for failure to properly prosecute. The Eighth Circuit affirmed. *Widtfeldt v.*

Comm'r, 449 F.App'x 561 (8th Cir. 2012) (unpublished *per curiam*). The IRS then assessed deficiencies against the estate and issued James a notice and demand for payment. The IRS filed suit in district court seeking both a money judgment against James personally for the unpaid taxes, interest, and penalties, and enforcement of that judgment against the two properties James had received.

The U.S. District Court for Nebraska (Judge Rossiter) held for the IRS, finding that the estate tax lien attached to the gross estate when the tax was not paid, and James, as recipient of the property became personally liable for the tax. IRC § 6342(a)(1). James argued that he had bought the properties from his mother in 1994, but he provided no supporting evidence. Furthermore, the court held that this issue had been decided by the Tax Court and could not be relitigated, because the Tax Court decision was applied to the same parties as the present case and considered the same questions of tax delinquency raised in this case. The court then ordered the sale of the two properties to satisfy the deficiencies.

The Court of Appeals affirmed *per curiam*, relying on the analysis of the district court.

3. Court of Federal Claims Refuses to Dismiss Claim that Late Estate Tax Payment and Filing Penalties Should be Avoided for Taxpayer's Reasonable Reliance on Advice of Counsel. *Leighton v. United States*, ___ Fed. Cl. ___, 2021 WL 3486478 (Aug. 9, 2021)

The taxpayer, Frank "Tom" Leighton, executor for the estate of his father, David Leighton. Tom relied on the advice of Freshwater Consultants of Alexandria, JDJ Family Office Services, and Richard Allen. The decedent had used Freshwater for his tax return preparation services. Tom and his brother hired JDJ to determine their tax filing and payment obligations for the estate. The estate hired Mr. Allen, an attorney, to work with JDJ and assist in the estate administration. The attorney told Tom that the estate need not file an estate tax return unless the gross estate exceeded $5,490,000 and Tom believed the estate to be under $2 million. JDJ worked with Freshwater Consultants to determine the size of the estate and whether there had been any lifetime gifts that might affect the size of the gross estate. They found none and so instructed the attorney. About two years after his father's death, Tom told the attorney that his father might have established several trusts. The attorney asked Freshwater about the trusts and they sent him a copy of a 2012 gift tax return showing transfers of over $5 million to the trusts. The attorney determined that the trust funds were includible in the decedent's gross estate. Tom had an estate tax return prepared, filed it, and paid $1.6 million to the IRS, which included tax, interest, and penalties. Tom then filed a claim for refund of the $257,712 late filing penalty and the $85,904 late payment penalty, arguing that he had reasonable cause for the late filing. The IRS did not respond so Tom filed a suit for refund. The government filed a motion to dismiss, contending that the facts asserted by Tom did not establish reasonable cause.

The Court of Federal Claims (Judge Tapp) held for the taxpayer and denied the motion. The court explained that "reasonable cause" requires that the untimeliness "was the result neither of carelessness, reckless indifference, nor intentional failure." *United States v. Boyle*, 469 U.S. 241, 246 (1985)). Rather, it must result from circumstances "beyond the taxpayer's control". *Id*. at 248 n.6. The taxpayer must show that he or she "exercised ordinary business care and prudence" but was still unable to file the return and pay the tax within the prescribed time. Treas. Reg. § 301.6651-1(c)(1). The court found that the taxpayer had alleged facts sufficient to show reasonable cause, if he could prove those allegations at trial. The IRS argued that the advice given the taxpayer was objectively unreasonable because it was based on insufficient facts. The court stated that the lack of sufficient facts could have been beyond the control of the taxpayer, and so the advice was not objectively unreasonable. The court also rejected the claim that the taxpayer's reliance on the statements of others was unreasonable, noting that while a taxpayer cannot rely on others to say when a return must be filed, they can rely on competent advisers to say whether the return must be filed. The court also noted that a taxpayer is not obliged to share details with a tax preparer that a reasonably prudent taxpayer would not know or that the taxpayer neither knew nor reasonably should have known. Thus, the taxpayer had made sufficient allegations to show reasonable cause and the court would let the case go to trial so that the validity of those allegations could be established.

4. Executor Cannot Avoid Late Filing and Payment Penalties by Relying on Attorney to Request an Estate Tax Extension. *Andrews v. United States*, 153 Fed. Cl. 665, 2021 WL 1904599, 127 A.F.T.R.2d 2021-1986 (May 12, 2021)

David Andrews was executor of the estate of Frank J. Andrews. The estate was required to file an estate tax return. David hired an attorney to assist in preparing the return but was having difficulty converting the estate's assets into cash. The attorney advised David to obtain a 6-month extension by filing Form 4768, and David asked the attorney to do it. The attorney failed to file the Form 4768, due to a scheduling error. Ultimately, the attorney filed the estate tax return late. The IRS assessed a over $500,000 in late filing and payment penalties and interest. David filed a claim for refund and filed suit for a refund of the penalties.

The Court of Federal Claims (Judge Davis) held for the government and dismissed David's complaint. David claimed to have acted reasonably in hiring a lawyer and relying on her advice, and that he had not delegated to the lawyer the filing of the estate tax return. The court held that David's actions fell clearly under *United States v. Boyle*, 469 U.S. 241, 249 (1985), that he had a nondelegable duty to file the return. Like filing a tax return, filing of an application for an extension is also a nondelegable duty. *Knappe v. United States*, 713 F.3d 1164, 1174 (9th Cir. 2013); *McMahan v. Comm'r*, 114 F.3d 366, 369 (2d Cir. 1997). Penalties cannot be avoided by delegating this task to an attorney or accountant. The court noted that *Boyle* did differentiate between relying on the mistaken advice of counsel concerning a question of tax law and relying on the professional actually to file the return or request an extension. *Boyle*, 469 U.S. at 250. The court held that while David hired an attorney to assist in preparing the estate tax return and the request for an extension, he ultimately asked the attorney to file the request for an extension and the attorney's failure to do so resulted in the late filing and payment. Thus, under *Boyle*, the penalties cannot be excused.

