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

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

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I. INTRODUCTION

The past twelve months have 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 December 1, 2016 through December 31, 2017.

The tax developments in this outline are divided into 6 categories: Tax Reform, Income Taxes, Estate Taxes, Gift Taxes, Generation-Skipping Transfer Taxes, and Special Valuation Rules.

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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.probatepracticereporter.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ordered supplemental briefs, and in its opinion, the court stated that "[a]lthough the technical advice memorandum is not precedential [footnote citing Sec. 6110(k)(3)], it shows that the Hardys' grouping was not clearly inappropriate"); *Fanning v. United States*, 568 F.Supp. 823 (E.D. Wash.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 of the last five categories is divided by Internal Revenue Code section, except that special consolidated discussions examine the various developments relating to the taxation of family partnerships and LLCs and charitable remainder trusts.

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. TAX REFORM

Budget Reconciliation Act of 2017. Pub. L. 115-97, 115th Cong., 1st Sess. (Dec. 22, 2017); H. Rep. 115-409, 115th Cong., 1st Sess. (2017) (Ways and Means Report); and H. Rep. 115-466, 115th Cong., 1st Sess. (2017) (Conference Report)

The Budget Reconciliation Act of 2017 ("BRA 2017") would make several important changes in the taxes directly related to estate planning. These changes include the following:

- **Increased Applicable Exclusion Amount and GST Exemption.** Perhaps the most significant estate planning-related change is a doubling of the estate and gift tax applicable exclusion amount, from \$5 million to \$10 million, for gifts made after and estates of decedents dying after December 31, 2017, and before January 1, 2026. BRA 2017 § 11061(a). By increasing the applicable exclusion amount, the BRA 2017 also automatically increases the GST exemption. See IRC § 2631(c).

  Note. The wording of the BRA 2017 is unclear regarding whether the applicable exclusion amount and GST exemption for 2018 is \$10 million per individual, or \$10 million indexed for inflation from 2011, when it was set at \$5 million with indexing. The legislative history states quite clearly that indexing is to continue from 2011. H. Rep. 115-466 at 219; H. Rep. 15-466 at 144. This may require technical correction.

- **Change in Indexing.** The BRA 2017 retains the inflation adjustments to the applicable exclusion amount and GST exemption under current law, but will apply to taxable years after December 31, 2017, the less generous Chained Consumer Price Index for All Urban Consumers ("C-CPI-U"). The C-CPI-U differs from the current Consumer Price Index for All Urban Customers ("CPI-U"), because it attempts to account for individuals' ability to alter consumption patterns in response to price changes. The C-CPI-U allows for consumer substitution between item categories in the market basket of consumer goods and services that make up the index, while the CPI-U only allows for modest substitution within item categories. Tax values that are indexed by the C-CPI-U in taxable years beginning after December 31, 2017. BRA 2017 § 11002. The changes to the inflation indexing do not sunset after 2025.

- **No Clawback.** The BRA 2017 also amends Section 2010(g) (regarding computation of estate tax), to direct the Treasury Secretary to prescribe whatever regulations may be necessary or appropriate to carry out the purposes of the section with respect to differences between the basic exclusion amount in effect: (1) at the time of the decedent's death; and (2) at the time of any gifts made by the decedent. This is expected to mean that there will be no "clawback" of the increased applicable exclusion amount or GST exemption that a donor uses if the donor dies after the expiration of the increased applicable exclusion amount and GST exemption. BRA 2017 § 11061(b).

  Treasury may have a problem adopting new regulations, because of Executive Order 13771 (Jan. 30, 2017). This Order requires that two existing regulations be eliminated for every new regulation promulgated. The Order does not include any express exception for regulations promulgated under newly-enacted laws.

- **No Repeal.** The final law did not adopt the provision in the House-passed version of the BRA 2017, that would have repealed the estate and generation-skipping transfer taxes after December 31, 2024.

Note. Doubling of the applicable exclusion amount and GST exemption for transfers in 2018 – 2025 is, for most clients, the most important estate planning change under the new law.

