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Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2923

Date: **29-Nov-21**

From: **Steve Leimberg's Estate Planning Newsletter**

Subject: **Mary Vandenack's Notes from the NYU Institute on Federal Taxation**

The **79th Annual NYU Institute on Federal Taxation** was held November 15 through November 19, 2021, virtually. **Mary E. Vandenack** attended the NYU Institute on Federal Taxation and agreed to share her notes. Members should click this link to review the meeting agenda: **79th Annual NYU Institute on Federal Taxation**

Mary E. Vandenack, J.D., ACTEC, CAP®, COLPM®, is founding and managing member of **Vandenack Weaver LLC** in Omaha, Nebraska. Mary is a highly regarded practitioner in the areas of tax, trusts and estates, private wealth planning, asset protection planning, executive compensation, business and business succession planning, tax dispute resolution, and tax-exempt entities. Mary's practice serves businesses and business owners, executives, real estate developers and investors, health care providers, companies in the financial industry, and tax-exempt organizations. Mary is a member of the American Bar Association Real Property Trust and Estate Section where she serves as on the Planning Committee, Nominations, and Council. Mary is a member of the American Bar Association Law Practice Division where she currently serves as Secretary. Mary has been named to ABA LTRC Distinguished Women of Legal Tech, received the James Keane Award for e-lawyering, and serves on ABA Standing Committee on Information and Technology Systems. Mary is a frequent writer and speaker on tax, benefits, asset protection planning, and estate planning topics as well as on practice management topics including improving the delivery of legal services, technology in the practice of law and process automation. Mary hosts a podcast called Legal Visionaries. https://www.vwattys.com/resources-vw-podcasts/

CURRENT DEVELOPMENTS

Legislative Update – Chair, John M. Gimigliano, Esq., Principal in Charge, Federal Legislative and Regulatory Services, KPMG, Washington D.C.

Presenters:

Jennifer Acuna, Esq., Principal, Federal Legislative and Regulatory Services, KPMG, Washington, D.C.

Douglas Poms, Esq., Principal, International Tax, KPMB, Washington DC.

Regulatory action by the new administration has been limited so far. Prop. Regs. for foreign persons and foreign-owned partnerships investing in qualified opportunity zone funds have been issued.

Final foreign tax regulations are expected in short-term. Final domestic partnership subpart F regulations are also expected.

Longer term regulations anticipated are final qualified pension fund regulations and final cloud regulations as well as application of section 245A at the CFC-level.

There is concern that existing international tax rules are not equipped to deal with modern digital business models. The OECD has been working on a solution for years. OECD seeks to establish a global minimum taxation regime that ensures that all internationally operating businesses pay at least a minimum level of tax on their income earned in each jurisdiction.

At this juncture, given the possible processes for a bill to be passed by year end, it is unclear whether there will be major tax legislation this year.

The current House proposal for business provisions includes an increase in the corporate tax rate to 21%, a minimum tax on global book income, an increase in GILTI rate, further limit on interest deductions, fossil fuel proposals, reinstatement of super fund, and stock buyback excise tax. The individual provisions include an individual surtax on high earners and limits on losses. The Biden proposals and Ways & Means proposals contain various other provisions including an increase in the ordinary income tax rate and increase in the capital gains rate.

Resources:

https://assets.kpmg/content/dam/kpmg/us/pdf/2021/09/tnf-tax-proposals-budget-reconciliation-approved-ways-means-sep16-2021.pdf

https://assets.kpmg/content/dam/kpmg/us/pdf/2021/05/tnf-biden-fy-2022-budget-may31-2021.pdf https://tax.kpmg.us/events/podcasts/catching-up.html

https://home.kpmg/us/en/home/insights/2015/03/taxnewsflash-legislative-updates.html

FROM THE EXPERTS: TAX CONTROVERSY AND TAX LITIGATION – CIVIL AND CRIMINAL UPDATE

Moderators: Sandra R. Brown, Esq., Principal, Hochman, Salkin, Toscher & Perez, PC, Beverly Hills, CA; Mark D. Allison, Esq., Member, Caplin & Drysdale, Chartered, New York, NY

Speakers: Damon Rowe, Director, Office of Fraud Enforcement, Internal Revenue Service, Washington, D.C.; Melissa Wiley, Esq., Member, Caplin & Drysdale, Chartered, Washington, D.C.; Zhanna A. Ziering, Esq., Member, Moore Tax Law Group, New York, NY

General IRS Updates

Current Enforcement Procedures:

- Expanded use of soft notices and other non-audit contracts
- Aggressively target areas of significant risk
- Enhanced coordination with treaty partners and international organizations
- All LB&I lawyers have been trained in the fundamentals of international taxation
- Revise and enhance case selection procedures to better identify high risk transactions
- Identify and pursue misuse by tax exempt organizations
- Implement comprehensive non-filer program
- Increase criminal investigations of existing and emerging high risk areas
- Identify and pursue promoters of tax schemes
- Develop and implement a coordinated preparer plan across IRS and preparer community
- Diligently administer a system of preparer sanctions
- Leverage research to identify areas of abuse by return preparers
- Continue focus on corporations, high income individuals, business income, and flow through entities.

Office of Fraud Enforcement

Office of fraud enforcement was created just over a year ago. Focus is enforcement initiatives in civil fraud cases and criminal referrals. Revenue officers have been strategically placed throughout the country. There are local fraud experts to assist with identification and development of potential fraud. IRS is leveraging data analytics technology and artificial intelligence to identify emerging threats.

Increased tax enforcement is taking place related to Families First Coronavirus Response Act, Coronavirus Aid, Relief, and Economic Security Act and The Consolidated Appropriations Act of 2021. The office has stopped at least $1 billion from going out. One area where there has been a lot of fraud is the employee retention credits. There has been a desire to get the credits out but to the right people.

Offers in Compromise are being referred to criminal enforcement. One issue is that those seeking offers in compromise are leaving off assets, particularly international assets.