5. **Executor Chance of Recouping Distributions from Executor or Beneficiaries Undermines Estate's Offer in Compromise.** ***Estate of Lee v. Comm'r*, T.C. Memo. 2021-92 (July 20, 2021)**

The decedent, Kwang Lee, died in September 2001, and Anthony J. Frese became executor of Lee's estate. Frese filed a late estate tax return and then made over $1 million in distributions to estate beneficiaries. An estate tax examination resulted in a $1 million deficiency assessment, along with a $255,000 late filing penalty and a $204,000 accuracy-related penalty. The estate contested the assessment and the Tax Court held the estate liable for $536,000 in taxes, with no penalties or additions. *Estate of Lee v. Comm'r*, T.C. Memo. 2009-84. IRS then assessed this amount. In 2013 the IRS sent the estate a notice of tax lien, and the estate requested a collection review hearing, which was held in 2016. The estate submitted a collection information statement showing that its only asset was a $183,000 checking account, which it offered in compromise. The IRS declined, noting that the estate could still seek to recover the taxes from the executor (under the federal priority statute, 31 U.S.C. § 3713) or from the distributees as transferees under Section 6324(a)(2), and that, therefore, the government should not accept the lower amount. The estate sued, arguing that the rejection of the offer in compromise it was an abuse of discretion and that the IRS failed to take determine the probability of collecting from the executor or beneficiaries before rejecting the offer.

The Tax Court (Judge Greaves) held that the estate had distributed $640,000 after the IRS had sent it a notice of deficiency and that, under 31 U.S.C. § 3713, the executor was personally liable for the amounts he distributed once the government's claim is already known, if the distribution leaves the estate without sufficient assets to satisfy the government's claim. Furthermore, the distributees could be liable as transferees under Section 6324(a)(2). The IRS can accept an offer in compromise if there is a doubt about collectability, but if there is a reasonable likelihood of collecting the full amount of the tax, the IRS need not accept the offer. Reg. § 301.7122-1(b). The court held that the IRS was not obligated to investigate the likelihood that it would be able to collect from the executor or transferees before it rejected the offer in compromise and deferred to its judgment as to whether it could reasonably expect to collect these amounts.

6. **Executor May be Personally Liable for Estate Taxes Having Preferred Himself or Other Beneficiaries before Paying the IRS; Transferee Liability and Fiduciary Liability Both Imposed.** ***United States v. Estate of Kelley*, 2020 WL 6194040,126 A.F.T.R.2d 2020-6605 (D.N.J. Oct. 22, 2020) (slip copy)**

Lorraine M. Kelley ("Lorraine") died and named her brother, Richard Saloom, and Richard J. Lecky as co-executors. Richard Saloom was also the sole beneficiary of the estate. Lorraine's executors filed a timely estate tax return reporting a tax liability of $214,412 and a gross estate of over $1.7 million. After an audit, Richard Sa444loom agreed to the assessment of $448,367 of additional tax liability. The estate distributed all of its assets to Richard, who also received the proceeds from an annuity owned by the Lorraine. Richard Saloom gave $50,000 of the annuity payments to his daughter Rose. After these distributions, the estate had no assets but it still owed the government $400,000 in estate tax. Richard Saloom entered into an installment agreement with the IRS and, after his death, Rose continued making installment payments on his behalf. Rose was named executrix of her father's estate, which included property worth over $1.1 million. She was also the sole beneficiary of her father's estate. The United States sued Richard's estate and Rose too as transferees of Lorraine's estate, and as fiduciaries of the two estates, and under the New Jersey Uniform Fraudulent Transfer Act ("UTFA"). The United States filed a four-count Motion for Summary Judgment.

The District Court for New Jersey (Judge Martinotti) granted three of the four motion counts in favor of the government. The court granted summary judgment against Richard Saloom's estate as a transferee of Lorraine's estate under Section 6324(a)(2). The court explained that this section imposes liability on transferees who receive property from a decedent's estate, if the estate fails to pay its taxes. See *United States v. Geniviva*, 16 F.3d 522, 524 (3d Cir. 1994). Richard Saloom had received $2.6 million in property from Lorraine's estate, and so his estate was the transferee of Lorraine's estate. The court also granted summary judgment that Richard Saloom was liable as a fiduciary of Lorraine's estate under 31 U.S.C. § 3713(b), because he had distributed estate assets to himself, rendering the estate insolvent, and he knew or should have known of the outstanding estate tax liability. See *United States v. Tyler*, 528 F.App'x 193, 200-02 (3d Cir. 2013); *United States v. Coppola*, 85 F.3d 1015, 1019 (2d Cir. 1996). The court also held that Rose had liability under 31 U.S.C. § 3713(b) because she distributed $1.1 million of her father's estate to herself, rendering it insolvent and she knew or should have known of the outstanding estate tax liability.

Note. The court rejected the motion for summary judgment that the New Jersey UFTA applied to Rose because the government could not show that the distribution of assets from the Richard Saloom Estate to Rose was done with an intent to defraud the estate's creditors.

7. 2% Interest Rate on Deferred Estate Taxes on Closely-Held Business Adjusted for Inflation. Rev. Proc. 2020-45 § 3.51, 2020-46 I.R.B. 1016 (Nov. 9, 2020)

The value of a closely-held business interest, the deferred estate taxes on which bear interest at a 2% rises to $1,590,000 for estates of decedents dying in 2021.

IV. GIFT TAXES

A. IRC § 2503. Gift Tax Annual Exclusion

Annual Exclusion Adjusted for Inflation. Rev. Proc. 2020-45 § 3.43, 2020-46 I.R.B. 1016 (Nov. 9, 2020)

The gift tax annual exclusion remains $15,000 for transfers made in 2021. The annual exclusion for gifts to a non-U.S. citizen spouse was raised to $159,000 for for gifts made in 2021.

B. IRC § 2519. Dispositions of certain life estates

Commutation of QTIP Trust is Taxable Gift of the Remainder Interest Under Section 2519. CCM 202118008 (May 7, 2021)

D died survived by S, D's spouse, and two adult children. D's will created a QTIP marital trust under which S receives all of the trust income and principal as needed for health, maintenance, and support. S is also granted a testamentary power to appoint the QTIP trust fund to and among D's descendants, and in default of that appointment, the remainder passes to D's children. S, as D's personal representative, deducted this trust as a QTIP under Section 2056(b)(7). S and D's children, both as remainder beneficiaries and as virtual representatives of the contingent and unborn beneficiaries, agreed to commute the trust, distributing all of the trust assets to S. The commutation instrument stated that the parties realized that this would be a taxable gift by S to the children of the value of the remainder interest, and a reciprocal gift by the children of that trust interest to S. S then also transferred corporate shares to irrevocable dynasty trusts created for the benefit of the children and their descendants and sold other assets to the trust in exchange for a promissory note. S and the children each filed gift tax returns reporting the commutation as a gift by S to the children of the value of the remainder interests, a gift by the children to S of the value of the remainder interests, and a gift to the children and descendants of the assets given to the dynasty trusts.