For very wealthy clients, the best plan is to make in 2018 an additional $5.59 million ($11.18 million for a married client) irrevocable gift to one or more generation-skipping trusts. This will shift future appreciation and lock-in the use of the increased applicable exclusion amount and GST exemption.

Most clients with taxable estates will be unwilling to part irrevocably with such large sums. Such clients will want to preserve their continued benefit from the transferred funds, either as a primary or secondary beneficiary. For such clients, there are at least two particularly good solutions.

First, a client can create a self-settled spendthrift trust in which he or she remains a discretionary beneficiary. At common law, a grantor's creditors can compel the trustee to distribute to the grantor the maximum amount that the trust permits the trustee to distribute. Thus, such transfers are incomplete for gift and estate tax purposes. Rev. Rul. 77-378, 1977-2 C.B. 347; Rev. Rul. 76-103, 1976-1 C.B. 293; *Herzog v. Comm'r*, 41 BTA 509 (1940), *aff'd*, 116 F2d 591 (2d Cir. 1941); *Paolozzi v. Comm'r*, 23 TC 182 (1954), *acq*. 1962-2 CB 5.

In 16 states, however, statutes vary the common law and permit the creation of self-settled spendthrift trusts. See Alas. Stat. §§ 34.40.010 to 34.40.130; 12 Del. Code §§ 3570 to 3576; Haw. Rev. Stat. §§ 554G-1 to 554G-

12; Mich. Comp. Laws §§ 700.1041 – 700.1050; Miss. Code §§ 91-9-701 to 91-9-723, 91-9-503, 91-9-505, 91-9-507; Mo. Rev. Stat. §§ 456.5–505; Nev. Rev. Stat. §§ 166.010 to 166.170; NH Rev. Stat. § 564-D:1-18; Ohio Rev. Code §§ 5816.01 to 5816.14; R.I. Gen. Laws §§ 18-9.2-1 to 18-9.2-7); S.D. Cod. Laws §§ 55-16-1 to 55-16-17; Tenn. Code Ann. § 35-16-101; Utah Code § 25-6-14; Va. Code §§ 64.2-745.1 – 64.2-745.2; W.Va. Code §§ 44D-5-503a–44D-5-503c; and Wyo. Stat. §§ 4-1-505, 4-10-510 to 4-10-523. There is little case law on point, but it is reasonable to believe that a trust created under a domestic self-settled spendthrift trust statute by a grantor residing in such a state and with assets situated in such a state should be a completed transfer for wealth transfer tax purposes. Individuals who do not reside in one of these states should also be able to create an effective self-settled spendthrift trust in one of these states, though it is likely that a court would carefully examine the transaction to determine that the trust assets truly have adequate contacts with the state whose law controls to avoid creating an incomplete transfer.

Second, a client can create a trust for the benefit of his or her spouse. Obviously, this provides a benefit to the client only as long as the marriage continues to be harmonious. A healthy dose of social realism is useful in such cases; one should assume that the client's marriage will be no more successful and enduring than those of a majority of other married couples, and that such a gift could easily divert assets from the client's control.

This problem can be overcome by having each spouse create a trust for the other spouse's benefit. This invites the government to apply the reciprocal trust doctrine, under which each grantor is treated as having retained over the trust he or she created those powers or interests granted the other spouse over that same trust. *Estate of Grace v. United States*, 395 US 316 (1969). This rule can be avoided, however, if the trust terms are sufficiently different that they are not treated as reciprocal. Such trusts are sometimes referred to as nonreciprocal spousal benefit trusts. See Katzenstein & Simantob, "Painless Giving Techniques That Achieve Transfer Tax Savings," 30 Est. Plan. 3 (July 2003); Mahon, "Spousal Access Trusts Makes Use of Enlarged Gift Tax Exemption," 39 Est. Plan. 22 (Aug. 2012).