LB&I Campaigns & Settlement Initiatives

An active list of LB&I campaigns can be found at: https://www.irs.gov/businesses/corporations/lbi-active-campaigns

Publication 5125 Examination Procedures

The LB&I examination process is outlined in Publication 5125. The link to that publication is:

https://www.irs.gov/pub/irs-utl/p5125.pdf

Early resolution opportunities include pre-filing agreements, compliance assurance process, advance pricing agreements, industry issue resolution.

Captive Insurance

A captive is an insurance company that insures the risks of its shareholders or persons related to its shareholders. Types of captive structures include parent-subsidiary captive arrangements, brother-sister captive arrangements, group captives and micro captives.

Insureds take deduction for insurance premiums if premium is a business expense. Captive is taxed under Subchapter L.

Captives made the list of the IRS "dirty dozen" list of tax scams in 2015. IRS Notice 2016-66 identified certain transaction relation to small captive insurance companies as transactions of interest. Participants identified in such notice are required to report under Treas. Reg. §301.6111-3. Material advisors are also required to report.

IRS concerns with micro-captives include:

- The captive transaction may have been marketed or promoted.
- Insurance policies may not constitute insurance if the captive was formed and operated for tax purposes.
- Insurance risk may be lacking or pricing of premiums may not be ordinary and necessary where risks are implausible or do not match insured's business needs.
- Risk pooling arrangements may lack risk distribution.
- Potential claims may not be filed or a claims procedure may not be followed.
- Captive may engage in related party financing.

There is no bright line rule.

IRS offered a settlement for certain taxpayers. Approximately 80% of taxpayers who were issued offer letters accepted settlement.

IRS made second limited time settlement offer in October, 2020. New audit teams were formed. There are approximately 500 cases docketed in Tax Court.

Syndicated Conservation Easements

A conservation easement is an interest in real property established by agreement between landowner and qualified organization. The agreement restricts the use of property for conservation purposes. Ownership remains with landowner subject to use restriction. The easement is recorded. Purposes of easement include achieving environmental objectives, land enjoyment objectives and obtaining a charitable tax deduction. Examples of properties over which conservation easements can be placed include golf course, undeveloped land, and farmland.

Charitable deduction for qualified conservation contribution is in §170(f)(3)(B)(iii). Qualified conservation contribution is defined in §170(h)(1) to include a qualified property interest to a qualified organization exclusively for conservation purposes.

An example of a conservation easement would be where taxpayer contributes money to a partnership which buys undeveloped land and places conservation easement over part of the land. Appraiser determines highest and best use is a residential development, which is legally permissible. Partnership donates the conservation easement and deducts the value.

In Notice 2017-10, syndicated conservation easements were designated as listed transactions. In 2018, transactions were added to list of LB&I's compliance campaign. In 2019, transactions were added to the IRS "dirty dozen" list of scams to avoid. In June 2020, IRs announced time-limited settlement offer for certain taxpayers. In December, 2020, DOJ announced first ever guilty please based on abuse of syndicated conservation easements.

The Senate Finance Committee investigated syndicated conservation easements.
https://www.finance.senate.gov/chairmans-news/finance-committee-releases-report-on-syndicated-conservation-easement-transactions

Office of Chief Counsel issued memo on determining fraud penalty in syndicated conservation easements. https://www.irs.gov/pub/irs-wd/202044009.pdf https://www.irs.gov/pub/irs-wd/202044010.pdf

Cryptocurrency Enforcement

IRS Notice 2014-21 stated that the IRS will treat virtual currency as property for federal tax purposes, provides guidance on how general federal tax principles apply to virtual currency transactions. In July 2018, the IRS announced a Virtual Currency Compliance campaign:

https://www.irs.gov/businesses/irs-lbi-compliance-campaigns-july-2-2018

In June 2020, guidance was issued regarding Microtask:

https://www.irs.gov/pub/irs-wd/202035011.pdf

Convertible virtual currency received by an individual for performing a microtask through crowdsourcing or similar platform is taxable income.

Cryptocurrency enforcement is occurring through the issuance of John Doe Summons and ensuing Summons Enforcement proceedings. Coinbase, the largest U.S. based virtual currency exchange, was ordered to produce documents on approximately 14,000 of its customers.

The IRS is believed to also have information obtained through Third Party Settlement Organization (TPSO) required by the Form 1099-K reporting system, as to cryptocurrency transactions. In general, a third party that contracts with a substantial number of unrelated merchants to settle payments between the merchants and their customers is a TPSO. A TPSO is required to report payments made to a merchant on a Form 1099-K when certain requirements are met.

IRS began sending “soft letters” to taxpayers in July 2019. The letters are one of three variations: Letter 6173, Letter 6174, Letter 6174-A. IRS indicates that the goal of these letters is to educate taxpayers about filing obligations. Form 1040 for the 2020 tax year includes a question on virtual currency.

Virtual currency is an ongoing focus area for IRS Criminal Investigation.

High Income Non-Filers

There has been a decline in audits of taxpayers with million dollar incomes. IRS is seeking to change this trend. Agents are being assigned to meet the directive. Specialists are being involved. Multiple entities and individuals are included.

Expectation is that several hundred examinations of high income taxpayers will be initiated. Approach will be cross-divisional. Steps taken to date include revenue officer sweeps, face to face engagement with taxpayers and focus on high income non-filers.

The Non-Filer enforcement initiative strategizes to catch/incentivize the high income (more than $100,000) non-filer. IRS is increasing the case creation in this category, using automated substitute for return preparation program, automated campus 6020(b) program and diligent return refund hold program.

A non-filer’s strategy for coming into compliance will depend on factors such as level or unreported income, involvement in listed transactions, source of income, degree of flagrancy in non-reporting and prior compliance or non-compliance.

Office of Promoter Investigations

IRS has added the Office of Promoter Investigations. The purpose is to purse promoters and combat abusive tax avoidance transactions.

A promoter is any person who organizes (or assists in the organization of) or participates in the sale of any interest in an entity, plan or arrangement and, in connection therewith, makes or furnishes (or causes another person to make or furnish) a statement with respect to the availability of any tax benefit by reason of participating in the plan or arrangement that the person knows or has reason to know is false or fraudulent as to any material matter. IRC §6700(a).