The IRS, in a Chief Counsel's Memorandum, stated that: (a) the termination of the trust was a disposition of S's qualifying income interest under Section 2519(a), and S made a taxable gift to the remainder beneficiaries of all of S's interests in the trust, other than the qualifying income interest that S retained; (b) the distribution of all of the trust assets to S is a gift to S of the remainder interest by the remainder beneficiaries; (c) the deemed gift of a remainder interest to S by the children was not consideration that offset S's deemed gift under Section 2519, because it did not augment S's gross estate; (d) the value of the S's gift to the remainder beneficiaries under Section 2519 was the fair market value of all of the entire trust, less the present value of the income interest on the date of disposition (determined actuarially under Section 7520); and (e) the value of the remainder beneficiaries' gifts to S was the value of their remainder interest in the trust and, absent the trustee's specific computation of this amount, the IRS will make its own determination pursuant to the valuation rules set forth in Section 7520.

Note. There is nothing surprising about the IRS deeming S to have made a taxable gift of the value of the remainder interest to the remainder beneficiaries; Section 2519 requires this result. The question about whether the deemed gift by the children offset S's deemed gift to the children, however, is more complicated. The IRS explained that a gift tax is imposed on any transfer for less than adequate and full consideration in money or money's worth of property. *Comm'r v. Wemyss*, 324 U.S. 303 (1945); and *Merrill v. Fahs*, 324 U.S. 308 (1945). For this purpose, adequate and full consideration is that which replenishes, or augments, the donor's taxable estate. The IRS discussed Rev. Rul. 69-505, 1969-2 C.B. 179, in which property held as joint tenants was transferred to a trust, each reserving a lifetime right to one-half of the trust income. Thus, each grantor's transfer to the other grantor would be offsetting consideration, to the extent that they were of equal value. Here, the IRS refused to treat the children's deemed transfer of the remainder interest to S as consideration for S's deemed transfer under Section 2519, because the entire value of the trust was already subject to inclusion in S's gross estate under Section 2044 before the commutation; the children's transfer did not augment S's estate.

V. GENERATION-SKIPPING TRANSFER TAXES

IRC § 2601. GST Tax Imposed

1. GST Exemption Adjusted for Inflation. Rev. Proc. 2020-45 § 3.41, 2020-46 I.R.B. 1016 (Nov. 9, 2020)

The GST exemption was adjusted for inflation to $11.7 million for transfers made in 2021.

2. Despite Delaware Tax Trap, Exercise of Special Power of Appointment in Further Trust for Beneficiaries Causes Neither Inclusion in the Powerholder's Gross Estate Nor Loss of GST Effective Date Protection. PLR 202120003 (May 21, 2021)

Trust, an irrevocable trust, was created after October 21, 1942 and before September 25, 1985, for the benefit of Grantor's Son and his descendants. The trustee shall apply trust income and principal for the education, maintenance and support of Son and his descendants and distribute the assets of Trust to Son after he reaches age w. Trust gives Son a special testamentary power of appointment to and among such persons as Son chooses, excluding himself, his estate, his creditors, or the creditors of his estate. In default of the exercise of this power, the Trust assets will continue to be held in trust for the benefit of Son's descendants until the youngest reaches age y. The trust shall terminate not later than 21 years after the death of the last to die of Grantor, Grantor's wife, and Son, and on termination Trust's assets shall be distributed to its income beneficiaries in proportion to their income interests. If a trustee resigns, a court shall appoint any national bank having trust powers and meeting certain capital and surplus limits to be the trustee. Once Son reaches age y, he may require the removal of any then-serving trustee. Son does not own any significant holdings of stock in any national bank, from the viewpoint of voting control, nor will he acquire such during his lifetime. Grantor and his wife died, Son is over the age of u, and Son and has three living children. Son proposes to exercise his testamentary power of appointment over Trust in favor of his children, in equal shares, and the then-living descendants, per stirpes, of any child who does not survive Son but who is survived by then-living descendants. Each such share will be held in a separate trust from which the trustee may make discretionary distributions of income and principal, and over which each child or grandchild is given a lifetime special power of appointment exercisable in favor of one or more charities. These trusts will terminate on the death of the trust beneficiary or, if earlier, day preceding the expiration of 21 years after the date of death of the last survivor of all members of the class that includes Son and certain named individuals, all of whom were born (or were in gestation) prior to the date on which Trust was created (the "Year Trust Designated Class"). Son's will also states that no interest of a beneficiary of a trust held under any such trust or pursuant to the exercise of a special power of appointment or any fiduciary power granted thereunder may be held in trust beyond the day preceding the expiration of 21 one years after the date of death of the last to die of the Year Trust Designated Class. Any trust created under Son's will or pursuant to the exercise of a power of appointment under his will that is then still being administered will terminate and be distributed outright as provided in the trust or otherwise to the trust's then income beneficiary.

The IRS stated that the Trust property will not be included in Son's gross estate for federal estate tax purposes and that Son's proposed exercise of his testamentary power of appointment over Trust's property will not subject Trust or the property transferred from Trust to the trusts established under Son's will to the generation-skipping transfer tax. Respecting the inclusion of Trust's assets in Son's gross estate, the IRS noted that Son held only a lifetime interest in Trust and a limited power of appointment, neither of which would result in inclusion of the assets in Son's gross estate. Furthermore, the proposed exercise of this power of appointment will not trigger Section 2041(a)(3) (the "Delaware tax trap"), because it will not postpone or suspend the vesting, absolute ownership or power of alienation of any interest in the Trust property for a period, measured from the date Trust was created, extending beyond any life in being at the date of creation of Trust plus a period of 21 years and a reasonable period of gestation. The IRS also noted that Son's power to remove a trustee does not result in the inclusion of the trust assets in Son's gross estate under Rev. Rul. 95-58, 1995-2 C.B. 191, because Son has no power to designate the successor and any successor designated by a court would not be related or significant to Son under Section 672. On the second issue, the IRS stated that the trust was irrevocable on September 25, 1985, and thus is protected from the GST tax by the effective date rules. Furthermore, Reg. § 26.2601-1(b)(1)(v)(B) provides that the release, exercise, or lapse of a non-general power of appointment is not treated as an addition to a trust if — (1) the power of appointment is created under an effective date-protected trust; and (2) the power is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gestation. Son's proposed exercise of his limited power of appointment, as discussed above, satisfies this requirement.