- **Cash Gifts to Public Charities.** The BRA 2017 increases the income-based percentage limit for certain charitable contributions by an individual taxpayer of cash to public charities and certain other organizations from 50 percent to 60 percent. This change applies to contributions made in any taxable year beginning after December 31, 2017, and before January 1, 2026. BRA 2017 § 11023(a). There is a five-year carryover for unused cash contribution deductions that are otherwise subject to the 60-percent limitation. Thus, someone who contributes to charity property worth 30 percent of their contribution base could deduct in the same year an equal cash contribution.

- **Contributions Giving Priority Rights to Buy Sports Tickets.** The BRA 2017 amends Section 170(l), which previously stated that a contributor could treat 80 percent of a payment as a charitable contribution where the amount is paid to or for the benefit of an institution of higher education (generally, a school with a regular faculty and curriculum and meeting certain other requirements), and the amount would be allowable as a charitable deduction but for the fact that the taxpayer receives (directly or indirectly) as a result of the payment the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution. The BRA 2017 now provides that no charitable deduction shall be allowed for a payment to an institution of higher education in a taxable year beginning December 31, 2017, in exchange for which the payor receives the right to purchase tickets or seating at an athletic event. BRA 2017 § 13704.

- **Charitable Reporting of Contributions.** The BRA 2017 amends Section 170(f)(8), which denies a deduction for any separate charitable contribution of $250 or more, unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution. Section 170(f)(8)(D) previously provided an exception where the donee organization files a return, on a form and in accordance with regulations as the Secretary prescribes, that includes the same content. The BRA 2017 eliminates this exception. BRA 2017 § 13705.

  This change is particularly interesting because, in 2015, Treasury proposed regulations authorizing charities to file such information. Prop. Reg. § 1.170A-13(f)(18), 80 Fed. Reg. 55802 (Sept. 17, 2015). The proposed regulations stated that a return filed by a donee organization under Section 170(f)(8)(D) must include, in addition to the information generally required on a contemporaneous written acknowledgment: (1) the name and address of the donee organization; (2) the name and address of the donor; and (3) the taxpayer identification number of the donor. In addition, the return must be filed with the IRS (with a copy provided to the donor) on or before February 28 of the year following the calendar year in which the contribution was made. Under the proposed regulations, donee reporting would have been optional and would have been available solely at the discretion of the donee organization. The Treasury withdrew the proposed regulations after charities complained that it infringed on the privacy rights of donors and expressed fear that the IRS might make the charitably reporting mandatory. See also *15 West 17th Street LLC v. Comm'r*, 147 T.C. ___ (No. 19) (2016), in which a charity attempted to file this information to salvage a $64.5 million deduction for the contributor, but the Tax Court held that no such filing could satisfy the requirements of Section 170(f)(8)(D) until regulations were promulgated. See also Amandeep S. Grewal, "Substance Over Form? Phantom Regulations and the Internal Revenue Code," 7 Hous. Bus. & Tax L.J. 42, 45-46 (2006).

- **Charitable Gifts by ESBTs.** The BRA 2017 modifies the rules regarding charitable contributions by an electing small business trust (ESBT). An ESBT is one of the types of trusts that may hold S corporation shares without terminating the corporation's election. Generally, that part of an ESBT that consists of the stock of an S corporation is treated as a separate trust and taxed on its share of the S corporation's income at the highest rate of tax imposed on individual taxpayers. In addition to nonseparately computed income or loss, an S corporation reports to its shareholders their *pro rata* share of certain separately stated items of income, loss, deduction, and credit, including the separate shares of charitable contributions made by the corporation. Thus, the treatment of a charitable contribution passed through by an S corporation depends upon the shareholder. Generally, because it is a trust, an ESBT is allowed a charitable contribution deduction for amounts of gross income, without limitation, which pursuant to the terms of the governing instrument are paid for a charitable purpose. No carryover of excess contributions is allowed.

  The BRA 2017 provides that the charitable contribution deduction of an ESBT is not determined by the rules generally applicable to trusts, but rather by the rules applicable to individuals. Thus, the percentage limitations and carryforward provisions applicable to individuals apply to charitable contributions made by the portion of an ESBT holding S corporation stock. BRA 2017 § 13542. Also, this should allow deductions for the fair market value of distributed appreciated assets, because the ESBT will no longer be tied to the requirement that deductible distributions must come from trust income. In addition, the substantiation requirements for individuals should now apply to charitable distributions from an ESBT.