A material advisor is anyone who provides material aid, assistance, or advice with respect to organizing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and directly or indirectly derives gross income in excess of the threshold amount (or such other amount as may be prescribed by the secretary) for such aid, assistance, or advice. IRC §6111(b)(1).

Current priorities of the office include cryptocurrency, COVID-related fraud, and abusive tax transactions.

Partnership Audit Procedures (BBA)

Bipartisan Budget Act ("BBA") of 2015 repealed TEFRA and instituted a new partnership audit regime, effective for tax years after December 31, 2017. Under this regime, the Tax Matters Partner is replaced with the Partnership Representative, who has more power to bind the partnership and the partner with respect to audit determinations made by IRS. Tax deficiencies are collected at the partnership level unless the partnership is eligible to elect to put out the deficiency to the partners.

IRS LB&I is now enhancing compliance efforts. Partnership compliance personnel are being hired. Forms are being updated. LB&I is focusing on sales of partnership interests and self-employment.

Foreign Penalties

U.S. citizens and residents must report and pay taxes on worldwide income. U.S. citizens, residents or a person in and doing business in the U.S. must file an FBAR with the government if they have financial accounts in foreign countries with aggregate values exceeding $10,000 at any time during the calendar year. Sanctions for violation may include the criminal charges of tax evasion, filing false tax returns, and conspiracy. Civil penalties include penalties of up to 50% of account balances per year for willful failure to file. Penalties may be added on to the 50%.

Resources:

https://www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-voluntary-disclosure-practice

https://www.irs.gov/individuals/international-taxpayers/options-available-for-u-s-taxpayers-with-undisclosed-foreign-financial-assets

https://www.fincen.gov/

OVDP and Streamlined Hotline – 1-267-466-0020 (new phone number)

FinCEN Resource Center: – 1-800-767-2825 or (703) 905-3591 – FRC@fincen.gov

Voluntary Disclosure

The Voluntary Disclosure Practice is a long-standing practice of the IRS that provides taxpayers with criminal exposure a means to come into tax compliance and potentially avoid criminal prosecution. The Voluntary Disclosure Practice is a compliance option for taxpayers who have committed tax or tax-related crimes and have criminal exposure due to their willful violation of the law. If the violation of the law was not willful, taxpayers should consider other options including correcting past mistakes by filing amended or past due returns.

•A voluntary disclosure will be considered along with all other factors in determining whether criminal prosecution will be recommended. A voluntary disclosure does not guarantee immunity from prosecution. The Voluntary Disclosure Practice creates no substantive or procedural rights for taxpayers. Taxpayers cannot rely on the fact that other similarly situated taxpayers may not have been recommended for criminal prosecution. IRS-CI's determinations, including but not limited to determinations concerning timeliness, completeness, truthfulness, rejection, and revocation decisions, are not subject to any administrative or judicial review or appeal process.

Interim Guidance dated November 20, 2018, announced updates to the voluntary disclosure practice. Voluntary disclosure practice remains centralized with Criminal Investigation in Philadelphia. Criminal Investigations requires pre-clearance for all voluntary disclosures. IRS revised Form 14457 in April 2020.

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The Voluntary Disclosure Practice is not available to taxpayers with illegal source income. Income from activities determined to be legal under state law but illegal under federal laws is considered illegal source income for purposes of the IRS-CI Voluntary Disclosure Practice. A voluntary disclosure occurs when the communication is truthful, timely, and complete.

https://www.irs.gov/vdp

https://www.irs.gov/individuals/internationaltaxpayers/options-available-for-u-s-taxpayers-withundisclosed-foreign-financial-assets

Collection Procedures & Resolution Approaches

Offer in Compromise: IRC § 7122 and I.R.M. 8.23. The IRS will settle an outstanding tax liability for less than the full amount owed if a taxpayer can meet certain financial conditions. Offers in compromise will typically be accepted if it the offer represents the most the IRS can expect to collect within a reasonable time. Acceptance of an offer depends on taxpayer income and assets.

Installment Payment Agreement: IRC § 6159 and I.R.M. 5.14. IRS may enter into an installment agreement and allow taxpayer extended time to pay.

Partial Installment Payment Agreement: IRC § 6159 and I.R.M. 5.14.2. IRS may enter into a partial installment agreement.

Currently Not Collectable- I.R.M. 5.16.1 The IRS has the authority to place an account in "currently not collectable" status. Collection action is suspended. Reasons for such status include expiring collection statutes, insolvency, and taxpayer hardship.

Collection Due Process- I.R.M. 8.22. Taxpayer has a right to have Appeals assist in collection alternatives. This is available to taxpayers after the IRS files certain notices of proposed or actual levies or liens.

Collection Appeal Program -I.R.M. 8.24. This program grants Appeals the right to review federal tax lien filings, levies, seizures, and issues related to installment agreements. This process can only be used after requesting a conference with an IRS collection manager.

Other Topics

Marijuana Industry Frequently Asked Questions:

https://www.irs.gov/businesses/small-businesses-self-employed/marijuana-industry-frequently-asked-questions

Passport Revocation

FAST Act of December 2014 requires the denial and authorizes the revocation or limitation of passports of taxpayers certified to the Department of State as having seriously delinquent tax debt. Seriously delinquent tax debt is an unpaid amount greater than $54,000 for which a notice of federal tax lien has been filed and the taxpayer's right to a hearing has been exhausted or a levy has been made under IRC 6331.

John Doe Summonses

IRC 7609(c)(3) and (f) authorize the IRS to issue a John Doe summons pursuant to an investigation of ϖ a specific, unidentified person or an ascertainable group or class of persons ϖ believed to be violating the tax laws. The government must obtain prior judicial approval from the U.S. District Court to issue a John Doe summons. Prior judicial approval is requested ex parte. The matter is ripe for the court's consideration as soon as it is filed. A proposed order will generally be lodged with the filing of the John Doe Petition and supporting declaration and authorities.

Taxpayer Advocate Service

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS. The TAS is led by Erin M. Collins, National Taxpayer Advocate and Bridget T. Roberts, Deputy National Taxpayer Advocate.