VI. PROPOSED HIGH NET WORTH WEALTH TAX. S.510, 117th CONG., 1ST SESS. (MARCH 1, 2021); AND H.R. 1459, 117th CONG., 1ST SESS. (MARCH 1, 2021)

A. Generally

S. 510 and H.R. 1459, the Ultra-Millionaire Tax Act of 2021, would add a new Chapter 18 to the Internal Revenue Code, imposing an annual 2% wealth tax on individuals and nongrantor trusts with a net worth of over $50 million and under $1 billion, and a 3% annual tax on individuals and nongrantor trusts with a net worth of over $1 billion. Prop. Section 2901(a), (b). The bill would apply to any calendar year ending after the date of enactment.

The Senate version was introduced in the Senate by Senator Elizabeth Warren (D-MA) and it has eight co-sponsors, all of whom are or caucus with the Democrats. The House version was introduced by Rep. Pramilla Jayapal (D-Wash.), and it has 30 co-sponsors, all of whom are Democrats.

B. Treatment of Trusts

The bill would treat assets held by a grantor trust as belonging to the grantor for purposes of calculating the tax and would treat non-grantor trusts as separate taxpayers. Prop. Sections 2901(a), (b), 2902(c)(3). The tax would not be imposed on tax-exempt charitable trusts or qualified retirement benefit trusts. Prop. IRC § 2901(c)(1). A trust that transfers property by gift or decanting to another trust after December 31, 2020, will be treated as a single taxpayer with the transferee trust for the year in which the transfer occurs. Prop. IRC § 2901(c)(3).

C. 6% Rate

The bill would raise the 3% tax to a 6% tax in any year in which there is federal legislation that (a) establishes a health insurance program that provides to all residents of the United States comprehensive protection against the costs of health care and health-related services, and that prohibits private entities from providing duplicate benefits. Prop. IRC § 2901(b)(2)(B).

D. Married Couples

The bill treats a married couple, whether or not they file a joint income tax return, as a single taxpayer for purposes of determining their net worth. Prop. IRC § 2901(c)(2).

E. Net Worth Defined

The bill defines a taxpayer's net worth as the net value of all of the assets that would be included in the taxpayer's gross estate for federal estate tax purposes if the taxpayer died during the taxable year. It includes real or personal, tangible or intangible, wherever situated. It is reduced by any debts, whether secured or unsecured, owed by the taxpayer. Prop. IRC § 2902(a).

Tangible property is not taken into account in determining the net worth of a taxpayer if it (1) is worth $50,000 or less (determined without regard to any debt owed by the taxpayer with respect to the property), and (2) it is not used in a trade or business of the taxpayer, used in connection with a deduction allowable under Section 212 (expenses in the production of income), or (3) is a collectible as defined in Section 408(m) (a collectible that cannot be owned by an IRA), a boat, an aircraft, a mobile, home, a trailer, a vehicle, or an antique or other asset that maintains or increases its value over time. Prop. IRC § 2902(b).

A taxpayer's net worth includes the value of any property transferred by the taxpayer after the date of enactment to a family member (as defined in Section 267(c)(4)) who is, on the last day of the calendar year, under the age of 18 years. Prop. IRC § 2902(c)(3).

F. Valuation Methods

Treasury is directed to establish valuation rules for this tax within 12 months of the date of enactment. These shall include rules for valuing assets that are not publicly traded or that have no readily ascertainable fair market value. Prop. IRC § 2902(d). These valuation methods may utilize:

> *(1) may utilize retrospective and prospective formulaic valuation methods not currently in use by the Secretary, [and]*
>
> *(2) may require the use of formulaic valuation approaches for designated assets, including formulaic approaches based on proxies for determining presumptive valuations, formulaic approaches based on prospective adjustments from purchase prices or other prior events, or formulaic approaches based on retrospectively adding deferral charges based on eventual sale prices or other specified later events indicative of valuation. . .*

Prop. IRC § 2902(d)(1), (d)(2).

Treasury may, but is not required to, address the use of valuation discounts. Prop. IRC § 2902(d)(3).

G. Taxpayers Who Die During Calendar Year

The tax would be prorated for taxpayers who died during the calendar year. Prop. IRC § 2903(a)(2). For purposes of the estate tax deduction under Section 2053 (the deduction for estate expenses, indebtedness and taxes), the wealth tax will be deemed to have been paid before the date of the taxpayer's death. Prop. IRC § 2903(a)(2).

H. Other Issues

The bill would require a minimum 30% audit rate on estates subject to the tax and impose a 40% tax on U.S. citizens who renounce their citizenship. Prop. IRC § 2905.

VII. SELECTED ATTACHMENTS

A. IRS/Treasury Priority Guidance Plan for 2021-2022 (Sept. 9, 2021), https://www.irs.gov/pub/irs-utl/2021-2022-pgp-initial.pdf -- Issues Related to Estate Planning

OFFICE OF TAX POLICY
AND
INTERNAL REVENUE SERVICE
2021-2022 PRIORITY GUIDANCE PLAN

EMPLOYEE BENEFITS

A. Retirement Benefits

2. Regulations and other guidance under §72(t) relating to the 10 percent additional tax on early distributions.[5]

3. Update to IRA regulations under §§ 219, 408, 408A, and 4973 for statutory changes and additional issues.

6. Regulations relating to SECURE Act modifications to §401(a)(9) and addressing other issues under §401(a)(9). [6]

* * *

10. Guidance on missing participants, including guidance on uncashed checks.

* * *

B. Executive Compensation, Health Care and Other Benefits, and Employment Taxes

8. Regulations on income inclusion and various other issues under §409A. Proposed regulations were published on December 8, 2008, and on June 22, 2016.

9. Regulations and other guidance under §§419A and 501(c)(9) relating to welfare benefit funds, including voluntary beneficiary associations (VEBAs).

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[5] New this year.

[6] New this year.

* * *

EXEMPT ORGANIZATIONS

5. Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.