- **The Kiddie Tax.** Section 1(g) (the "kiddie tax") sets the income tax rate for the net unearned income of a child who: (1) has not reached the age of 19 by the close of the taxable year, or is a full-time student under the age of 24 and either of the child's parents is alive at such time; (2) has unearned income over $2,100 (for 2017); and (3) does not file a joint return. These rules tax such unearned income over $2,100 at the parents' tax rates, if the parents' tax rates are higher than those of the child.

  The BRA 2017 replaces the kiddie tax with a rule taxing the net unearned income of a child at the ordinary income and capital gains rates applied generally to trusts and estates, with respect to taxable years beginning after December 31, 2017 and not after December 31, 2025. This means that the child's tax is unaffected by the tax situation of the child's parent or the unearned income of any siblings. BRA 2017 § 11001.

- **Reporting by Buyer of Existing Life Insurance Policy.** The BRA 2017 imposes reporting requirements for the purchaser who buys an existing life insurance contract in a "reportable policy sale." BRA 2017 § 13520(a). This requirement applies to every person who acquires a life insurance contract or an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured (apart from the acquirer's interest in the life insurance contract). An indirect acquisition includes the acquisition of an interest in a partnership, trust, or other entity that holds an interest in the life insurance contract.

The buyer in such cases reports information about the purchase to the IRS, to the insurance company that issued the contract, and to the seller. The information reported by the buyer about the purchase is:

(1) the buyer's name, address, and taxpayer identification number ("TIN");
(2) the name, address, and TIN of each recipient of payment in the reportable policy sale;
(3) the date of the sale;
(4) the name of the issuer; and
(5) the amount of each payment.

The statement the buyer provides to any issuer of a life insurance contract is not required to include the amount of the payment or payments for the purchase of the contract.

- **Reporting by Insurer.** On receipt of such a report, or on any notice of the transfer of a life insurance contract to a foreign person, the insurer is required to report to the IRS and to the seller the following information:

the name, address, and TIN of the seller or the transferor to a foreign person;
the basis of the contract (the investment in the contract under Section 72(e)(6)); and
the policy number of the contract.

Notice of the transfer of a life insurance contract to a foreign person includes any sort of notice, including information provided for nontax purposes such as change of address notices for purposes of sending statements or for other purposes, or information relating to loans, premiums, or death benefits with respect to the contract. BRA 2017 § 13520(a). This reporting requirement is effective for reportable policy sales occurring after December 31, 2017. BRA 2017 § 13520(d)(1).

The insurer who pays a death benefit under a life insurance contract that has been transferred in a reportable policy sale (a "reportable death benefit") must report to the IRS and the payee the following information:

(1) the name, address and TIN of the person making the payment;
(2) the name, address, and TIN of each recipient of a payment;

(3) the date of each such payment;
(4) the gross amount of the payment; and
(5) the payor's estimate of the buyer's basis in the contract.

For purposes of these reporting requirements, a payment means the amount of cash and the fair market value of any consideration transferred in a reportable policy sale. BRA 2017 § 13520(a). This reporting requirement is effective for reportable death benefits paid after December 31, 2017. BRA 2017 § 13520(d)(2).

- **Basis in a Life Insurance Policy.** The Act also addresses the basis of life insurance contracts. In Rev. Rul. 2009-13, 2009-21 I.R.B. 1029, the IRS ruled that income recognized under Section 72(e) on surrender to the life insurance company of a life insurance contract with cash value is ordinary income. In the case of sale of a cash value life insurance contract, the IRS ruled that the insured's (seller's) basis is reduced by the cost of insurance, and the gain on sale of the contract is ordinary income to the extent of the amount that would be recognized as ordinary income if the contract were surrendered (the "inside buildup"), and any excess is long-term capital gain. Gain on the sale of a term life insurance contract (without cash surrender value) is long-term capital gain under the ruling. In Rev. Rul. 2009-14,2009-21 I.R.B. 1031, the IRS ruled that under the transfer for value rules, a portion of the death benefit received by a buyer of a life insurance contract on the death of the insured is includable as ordinary income. The portion is the excess of the death benefit over the consideration and other amounts (e.g., premiums) paid for the contract. Upon sale of the contract by the purchaser of the contract, the gain is long-term capital gain, and in determining the gain, the basis of the contract is not reduced by the cost of insurance.