1-877-777-4776
https://www.taxpayeradvocate.irs.gov/

https://www.irs.gov/taxpayer-advocate

Form 911 Filing Requirements:
Financial Difficulties
Immediate Threat
No Response from the IRS

ETHICAL ISSUES FOR TAX PRACTITIONERS: GOOD TAX PLANNING, AGGRESSIVE TAX ADVICE, OR CRIMINAL TAX EVASION

Chair: Bryan C. Skarlatos, Esq., Partner, Kostelanetz & Fink, New York

Speakers: Miriam L. Fisher, Esq., Global Chair of Tax Controversy, Latham & Watkins, Washington, DC; Christopher S. Rizek, Esq., Member, Caplin & Drysdale, Chartered, Washington, DC

On July 18, 2021, the IRS launched the Tax Pro Account that is available for tax professionals with CAF numbers to request online Powers of Attorney and Tax Information Authorizations. Simultaneously, the IRS added an "Authorization" tab to Online Accounts, so taxpayers can approve (or reject) these online authorization requests and sign electronically. If information on the online POA or TIA is validated by the IRS, including verification that a practitioner is in good standing, the authorization is recorded to CAF almost immediately, thereby avoiding the longer wait time for manually processing Forms 2848 and 8821. To check out the Tax Pro Account, go to the Tax Pro page on IRS.gov and the IRS' Digital Day Webinars include a walk-thru on requesting authorizations through the Tax Pro Account.

Secure Access Digital Identity ("SADI") will enable the ability to accept credentials from Credential Service Providers ("CSP's"). SADI aims to reduce barriers to access IRS online. SADI will provide greater coverage by expanding additional pieces of evidence for Identity Proofing while the CSP's held desk increases assistance with access via help desks. Transition started November 14, 2021.

There is nothing sinister in arranging one's affairs as to keep taxes as low as possible. Commissioner v. Newman, 159 F2d 848, 850-51 (2nd Cir. 1947). Avoidance of tax is not a criminal offense. Internal Revenue Manual 9.1.3.3.2.1.

Virtually all difficult ethical problems arise from conflicts between a practitioner's responsibilities to clients, the tax system and practitioner's own interest while earning a living.

The sources of ethical standards in tax practice for practitioners include AICPA Statements on Standards for Tax Services, National Association of Enrolled Agents Code of Ethics and Rules of Professional Conduct, Tax Executive Institute Standards of Conduct, Circular 230, ABA Model Rules of Professional Conduct; ABA Ethical Opinions, Civil Penalty Standards, and Criminal Penalty Standards. For taxpayers, civil and criminal penalty standards apply.

Confidentiality is not in Circular 230 although it is in ABA Ethical Rules. Revisions to Circular 230 are being considered and currently at Treasury for review.

IRS is not a tribunal so there is no duty to bring adverse authority to the IRS' attention. There is however a duty not to mislead the IRS. ABA Opinion 85-352 provides that a lawyer may advise a client to take a position if there is a realistic possibility of success if the matter is litigated. Standards have been legislatively overruled and are evolving, especially in light of dealing with tax shelter issues. See IRC 6694.

IRC 6694 applies to return preparers and includes tax advice, including a non-signing preparer. IRC 6708/6708 provides penalties for failure to maintain a list of reportable transactions. The penalties are significant.

Criminal penalties can apply to tax advisors under 7201, 7206, 7212, 7216 and 18 USC 371.

Ordinary everyday tax advice can expose preparers to penalties.

Standards vary based on whether you are a planner, a preparer, or a representative. A planner renders advice in advance of a transaction. A preparer renders advice about reporting after a transaction. A representative renders advice during an audit or investigation.

Treas. Reg. 1.66994-1(e) provides that practitioners can generally rely on information provided by other advisors and taxpayer. Reasonable inquiries are required if anything appears to be incomplete or inaccurate.

A preparer may not sign a return or advise on a position of the position lacks a reasonable basis. To be reasonable, a position must be supported by substantial authority or has a reasonable basis which is disclosed.

Substantial authority requires that the weight of authority is substantial in relation to authority that is contrary. See *Osteen v. Commissioner*, 62 F. 3d 356 (11th Cir. 1995) and *Kleuner v. Commissioner*, 154 F3d 140 (6th Cir. 1998).

Adequate disclosure is defined in Treas. Reg. 1.6662-4(f) and Circular 230, sec. 10.34(c). Adequate disclosure does not work for tax shelters.

A summary of requirements for tax preparers is: Competence, Due Diligence, Standards.

Circular 230 indicates that a practitioner “must not, in evaluation a federal tax matter, take into account the possibility that the tax return will not be audited or that the matter will not be raised on audit.” Circular 230, §10.37(a)(2).

PARTNERSHIPS, LLCs AND REAL ESTATE:

Co-Chairs: Andrea M. Whiteway, Esq., Principal, EY, Washington, DC

<u>Qualified Opportunity Zone Funds Section 1400Z</u>

Speakers: Sanford C. Presant, Esq., Shareholder, Greenberg Traurig, Los Angeles, CA; James O. Lang, Esq., Shareholder, Greenberg Traurig, Tampa, FL

A Qualified Opportunity Zone Fund is an investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property. Capital gains invested in such funds create the opportunity for tax deferral, tax reduction and tax exclusion.

There are two types: Qualified Opportunity Zone Business; Qualified Opportunity Zone Business Property.

O-Zone financing is intended to unlock the private investment potential of over $6 trillion of captive capital games across private individuals and companies. See 1400Z-1 and 1400-Z of the Code.

The primary tax benefits are tax deferral, tax abatement and no additional taxation on post-investment appreciation in certain qualifying investments.

Investors can receive tax advantaged returns. A higher IRR can result because of the favorable tax treatment. O-Zones can fill a capital stock gap for project sponsors by creating a source of equity infusion.

Final regulations were published on January 13, 2020. There were some issues and corrective regulations were issued in August, 2021, that provide clarity on holding of tangible property. There has been some relief in the OZ timeframes related to COVID delays.

8,700 funds have been created nationally. Funds are corporation or partnership organized for investment in qualified O-Zone property. Entity self certifies status.

Tangible property used in a trade or business must be acquired by purchase after December 31, 2017, must be used in a business and must be substantially improved.