6. Guidance regarding the excise taxes on donor advised funds and fund management.

* * *

GIFTS AND ESTATES AND TRUSTS

1. Final regulations establishing a user fee for estate tax closing letters. Proposed regulations were published on December 31, 2020.

2. Final regulations under §§ 1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016.[7]

3. Regulations under §2010 addressing whether gifts that are includible in the gross estate should be excepted from the special rule of § 20.2010-1(c). [8]

4. Regulations under §2032(a) regarding imposition of restrictions on estate assets during the six month alternate valuation period. Proposed regulations were published on November 18, 2011. Regulations under §2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate.

5. Regulations under §2632 providing guidance governing the allocation of generation-skipping transfer (GST) exemption in the event the IRS grants relief under §2642(g), as well as addressing the definition of a GST trust under §2632(c), and providing ordering rules when GST exemption is allocated in excess of the transferor's remaining exemption. [9]

6. Final regulations under §26542(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption.

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[7] New this year.

[8] New this year.

[9] New this year.

7. Final regulations under §2801 regarding the tax imposed on U.S. citizens and residents who receive gifts or bequests from certain expatriates. Proposed regultaions were published September 10, 2015.[10]

9. Regulations under §7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests.[11]

INSURANCE COMPANIES AND PRODUCTS

1. Final regulations under § 72 on the exchange of property for an annuity contract. Proposed regulations were published on October 18, 2006.

* * *

INTERNATIONAL

H. Other

3. Guidance under §§6039F, 6048, and 6677 on foreign trust reporting and reporting with respect to large foreign gifts, and regulations under §§643(i) and 679 relating to certain transactions between U.S. persons and foreign trusts. Revenue Procedure 2020-17 excepting certain tax-favored foreign retirement and non-retirement trusts from section 6048 reporting was published on March 16, 2020.

[10] New this year.

[11] Deleted this year: "Guidance on basis of grantor trust assets at death under §1014."

B. IRS No-Rulings – Domestic - List for 2021 -- Estate, Gift, GST Tax and Related Issues. Excerpts from Rev. Proc. 2021-3, 2021-1 I.R.B. 140 (Jan. 4, 2021)

SECTION 3. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED

.01 Specific Questions and Problems.

(11) Section 61. — Gross Income Defined. — Whether a split-dollar life insurance arrangement is "materially modified" within the meaning of § 1.61-22(j)(2) of the Income Tax Regulations. (Also §§ 83, 301, 1401, 2501, 3121, 3231, 3306, 3401, and 7872.)

(12) Sections 61, 111, and 1001. — Gross Income Defined; Recovery of Tax Benefit Items; Determination of Amount of and Recognition of Gain or Loss. — Whether, in connection with a transaction involving the establishment or amendment of a welfare benefit fund (including Voluntary Employees' Beneficiary Associations (VEBAs)), a transfer of assets between welfare benefit funds (including VEBAs), or a new or different use of assets of a welfare benefit fund (including a VEBA), (i) the employer, plan sponsor, welfare benefit fund (including a VEBA), or covered individuals must include any amount in gross income under § 61 or the tax benefit rule, or (ii) the employer or welfare benefit fund (including a VEBA) have engaged in a sale or exchange of assets under § 1001.

* * *

(14) Section 79. — Group-Term Life Insurance Purchased for Employees. — Whether a group insurance plan for 10 or more employees qualifies as group-term insurance, if the amount of insurance is not computed under a formula that would meet the requirements of § 1.79-1(c)(2)(ii) of the Income Tax Regulations had the group consisted of fewer than 10 employees.

* * *

(17) Section 101. — Certain Death Benefits. — Whether there has been a transfer for value for purposes of § 101(a) in situations involving a grantor and a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(18) Sections 101, 761, and 7701. — Certain Death Benefits; Terms Defined; Definitions. — Whether, in connection with the transfer of a life insurance policy to an unincorporated organization, (i) the organization will be treated as a partnership under §§ 761 and 7701, or (ii) the transfer of the life insurance policy to the organization will be exempt from the transfer for value rules of § 101, when substantially all of the organization's assets consist or will consist of life insurance policies on the lives of the members.

(19) Section 102. — Gifts and Inheritances. — Whether a transfer is a gift within the meaning of § 102(a).

* * *

(38) Section 170. — Charitable, Etc., Contributions and Gifts. — Whether a charitable contribution deduction under §170 is allowed for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 170(c).

(39) Section 170. — Charitable, Etc., Contributions and Gifts. — Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note.

(40) Section 170. — Charitable, Etc., Contributions and Gifts. — Whether an organization is or continues to be described in § 170(b)(1)(A) (other than clause (v)) or § 170(c)(2) - (5), including, for example, whether changes in an organization's activities or operations will affect or jeopardize the organization's status as an organization described in those sections. The Associate Chief Counsel (EEE) will rule, however, on specific legal questions related to §§ 170(b)(1)(A) or 170(c) that are not otherwise described in this revenue procedure. See Rev. Proc. 2021-5, this Bulletin, for the procedures for obtaining determination letters on public charity status under § 170.

* * *

(45) Section 264. — Certain Amounts Paid in Connection with Insurance Contracts. — Whether § 264(d)(1) applies.

(46) Section 264(c)(1). — Contracts Treated as Single Premium Contracts. — Whether "substantially all" the premiums of a contract of insurance are paid within a period of 4 years from the date on which the contract is purchased. Also, whether an amount deposited is in payment of a "substantial number" of future premiums on such a contract.

* * *

(50) Section 302. — Distributions in Redemption of Stock. — Whether § 302(b) applies when the consideration given in redemption by a corporation consists entirely or partly of its notes

payable, and the shareholder's stock is held in escrow or as security for payment of the notes with the possibility that the stock may or will be returned to the shareholder in the future, upon the happening of specific defaults by the corporation.

(51) Section 302. — Distributions in Redemption of Stock. — Whether § 302(b) applies when the consideration given in redemption by a corporation in exchange for a shareholder's stock consists entirely or partly of the corporation's promise to pay an amount based on, or contingent on, future earnings of the corporation, when the promise to pay is contingent on working capital being maintained at a certain level, or any other similar contingency.