  The BRA 2017 provides that, in determining the basis of a life insurance or annuity contract, no adjustment is made for mortality, expense, or other reasonable charges incurred under the contract (known as "cost of insurance"). This reverses the position taken in Revenue Ruling 2009-13 that on sale of a cash value life insurance contract, the insured's (seller's) basis is reduced by the cost of insurance. BRA 2017 § 13521(a). This change in the basis rules applies to transactions entered into after August 25, 2009. BRA 2017 § 13521(b).

- **Transfers for Value.** The BRA 2017 also provides that the various exceptions to the transfer for value rules do not apply in the case of a transfer of a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale. Thus, some portion of the death benefit ultimately payable under such a contract may be includable in income. BRA 2017 § 13522(a). This rule applies to transfers occurring after December 31, 2017. BRA 2017 § 13522(b).

- **Income Tax Rate for Trusts and Estates.** The new law modifies the income tax rates for trusts and estates, though they remain quite compacted. The income tax rates for trusts and estates for taxable years beginning after December 31, 2017, are:

Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

BRA 2017 § 11001(a).

- **Change in Indexing.** The dollar amounts for bracket thresholds are adjusted for inflation and then rounded to the next lowest multiple of $100 in future years. The indexing will use the Chained Consumer Price Index for All Urban Consumers ("C-CPI-U"), rather than the Consumer Price Index for All Urban Consumers ("CPI-U"). This should produce a slightly smaller inflation adjustment. BRA 2017 § 11002. See discussion above.

- **Miscellaneous Itemized Deductions.** The BRA 2017 also eliminates the individual tax deduction for miscellaneous itemized deductions that would otherwise have been subject to the two percent floor under Section 67. This applies to taxable years beginning after December 31, 2017, and before January 1, 2026. BRA 2017 § 11045. The Act essentially repeals Section 67(a), so that a trust's expenses that are miscellaneous itemized deductions would no longer be deductible. Section 67(e)(1), however, allows "the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate." Those deductions are not affected by the elimination of Section 67(a), and so trustee fees, to the extent they are not investment management fees and other fees described in Section 67(e)(1), would remain deductible. With respect to estate planning, this means that clients will no longer be able to deduct: (a) that portion of their estate planning fees that is attributable to tax planning or tax compliance related to estate planning; (b) appraisal fees for charitable contributions; (c) excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust; or (d) investment fees and expenses.

- **Qualifying Beneficiaries of an ESBT.** The BRA 2017 also expands the class of qualifying beneficiaries of an electing small business trust. Previously, a nonresident alien individual could not be a shareholder of an S corporation and or a potential current beneficiary of an ESBT. Int. Rev. Code §§ 1361(b)(1)(C), 1361(c)(2)(B)(v). The BRA 2017 now permits a nonresident alien individual to be a potential current beneficiary of an ESBT. This change applies beginning January 1, 2018. BRA 2017 § 13541.

- **Pass-Through Businesses Owned by an Estate or Trust.** The BRA 2017 provides that, for taxable years beginning after December 31, 2017 and before January 1, 2026, an individual taxpayer generally may deduct 20 percent of qualified business income from a partnership, S corporation, or sole proprietorship. The House and Senate bills had denied this deduction to entities owned by a trust or estate, but the Conference Committee made trusts and estates are eligible for the 20-percent deduction. The new law also states that W-2 income from entities owned by trusts and estates is apportioned between the beneficiaries and the fiduciary under Section 199(d)(1)(B)(i). BRA 2017 § 11011.