The heart of OZ compliance lies in safe harbors that have been established. Safe harbors exist related to rules regarding working capital, percentage of gross income that must be derived from active conduct of business, and compliance deadlines for qualifying property.

Types of investors in OZ funds include family offices, high net worth individuals, investment bank platforms, private equity, venture capital, real estate specialty funds, and hedge funds.

Some states are providing expedited planning and incentives for OZ funds. OZ funds are being "twinned" with historic rehabilitation credits, renewable energy, tax credits, private activity bonds and grants. In addition, partnering with affordable housing programs is occurring.

Decisionmaking within the BBA centralized partnership audit rules

Speaker: Jennifer M. Black, Esq., Senior Counsel, Office of Associate Chief Counsel, (Procedure & Administration), Internal Revenue Service, Washington, DC; Kate Kraus, Esq., Partner, Allen Matkins Meck Gamble Mallory & Natsis, Los Angeles, CA; Ossie Borosh, Esq., Principal, KPMG, Washington, DC

New partnership rules affect decision-making in the context of due diligence in transactions, indemnities in transaction documents, structuring transactions, correcting previous reporting, and paying liabilities on adjustments on audits. What are the consequences of various approaches if the partnership ceases to exist?

Certain partnerships can elect out of the non-TEFRA rules. IRC 6225 allows partnership to pay tax at highest rate in current year. IRC 6226 allows partnership to push out taxes in current year. Electing out is rarely an option.

Generally, partnerships subject to the BBA cannot file an amended return or amended Schedules K-1 for tax years beginning after December 31, 2017, but rather must file an administrative adjustment request (—AAR‖) to adjust a partnership-related item on a partnership return that has already been filed. AARs are materially different from an —amended return. AARs are filed electronically on Form 8082, or if partnership is not required to file electronically, may be filed on Form 1065X with amended return. Do not file amended Forms 1065 and Schedules K-1, unless permitted by the IRS, e.g., Rev. Proc. 2020-23; Rev. Proc. 2021-29.

Hot Like Kind Exchange Issues

Speakers: Anne Andrews, Partner, PWC, San Jose, CA; Glenn M. Johnson, Esq., Partner, EY, Washington, DC; Robert D. Schachat, Esq., Managing Director, BDO USA, Washington, DC

To qualify for tax free deferral under 1031, relinquished property must be exchanged for replacement property. This can be viewed as four requirements: Real property; like kind; held for investment or use in a trade or business; exchange.

Gain realized in a like-kind exchange is still recognized to the extent taxpayer receives cash or other property that is not of a like-kind ("boot"). Even if an exchange qualifies as tax free under 1031, ordinary income recapture can be triggered.

TCJA amended section 1031 to restrict real property exchanges to real property exchanges. Regulations amend the definitions of real property. Gain or loss is not recognized on the exchange of real property held for productive use in a trade or business or for investment ("Relinquished Property") if such real property is exchanged solely for real property of like kind which is to be held either for productive use in a trade or business or for investment ("Replacement Property"). Generally the existing 45-day identification and 180-day receipt, boot recognition, and related party rules were retained. The regulations have the goal of being consistent as to what is considered real estate for purposes of the like-kind exchange rules.

The regulations include in the definition of "real property" land and improvements that are inherently permanent structures and structural components thereof. Unsevered natural products of land, including growing crops, plants, timber; mines; wells; and other natural deposits, generally are treated as real property.

The final regs include real property under state or local law. Reg. 1.1031(a)-3(a)(1). Status is tested on the date the property is transferred in an exchange.

Building includes houses, apartments, hotels, motels, barns, enclosed garages, stores, warehouses, enclosed stadiums and arenas, enclosed shopping malls, enclosed transportation stations, factories and office buildings pursuant to the final regulations.

Real property excludes stock, other securities, interests in a partnership, and certificates of trust or beneficial interests.

An interest in real property includes a license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure in the nature of a leasehold, easement or similar right; and not to engage in or operate a business on real property, regardless of its classification under state of local law.

Biden legislative proposals would limit gain deferral annually to $500,000/$1,000,000. This would be effective for exchanges in tax years after December 31, 2021.

Leasehold interests can be exchanged.

You cannot do a self exchange. Construction of new building on land already owned by taxpayer is not like kind. Bloomington Coca-Cola Bottling Co. v. Commissioner, 189 F.2d (7th Cir. 1951); Rev. Rul. 67-255, 1967-2 CB 270.

Sale for cash followed by reinvestment of cash in like-kind property does not qualify under §1031. Crandall v. Commissioner, T.C. Summary Opinion 2011-14 (failure to use qualified intermediary or qualified escrow, discussed below, resulted in actual receipt).

Underwater property can be exchanged. PLR 201302009. Lender cooperation is helpful. There should be not sales contract in foreclosure. To minimize cash portion of replacement property, taxpayer may acquire credit net lease property.

Taxable loss is disallowed in a 1031 exchange. Redwing Carriers, Inc. v. Tomlinson, 399 F.2d 652 (5th Cir. 1968). To avoid loss disallowance, use different taxpayers to transfer and receive property, use separate agreements and separate closing dates.

CLOSELY-HELD BUSINESSES Chair: Jerald David August, Esq., Partner, Fox Rothschild, Philadelphia, PA

<u>Section 1031 Issues</u>

Speaker: Terence Floyd Cuff, Esq., Of Counsel, Loeb & Loeb, Los Angeles

A drop and swap involves a partnership or LLC distributing real property to one or more partners or members. The property may be distributed as a whole or as a tenancy-in-common interest. The ability to distribute property might be restricted by operating agreement provisions or loan documents.

If two of three partners exchange their interests for the same property and the third exchanges his or her interest for a different property, the drop and swap likely works with respect to the two members that exchange for a property together but the exchange of the third partner may be challenged as lacking economic substance or step transaction. See *Court Holding Co. v. United States*, 324 U.S. 331 (1945).

Factors that tend against application of economic substance doctrine include: transaction is not promoted by tax advisors; transaction is not highly structured; transaction is at arm's length with unrelated third parties;

transaction does not accelerate a loss or duplicate a deduction; transaction has business purpose apart from federal tax benefits; transaction is not prepackaged.