(52) Section 302. — Distributions in Redemption of Stock. — Whether § 302(b) applies to a redemption of stock, if, after the redemption, the distributing corporation uses property that is owned by the shareholder from whom the stock is redeemed and the payments by the corporation for the use of the property are dependent upon the corporation's future earnings or are subordinate to the claims of the corporation's general creditors. Payments for the use of property will not be considered to be dependent upon future earnings merely because they are based on a fixed percentage of receipts or sales.

(53) Section 302. — Distributions in Redemption of Stock. — Whether the acquisition or disposition of stock described in § 302(c)(2)(B) has, or does not have, as one of its principal purposes the avoidance of Federal income taxes within the meaning of that section, unless the facts and circumstances are materially identical to those set forth in Rev. Rul. 85-19, 1985-1 C.B. 94; Rev. Rul. 79-67, 1979-1 C.B. 128; Rev. Rul. 77-293, 1977-2 C.B. 91; Rev. Rul. 57-387, 1957-2 C.B. 225; Rev. Rul. 56-584, 1956-2 C.B. 179; or Rev. Rul. 56-556, 1956-2 C.B. 177.

(54) Section 302(b)(4) and (e). — Redemption from Noncorporate Shareholder in Partial Liquidation; Partial Liquidation Defined. — The amount of working capital attributable to a business or portion of a business terminated that may be distributed in partial liquidation.

* * *[12]

[12] Deleted from this no-rulings list was previous section 3.01(93), which read:

> *(93) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether any portion of the items of income, deduction, and credit against tax of the trust will be included in computing under § 671 the taxable income, deductions and credits of grantors when distributions of income or corpus are made — (A) at the direction of a committee, with or without the participation of the grantor, and (1) a majority or unanimous agreement of the committee over trust distributions is not required, (2) the committee consists of fewer than two persons other than a grantor and a grantor's spouse; or (3) all of the committee members are not beneficiaries (or guardians of beneficiaries) to whom all or a portion of the income and principal can be distributed at the direction of the committee or (B) at the direction of, or with the consent of, an adverse party or parties, whether named or unnamed under the trust document (unless distributions are at the direction of a committee that is not described in paragraph (A) of this section).*

This item was added to the list in 2020. See, however, new items 5.01(8) – (10), (15), and (17).

(70) Section 419(e). — Welfare Benefit Fund. — Whether a captive insurance arrangement through which an employer provides health insurance to current or retired employees is a welfare benefit fund.

* * *

(72) Section 451. — General Rule for Taxable Year of Inclusion. — The tax consequences of a nonqualified unfunded deferred-compensation arrangement with respect to a controlling shareholder-employee eligible to participate in the arrangement.

(73) Section 451. — General Rule for Taxable Year of Inclusion. — The tax consequences of nonqualified unfunded deferred-compensation arrangements in which the arrangements fail to meet the requirements of Rev. Proc. 92-65, 1992-2 C.B. 428, and Rev. Proc. 71-19, 1971-1 C.B. 698.

* * *

(81) Sections 507, 664, 4941, and 4945. — Termination of Private Foundation Status; Charitable Remainder Trusts; Taxes on Self-Dealing; Taxes on Taxable Expenditures. — Issues pertaining to the tax consequences of the termination of a charitable remainder trust (as defined in §664) before the end of the trust term as defined in the trust's governing instrument in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets.

* * *

(83) Sections 511, 512, 513, and 514. — Imposition of Tax on Unrelated Business Income of Charitable, Etc., Organizations; Unrelated Business Taxable Income; Unrelated Trade or Business; Unrelated Debt-Financed Income. — Whether unrelated business income tax issues arise when charitable lead trust assets are invested with charitable organizations.

* * *

(87) Section 641. — Imposition of Tax. — Whether the period of administration or settlement of an estate or a trust (other than a trust described in § 664) is reasonable or unduly prolonged.

(88) Section 642(c). — Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose. — Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded.

(89) Section 643(f). — Treatment of multiple trusts. — Whether two or more trusts shall be treated as one trust for purposes of subchapter J of chapter 1.

(90) Section 664. — Charitable Remainder Trusts. — Whether the settlement of a charitable remainder trust upon the termination of the noncharitable interest is made within a reasonable period of time.

(91) Section 664. — See section 3.01(81), above.

(92) Section 671. — Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners. — Whether the grantor will be considered the owner of any portion of a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

* * *

(97) Section 1001. — Determination of Amount of and Recognition of Gain or Loss. — Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets, is treated as a sale or other disposition by the beneficiaries of their interests in the trust.

* * *

(104) Section 1221. — Capital Asset Defined. — Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets, is treated as a sale or exchange of a capital asset by the beneficiaries.

* * *

(110) Section 2031. — Definition of Gross Estate. — Actuarial factors for valuing interests in the prospective gross estate of a living person.

(111) Section 2055. — Transfers for Public, Charitable, and Religious Uses. — Whether a charitable contribution deduction under § 2055 is allowed for the transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2055(a).

(112) Section 2512. — Valuation of Gifts. — Actuarial factors for valuing prospective or hypothetical gifts of a donor.

(113) Section 2522. — Charitable and Similar Gifts. — Whether a charitable contribution deduction under § 2522 is allowable for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2522(a).

(114) Section 2601. — Tax Imposed. — Whether a trust exempt from generation-skipping transfer (GST) tax under §26.2601-1(b)(1), (2), or (3) of the Generation-Skipping Transfer Tax Regulations will retain its GST exempt status when there is a modification of a trust, change in the administration of a trust, or a distribution from a trust in a factual scenario that is similar to a factual scenario set forth in one or more of the examples contained in §26.2601-1(b)(4)(i)(E).

* * *

(122) Section 4941. — Taxes on Self-Dealing. — Whether transactions during the administration of an estate or trust meet the requirements of the exception to § 4941 set forth in § 53.4941(d)-1(b)(3) of the Private Foundation Excise Tax Regulations, in cases in which a disqualified person issues a promissory note in exchange for property of an estate or trust.

* * *[13]

(128) Section 4976(b)(1)(C). — Disqualified Benefit. — Whether a transfer of assets between welfare benefit funds (including voluntary employees' beneficiary associations (VEBAs)), or a new or different use of assets of a welfare benefit fund (including a VEBA), results in a reversion to the employer.

* * *

(134) Section 6166. — Extension of Time for Payment of Estate Tax Where Estate Consists Largely of Interest in Closely Held Business. — Requests involving § 6166 if there is no decedent.

* * *

(138) Section 7701. — Definitions. — The classification for Federal tax purposes of a fideicomiso or other land trust created under local law, applying the principles of Rev. Rul. 2013-14, 2013-26 I.R.B. 1267, or Rev. Rul. 92-105, 1992-2 C.B. 204.

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[13] Deleted from this no-rulings list was previous section 3.01(125), which read:

> *(125) Section 4947.— Application of Taxes to Certain Nonexempt Trusts. — Whether a trust which is not exempt from tax under § 501(a) is described in § 4947(a)(2) where a grantor, trustee, executor, administrator, donor, or beneficiary has represented that the trust has no amounts in trust for which a deduction was allowed under § 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, because no grantor, trust, estate, donor, or beneficiary has taken or plans to take any such deduction.*

This item was added to the list in 2020.

SECTION 4. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED[14]

.01 Specific Questions and Problems.

* * *

(6) Sections 101 and 7702. — Certain Death Benefits; Life Insurance Contract Defined. — Whether amounts received under an arrangement with an entity that is not regulated as an insurance company may be treated as received under a "life insurance contract" within the meaning of §§ 101(a) and 7702.

* * *

(16) Section 170. — Charitable, Etc., Contributions and Gifts. — Whether a transfer to a pooled income fund described in § 642(c)(5) qualifies for a charitable contribution deduction under § 170(f)(2)(A).

(17) Section 170. — Charitable, Etc., Contributions and Gifts. — Whether a transfer to a charitable remainder trust described in § 664 that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under § 170(f)(2)(A).

(18) Section 170. — Charitable, Etc., Contributions and Gifts. — Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property may deduct the fair market value of the property transferred and leased back as a charitable contribution.

* * *

(23) Section 302. — Distributions in Redemption of Stock. — The tax effect of the redemption of stock for notes, when the payments on the notes are to be made over a period in excess of 15 years from the date of issuance of such notes.

* * *

(37) Section 642. — Special Rules for Credits and Deductions. — Whether a pooled income fund satisfies the requirements described in § 642(c)(5).

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[14] Section 2.01 states that "'Not ordinarily' means that unique or compelling reasons must be demonstrated to justify the issuance of a ruling or determination letter."

(38) Section 664. — Charitable Remainder Trusts. — Whether a charitable remainder trust that provides for annuity or unitrust payments for one or two measuring lives or for annuity or unitrust payments for a term of years satisfies the requirements described in § 664.

(39) Section 664. — Charitable Remainder Trusts. — Whether a trust that will calculate the unitrust amount under § 664(d)(3) qualifies as a § 664 charitable remainder trust when a grantor, a trustee, a beneficiary, or a person related or subordinate to a grantor, a trustee, or a beneficiary can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract to take advantage of the difference between trust income under § 643(b) and income for Federal income tax purposes for the benefit of the unitrust recipient.

(40) Sections 671 to 679. — Grantors and Others Treated as Substantial Owners. — In a non-qualified, unfunded deferred compensation arrangement described in Rev. Proc. 92-64, 1992-2 C.B. 422, the tax consequences of the use of a trust, other than the model trust described in that revenue procedure.

* * *

(42) Section 678. — Person Other than Grantor Treated as Substantial Owner. — Whether a person will be treated as the owner of any portion of a trust over which that person has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner of the trust under § 671 if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, if the trust purchases the property from that person with a note and the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(43) Section 679. . — See sections 4.01(40) and 4.01(41), above.

* * *

(47) Section 1362. — Election; Revocation; Termination. — All situations in which the Service has provided an automatic approval procedure or administrative procedure for an S corporation to obtain relief for late S corporation, qualified subchapter S subsidiary, qualified subchapter S trust, or electing small business trust elections. See Rev. Proc. 2013-30, 2013-36 I.R.B. 173. (For instructions on how to seek this relief, see the preceding revenue procedure.)

* * *

(49) Sections 2035, 2036, 2037, 2038, and 2042. — Adjustments for Certain Gifts Made Within Three Years of Decedent's Death; Transfers with Retained Life Estate; Transfers Taking Effect at Death; Revocable Transfers; Proceeds of Life Insurance. — Whether trust assets are includible in a trust beneficiary's gross estate under § 2035, 2036, 2037, 2038, or 2042 if the beneficiary sells property (including insurance policies) to the trust or dies within 3 years of selling such

property to the trust, and (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(50) Section 2055. — Transfers for Public, Charitable, and Religious Uses. — Whether a transfer to a pooled income fund described in § 642(c)(5) qualifies for a charitable deduction under § 2055(e)(2)(A).

(51) Section 2055. — Transfers for Public, Charitable, and Religious Uses. — Whether a transfer to a charitable remainder trust described in § 664 that provides for annuity or unitrust payments for one or two measuring lives or a term of years qualifies for a charitable deduction under §2055(e)(2)(A).

(52) Section 2501. — Imposition of Tax. — Whether the sale of property (including insurance policies) to a trust by a trust beneficiary will be treated as a gift for purposes of § 2501 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(53) Section 2503. — Taxable Gifts. — Whether the transfer of property to a trust will be a gift of a present interest in property when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(54) Section 2514. — Powers of Appointment. — If the beneficiaries of a trust permit a power of withdrawal to lapse, whether § 2514(e) will be applicable to each beneficiary in regard to the power when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(55) Section 2522. — Charitable and Similar Gifts. — Whether a transfer to a pooled income fund described in § 642(c)(5) qualifies for a charitable deduction under § 2522(c)(2)(A).

(56) Section 2522. — Charitable and Similar Gifts. — Whether a transfer to a charitable remainder trust described in § 664 that provides for annuity or unitrust payments for one or two measuring lives or a term of years qualifies for a charitable deduction under § 2522(c)(2)(A).

(57) Section 2601. — Tax Imposed. — Whether a trust that is exempt from the application of the generation-skipping transfer tax because it was irrevocable on September 25, 1985, will lose its exempt status if the situs of the trust is changed from the United States to a situs outside of the United States.

(58) Section 2702. — Special Valuation Rules in Case of Transfers of Interests in Trusts. — Whether annuity interests are qualified annuity interests under § 2702 if the amount of the annuity payable annually is more than 50 percent of the initial net fair market value of the property transferred to the trust, or if the value of the remainder interest is less than 10 percent of the initial net fair market value of the property transferred to the trust. For purposes of the 10 percent test, the value of the remainder interest is the present value determined under § 7520 of the right to receive the trust corpus at the expiration of the term of the trust. The possibility that the grantor may die prior to the expiration of the specified term is not taken into account, nor is the value of any reversion retained by the grantor or the grantor's estate.