The question in the drop and swap is whether the member is a bona fide owner of the relinquished property prior to the exchange.

Taxpayers have a favorable record litigating on these issues but the resolution is uncertain.

An alternate would be to distribute the tenancy in common interest in advance of a transaction. There could be a distribution one year prior to a transaction, six months prior to a transaction, prior to listing, prior to negotiating a sale, prior to closing. There is risk associated with each of these choices. To reduce risk, entity formalities should be implemented and followed. The member who received the tenancy in common interest should be a party to the listing agreement, participate in negotiation, pay his or her share of expenses. Deed out could be recorded.

Those drafting partnership agreements should be careful about how language requiring cooperation in exchanges is covered and what the partnership has promised to do. Drafters should also be conscious of the audit aspects of the drop and swap exchange.

TRUSTS & ESTATES

Chair: Sanford J. Schlesinger, Esq., Founding Partner, Schlesinger Lazetera & Auchincloss, New York, NY

<u>The Only Things Certain In Life Are Death and Taxes</u>

Speaker: Sanford J. Schlesinger, Esq., Founding Partner, Schlesinger Lazetera & Auchincloss, New York, NY

Inflation adjusted numbers for 2022 are out but the House passed bill could impact some of the numbers that have been published.

https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2022

Annual exclusion increasing to $16,000 per person per year. Lifetime gift and estate tax exclusion is increasing to $12,060,000.

House voted today to pass Build Back Better Act.

SALT limitation cap is increased from $10,000 to $80,000. For non-grantor trusts, the limitations if $40,000. The limitation will sunset back to $10,000 in the future.

There is no change to federal income tax rates for individuals with income of less than $10,000,000. There is no change to capital gains rate for those with income of less than $10,000,000. For those with more income (and trusts and estates with $200,000 of income) will pay 25%.

There is no change to step up in basis rules or deemed realization in the Act passed today.

Grantor trust proposed changes are not included in the bill. There are also no changes to valuation discounts.

There is no change to C corporation tax rates and no changes to 199A.

There is no change to the carried interest rules.

The bottom line is there are very few changes that impact trusts and estates.

There is a new tax surcharge that will apply to the top .02 percent of taxpayers. There is a 5% surcharge with modified adjusted gross income in excess of $10,000,000. For a non-grantor trust or estate, the threshold is $200,000. There is a second tier of the surcharge that applies to those with MAGI in excess of $25 million. Threshold for a non-grantor trust or estate is $400,000.

Excess business losses are disallowed.

Flow through entity income will be subject to social security.

The bill prohibits contributions to a Roth or traditional IRA for a tax year if the contributions will cause the total value of an individual's IRA and defined contribution retirement accounts to exceed (or further exceed) $10 million. The limitation will apply to individuals with income over $400,000 (single filers and married filing separately), $425,000 (heads of household), or $450,000 (married taxpayers filing jointly).

If an individual's combined traditional IRA, Roth IRA, and defined contribution retirement account balances exceed $10 million at the end of a tax year and the individual meets the income thresholds noted in the previous paragraph, a minimum distribution would be required for the following year.

The bill prohibits all employee after-tax contributions in qualified plans and after-tax IRA contributions from being converted to a Roth IRA regardless of income level, effective for distributions, transfers, and contributions made after Dec. 31, 2021.

The bill will amend Sec. 1202 to disallow the 75% and 100% exclusion of gain from the sale of stock if the taxpayer's AGI is over $400,000 or if the taxpayer is a trust or estate.

The bill also eliminates Roth conversions for both IRAs and employer-sponsored plans for single taxpayers (or taxpayers married filing separately) with taxable income over $400,000, married taxpayers filing jointly with taxable income over $450,000, and heads of household with taxable income over $425,000 (all indexed for inflation). This provision applies to distributions, transfers, and contributions made in tax years beginning after Dec. 31, 2031.

Florida, Alaska, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming do not tax the income of non-grantor trusts.

States with an estate tax include Connecticut, Hawaii, Maine, Illinois, Massachusetts, New York, Minnesota, Oregon, Rhode Island, Vermont, Washington D.C., and Washington. States with an inheritance tax include Kentucky, Nebraska, New Jersey and Pennsylvania.

Maryland levies both an inheritance tax and estate tax. Iowa has an inheritance tax but it is repealed over the next five years.

<u>Grantor Trust Planning In Light of Proposed Tax Law Changes</u>

Speakers: Louis Nostro, Esq., Shareholder, Gunster, Miami, FL

The proposed new Section 2901 (which did not make it into the House passed Build Back Better Act), would have included in a taxpayer's estate assets which the taxpayer was classified as the deemed owner. Keep in mind that it is not uncommon for proposed legislation to be resurrected.

Grantor trusts in existence as of the date of enactment would have been grandfathered. Contributions to a grandfathered grantor trust would be included in the grantor's estate for estate tax purposes.

Common grantor trusts are grantor retained annuity trusts (GRATs), intentionally defective grantor trusts (IDGTs), spousal limited access trusts (SLATs), irrevocable life insurance trusts (ILIT), and qualified personal residence trusts (QPRTs).

<u>Basic Features of a GRAT</u>

Grantor Retained Annuity Trusts (GRATs have become an integral part of estate plans for wealthy clients. A GRAT allows you to transfer all appreciation over the IRC Section 7520 interest rate to children or other beneficiaries gift tax free. The November 2021 Section 7520 rate is only 1.4% (This rate has fluctuated between 0.6% and 3.2% over the past five years). GRATs can be structured with a term of as little as two years. GRATs can be established on a zeroed-out basis (using less than $1 of the grantor's gift tax exemption to shift all growth of the GRAT assets in excess of the Section 7520 rate to GRAT beneficiaries at the end of the GRAT term).

To obtain a step up in basis with assets in a GRAT, sell the assets before the GRAT term ends or swap assets with the GRAT.

Sale to a Grantor Trust – In General

A sale to a grantor trust is a strategy in which a grantor creates an irrevocable trust and then sells assets to the trust in an exchange for a note and then invests in a manner that produces a rate of return that is greater than the interest rate on the note evidencing the debt. As long as the promissory note bears interest at the appropriate AFR, the value of the note for gift tax purposes will be its face amount. No gift will occur upon the sale to the trust for a note. As the sale is made to a grantor trust, as to the grantor, the loan evidenced by the note is treated as being between the grantor and herself for income tax purposes. The grantor does not recognize interest income on the note. Transactions between grantor and grantor trust have no income tax consequences.

Spousal Limited Access Trust

The SLAT structure involves the donor spouse making a gift of assets to an irrevocable trust for beneficiaries other than the spouse but providing the spouse access during the beneficiary spouse's life. Done correctly, the assets will be excluded from the estate of the donor spouse (and the beneficiary spouse) but will allow the beneficiary spouse to access assets in the SLAT if needed. Spousal access terminates upon the death of the beneficiary spouse. Thus, it is important to keep in mind that the donor spouse should have sufficient assets so that the donor spouse is not likely to need access to the SLAT upon the death of the beneficiary spouse.

Avoid the Reciprocal Trust Issue

To avoid application of the reciprocal trust doctrine, use different trustees, different income distribution guidelines, different principal distribution standards, provide on spouse a testamentary limited power of appointment, use a different trust situs, fund at different times.

Irrevocable Life Insurance Trust

The face value of life insurance policies owned by a properly structured and administered irrevocable life insurance trust (ILIT) can avoid estate tax inclusion at the death of an insured. Insured makes gifts to trust which are used to pay premiums. Premium financed, split dollar and other vehicles are also used in ILIT planning.

Millionaire's Surtax

The Build Back Better Act imposes a stringent surtax on non-grantor trusts. Extremely high income individual taxpayers will be subject to a surtax on adjusted gross income above $10 million: 5% above $10 million; An additional 3% above $25 million. This affects the wealthiest 0.02% of Americans.

The surtax would apply to trusts with modified adjusted gross income (MAGI in excess of the following levels: 5% on trusts with income in excess of $100,000; Additional 3% on trusts with income in excess of $200,000. MAGI is AGI with certain seldom-used deductions added back in. Please recall that the 37% trust tax rate begins at just $13,050 of income. Income may need to be distributed within 65 days of the close of the trust year to avoid application of the new 42%/45% federal income tax rate.

<u>Qualified Personal Residence Trust</u>

A qualified personal residence trust (QPRT) is a specific type of irrevocable trust that allows its creator to remove a personal home from their estate for the purpose of reducing the amount of gift tax that is incurred when transferring assets to a beneficiary. Individual transfers residence to QPRT and retains right to reside in residence. There is a designation of beneficiaries at end of term. Initial transfer is a taxable gift determined by actuarial value of remainder interest passing to beneficiaries.

<u>2022 to 2025 Planning Considerations</u>

Continue to use grantor trusts wherever possible.

Utilize valuation discounts in planning.

Take advantage of low interest rates with GRAT planning, sales to defective grantor trusts and use of charitable lead annuity trusts.

Avoid the tsunami of 2025.

<u>Family Limited Partnerships and Other Closely-Held Entities: The Continuing Saga</u>

John W. Porter, Esq., Partner, Baker Botts, Houston, TX

The IRS is looking at estate and gift tax returns with regularity since the moratoriums on audit came to an end. The IRS is keeping a good pace on examining these issues even though virtual.

Planners should consider preparing for audit at the planning stage. IRS challenges include valuation, formula transfers, section 2036, installment sales to intentionally defective grantor trusts, grants, S corporation valuation, Ahmanson Foundation/Warne, and penalties. More and more penalties are being asserted by the IRS.

Smaldino V. Commissioner No. 5437-18; T.C. Memo 2021-127. Petitioner, as trustee of the Smaldino Family Trust, executed a document captioned “ASSIGNMENT SEPARATE FROM CERTIFICATE”, which states that he assigns and transfers” to Mrs. Smaldino a “sufficient number” of nonvoting units in the LLC “so that the fair market value of such nonvoting units as determined for federal gift tax purposes shall be Five Million Two Hundred Forty Nine Thousand One Hundred Eighteen and 42/100ths Dollars ($5,249,118.42)". Petitioner and Mrs. Smaldino decided upon this amount on the basis of her then-available Federal estate and gift tax exemption. Mrs. Smaldino executed an "ASSIGNMENT SEPARATE FROM CERTIFICATE", which states that she "assigns and transfers" to Allen Douglass Smaldino, as trustee of the Dynasty Trust, nonvoting shares of the LLC that are described identically as in the certificate whereby petitioner had purportedly assigned these same LLC interests to her. This document, which is signed by both Mrs. Smaldino and Allen Douglass Smaldino, states that it is "Effective: April 15, 2013" but does not indicate the date it was executed. Petitioner, as trustee of the Smaldino Family Trust, executed a document captioned "ASSIGNMENT SEPARATE FROM CERTIFICATE", which states that he "assigns and transfers" to Allen Douglass Smaldino, as trustee of the Dynasty Trust, a "sufficient number" of nonvoting units in the LLC "so that the fair market value of such nonvoting units as determined for federal gift tax purposes shall be One Million Thirty One Thousand Eight Hundred Eighty One and 58/100ths Dollars ($1,031,881.58)." This document, which is signed by both petitioner and Allen Douglass Smaldino, states that it is "Effective: April 15, 2013" but does not indicate the date it was executed. The Tax Court held that an Smaldino made a gift of 49 percent of the class B membership interests in a limited liability company to a trust for his children and grandchildren, finding that he indirectly gifted shares that he transferred to his wife who then transferred them to the trust. The court also determined the value of the LLC interests based on an IRS expert's report.

Understand and preserve all privileges including attorney-client privilege, work product immunity, and tax practitioner's privilege. Remember that your files can be subpoenaed, including emails. You might be required to testify about the reasons for creating a particular strategy.

When planning transactions, discuss and document both the non-tax advantages as well as the tax advantages of potential strategies.

What is being seen at the audit level is that valuation reports are being sent to internal experts for review. Even Appeals have their own valuation experts these days. In some cases, the IRS will use outside appraisers.