(59) Section 2702. — Special Valuation Rules in Case of Transfers of Interests in Trusts. — Whether a trust with one term holder satisfies the requirements of §2702(a)(3)(A) and § 25.2702-5(c) to be a qualified personal residence trust.

(60) Section 2702. — Special Valuation Rules in Case of Transfers of Interests in Trusts. — Whether the sale of property (including insurance policies) to a trust by a trust beneficiary is subject to § 2702 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

* * *

(62) Section 4947(a)(2). — Split-Interest Trusts. — Whether a split-interest trust is described in § 4947(a)(2) because it has no amounts in trust for which a deduction was allowed under § 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522.

* * *

SECTION 5. AREAS UNDER STUDY IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED UNTIL THE SERVICE RESOLVES THE ISSUE THROUGH PUBLICATION OF A REVENUE RULING, A REVENUE PROCEDURE, REGULATIONS, OR OTHERWISE

.01 Specific Questions and Problems.

* * *

(8) Sections 661 and 662. — Deduction for Estates and Trusts Accumulating Income or Distributing Corpus; Inclusion of Amounts in Gross Income of Beneficiaries of Estates and Trusts Accumulating Income or Distributing Corpus. — Whether the distribution of property by a trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is a distribution for which a deduction is allowable under § 661 or which requires an amount to be included in the gross income of any person under §662.

(9) Section 671. — Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners. — Whether the grantor will be considered the owner of any portion of a transfer in trust under §§ 673 to 677 that is purported to be an incomplete gift under § 2511, specifically including, but not limited to, a transfer to a trust providing for distributions at the direction of a committee to the donor and the committee members either by unanimous consent of the committee members or a majority of the committee members with the consent of the donor.[15]

(10) Section 678. — Person other than Grantor Treated as Substantial Owner. — Whether the beneficiaries of a trust will be considered the owners of any portion of such trust when two or more of such beneficiaries have the power to distribute income or principal to themselves by unanimous consent.[16]

(11) Section 1014. — Basis of Property Acquired from a Decedent. — Whether the assets in a grantor trust receive a §1014 basis adjustment at the death of the deemed owner of the trust for income tax purposes when those assets are not includible in the gross estate of that owner under chapter 11 of subtitle B of the Internal Revenue Code.

(12) Section 2036. — Transfers with Retained Life Estate. — Whether the corpus of a trust will be included in a grantor's estate when the trustee of the trust is a private trust company owned partially or entirely by members of the grantor's family.

(13) Section 2038. — Revocable Transfers. — Whether the corpus of a trust will be included in a grantor's estate when the trustee of the trust is a private trust company owned partially or entirely by members of the grantor's family.

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[15] This item is new for 2021.

[16] This item is new for 2021.

(14) Section 2041. — Powers of Appointment. — Whether the corpus of a trust will be included in an individual's estate when the trustee of the trust is a private trust company owned partially or entirely by members of the individual's family.

(15) Sections 2041 and 2514. — Powers of Appointment. — Whether the beneficiaries of a trust hold general powers of appointment over any portion of a transfer to a trust when (A) two or more of such beneficiaries have the power to distribute income or principal to themselves by unanimous consent and without the consent of the donor and either (B) such beneficiaries must be replaced upon the lapse of their powers as the result of death or otherwise or (C) all of such beneficiaries' powers described by (A) lapse upon the death of any one of the beneficiaries.[17]

(16) Section 2501. — Imposition of Tax. — Whether the distribution of property by a trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a “decanting”) resulting in a change in beneficial interests is a gift under § 2501.

(17) Section 2511. — Transfers in General. — Whether a transfer in trust that is purported not to be considered owned by the grantor under § 671 is an incomplete gift, specifically including, but not limited to, a transfer to a trust providing for distributions at the direction of a committee to the donor and the committee members either by unanimous consent of the committee members or a majority of the committee members with the consent of the donor.[18]

(18) Sections 2601 and 2663. — Tax Imposed; Regulations. — Whether the distribution of property by a trustee from an irrevocable generation-skipping transfer tax (GST) exempt trust to another irrevocable trust (sometimes referred to as a “decanting”) resulting in a change in beneficial interests is the loss of GST exempt status or constitutes a taxable termination or taxable distribution under § 2612.

SECTION 6. AREAS COVERED BY AUTOMATIC APPROVAL PROCEDURES IN WHICH RULINGS WILL NOT ORDINARILY BE ISSUED

.08 Section 2010(c)(5)(A). — Election Required. — All requests filed before the second anniversary of the decedent's date of death for an extension of time under §301.9100-3 to make an election under §2010(c)(5)(A), where the Service has provided an administrative procedure to seek such an extension. See Rev. Proc. 2017-34, 2017-26 I.R.B. 1282 (procedure providing for an extension of time to certain taxpayers to make a “portability” election under § 2010(c)(5)(A)).

* * *

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective January 4, 2021.

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[17] This item is new for 2021.

[18] This item is new for 2021.

C. IRS No-Rulings – International - List for 2021 -- Estate, Gift, GST Tax and Related Issues. Excerpts from Rev. Proc. 2021-7 2021-1 I.R.B. 290 (Jan. 4, 2021)

SECTION 3. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED

.01 Specific Questions and Problems.

(7) Sections 7701(b) and 894 – Definition of a Resident Alien and Nonresident Alien. – Whether an alien individual is a nonresident of the United States, including whether the individual has met the requirements of the substantial presence test or exceptions to the substantial presence test. However, the Service may rule regarding the legal interpretation of a particular provision of §7701(b) or the regulations thereunder.

* * *

SECTION 4. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED[19]

.01 Specific Questions and Problems.

(29) Section 2501.-Imposition of Tax. —Whether a partnership interest is intangible property for purposes of §2501(a)(2) (dealing with transfers of intangible property by a nonresident not a citizen of the United States).

(30) Section 7701.-Definitions.- Whether an estate or trust is a foreign estate or trust for federal income tax purposes.

* * *

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective January 4, 2021.

[19] Section 2.01 states that "'Not ordinarily' means that unique or compelling reasons must be demonstrated to justify the issuance of a ruling or determination letter."