Formula clauses should be in the practitioner toolkit. The use of formula transfers potentially allow transfers to define the dollar value of hard to value assets passing taxable transferees will hold to transferees. Types of formula clauses include defined value clause based on values as finally determined for estate/gift tax purposes, defined value clause, and price adjustment clause. Reversion clauses don't work.

The formula language that you use makes all the difference.

Defined Value Clause Based on Value as finally determined for estate/gift tax purposes:

Wandry language: "I hereby transfer to _____ that number of shares of ABC Company with a fair market value as finally determined for federal gift tax purposes equal to $ [X] .

Petter language: "I hereby transfer X shares of XYZ Company to [taxable transferee] and [charity/QTIP/GRAT] to be allocated between the transferees as follows: (1) that number of shares with a fair market value as finally determined for federal gift tax purposes equal to $ [X] to [taxable transferee]; and (2) the remainder of the shares to [charity/QTIP/GRAT].

If you are using *Petter* language, Porter prefers seeing a public charity. Private foundation poses more risk. Lifetime QTIPs and GRATs are a possibility but there isn't case law yet.

Defined Value Clause

McCord and Hendrix are examples of defined value clauses and typically refer to a specific dollar amount.

Price Adjustment Clauses

King language: "I hereby sell X shares of XYZ Company in exchange for a promissory note with a principal amount of $ [X] (which the parties believe to be equal to the fair market value of the shares). The term of the promissory note shall be [add note terms/interest]. If the fair market value of the shares as finally determined for federal gift tax purposes is greater or less than $[X], the principal amount of the note shall be adjusted to the finally determined value effective as of the date of the transfer. The parties intend for the sale to be at fair market value and that no gift result from the sale.

Reversion clauses don't work. *Procter***.**

In *Nelson v. Commissioner*, T.C. Memo 2020-81 (June 20, 2020), is a good example of the importance of structuring formula clause language with extraordinary care. The language referred to a value as determined by a qualified appraiser rather than as "finally determined for estate and gift tax purposes."

If you use a formula clause, disclose the transaction in a gift tax return to get the statute of limitations running. Report the transaction consistent with the formula. Report the formula in the gift tax return schedule. Then, report states that "based on the appraisal attached hereto, the party has transferred X number of shares".

Section 2036 continues to be the most litigated issue. The ramifications of Section 2036 are draconian.

Sales should be bona fide sales for adequate and full consideration. Court focuses significant attention to this issue. There should be non-tax reasons for the entity. Non-tax reasons include centralized asset management, involving next generation in management, protect from creditors/failed marriage, preservation of investment philosophy, avoiding fractionalization of assets, and avoiding imprudent expenditures by future generations.

Distribution powers should have limitations on the discretion to distribute. Investment powers are not an issue with respect to the senior family member (*Byrum v. US*); however, distribution powers are (*Cohen/Byrum*). If there are guardrails put on senior family member regarding distributions (business decisions necessary to carry on business, e.g.), you may be able to avoid 2036 issue with respect to senior family members. Broad and unlimited distribution powers of a senior family member will be problematic under 2036(a)(2). Involving a next generation family member is helpful in terms of establishing non-tax reasons for entity. If senior family member is manager of general partner, also ensure there are sufficient guardrails. For example, name a co general partner and provide other non-tax purposes.

In some states, the general partner is a fiduciary. To the extent that the general partner is a fiduciary, that helps make an argument against 2036(a)(2). The fiduciary argument is stronger to the extent that the general partner has a smaller interest.

The important feature of the Powell case is that there is an indication that if the senior family member has the right to vote on dissolution, a 2036(a)(2) issue may exist. Porter thinks the case is wrong but notes that we must address it. To avoid the issue, satisfy the bona fide sale test. Create two classes of interests. Senior member disposes of all interests in the entity more than three years before death. Terminate entity more than three years before death. The best strategy is to satisfy bona fide sale test to avoid getting to the 2036 issue.

Gift tax issues related to installment sales to intentionally defective grantor trusts include FMV of interest sold, FMV of consideration received. Estate tax issues include adequate and full consideration and payment of note.

Anticipate an audit at the planning stage. The IRS issues broad requests such as "all documents relating to the creation of the entity from any attorney, accountant, or firm involved in recommending the creation of the entity."

Understand and preserve all privileges: Attorney-client privilege; work product immunity; tax practitioner's privilege. Some of the best evidence for non-tax reasons comes from contemporaneous correspondence.

Tax affecting in S corporation valuations has been a recent subject of cases. Tax affecting allowed in Estate of Jones v. Comm'r and Kress v. United States. Tax affecting not allowed in Estate of Jackson v. Comm'r because the Estate's experts (1) did not persuade the court that a taxpaying entity would be the likely hypothetical buyer of the assets at issue, (2) did not consider the tax detriments and benefits of pass-through status, and (3) the Estate's expert disagreed on the appropriate tax rate.

<u>Ahmanson Foundation/Warne – Avoiding the charitable/marital gross estate mismatch</u>

Ahmanson Found. v. United States, 674 F.2d 761 (9th Cir. 1981). Decedent owned (through a revocable trust) a corporation that had 100 shares. Only one of those shares was a voting share; the remaining 99 shares were nonvoting. The decedent bequeathed the one voting share to his son and the 99 nonvoting shares to a charitable foundation. Gross estate value based on value of all 100 shares of the corporation. Charitable deduction based on value of the non-voting shares received by the charity, which included discounts for lack of control and lack of marketability. When valuing charitable contributions, we do not value what an estate contributed; we value what the charitable organizations received.

Estate of Warne v. Commissioner, T.C. Memo 2021-19 (Feb. 18, 2021). 100% of Royal Gardens, LLC included in decedent's gross estate. 75% passed to family foundation; 25% passed to a church. Relying on Ahmanson Foundation, court held that —the estate may deduct only the 25% and 75% interests received by the respective charities.

IRS 6662(g) and (h) impose a penalty for a substantial and gross under-valuation. There is a reasonable cause exception under 6664(c). Relying on appraisal may not be reasonable. *Morrissette v. Comm'r*, T.C. Memo 2021-60.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Mary Vandenack

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