III. INCOME TAXES

A. IRC § 1. Income Tax Rates

Income Tax Rates Adjusted for Inflation. Rev. Proc. 2017-58, § 3.01, 2017-45 I.R.B. 489 (Nov. 6, 2017)

These rules were changed by the BRA 2017, but before that, the 2018 income tax rates for trusts and estates were as follows:

Income	Rate
Not over $2,600	15%
Over $2,600 but not over $6,100	$90 + 25% on excess over $2,600
Over $6,100 but not over $9,300	$1,265 + 28% on excess over $6,100
Over $9,300 but not over $12,700	$2,161 + 33% on excess over $9,300
Over $12,700	$3,283 plus 39.6% on excess over $12,700

IRC § 1(e).

Before the BRA 2017, the kiddie tax applied to income over $1,050 in 2018, under IRC § 63(c)(5)), and a parent could elect to include in gross income up $10,500 of a child's income in 2018. IRC § 1(g)(4)(A).

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

1. Syndicated Conservation Easement Added as Listed Transaction Under Section 6011. Notice 2017-10, 2017-4 I.R.B. 544 (Jan. 23, 2017); Notice 2017-29, 2017-20 I.R.B. 1243 (May 15, 2017); Notice 2017-58, 2017-42 I.R.B. 326 (Oct. 16, 2017)

Treasury has added to the catalogue of listed tax-avoidance transactions that must be reported under IRC §§ 6111 and 6112 and Reg. § 1.6011-4(b)(2) certain syndicated conservation easement transactions. The transaction is described as one which: (a) purports to give investors charitable contribution deductions significantly greater than the amount invested; (b) involves investments investors in a partnership or other pass-through entity that owns or acquires real property; (c) may include additional tiers of pass-through entities; (d) syndicates ownership interests in the pass- through entity or in one or more of the tiers of pass-through entities; (e) uses promotional materials suggesting to prospective investors that an investor may be entitled to a share of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment; (f) obtains what purports to be a qualified appraisal that greatly inflates the value of the conservation easement based on unreasonable conclusions about the development potential of the property; (g) contributes a conservation easement encumbering the property to a tax-exempt entity. The promotions state that investors who held their direct or indirect interests in the pass-through entity for one year or less may rely on the pass-through entity's holding period in the underlying real property to treat the donated conservation easement as long-term capital gain property under Section 170(e)(1). The IRS stated that it intends to challenge the purported tax benefits from this transaction based on the overvaluation of the conservation easement, and possibly also based on the partnership anti-abuse rule, economic substance, or other rules or doctrines. The IRS also noted that the charitable donee will not be treated as a party to or participant in the transaction.

Note. In Notice 2017-29, the IRS stated that disclosures of participation in a syndicated conservation easement, required by Notice 2017-10, will not be due until October 2, 2017, rather than June 21, 2017, as originally announced, and clarified that donee-charities are not material advisors, for purposes of the disclosure rules. In Notice 2017-58, the IRS stated that these disclosures of participation were due on October 31, 2017, rather than October 2, 2017, for participants whose residence or principal place of business was located in a Hurricane Harvey, Irma, or Maria covered disaster area, or whose records needed to meet the disclosure requirements were maintained in such an area. Taxpayers claiming the benefit of this extension should mark “Hurricane Harvey,” “Hurricane Irma,” or “Hurricane Maria” on the top of their Form 8886, Reportable Transaction Disclosure Statement.

2. **Conservation (Including Façade) Easements Raise Numerous Problems. *BC Ranch, II, L.P. v. Comm’r*, 867 F.3d 547 (5th Cir. Aug. 11, 2017), *rev’g and rem’g Bosque Canyon Ranch, L.P. v. Comm'r*, T.C. Memo. 2015-130; *RP Golf v. Comm’r*, 860 F.3d 1096 (8th Cir. Feb. 7, 2017), *aff’g* T.C. Memo. 2016-80; *Palmolive Building Investors, LLC v. Comm’r*, 149 T.C. ___ (No. 18) (Oct. 10, 2017); *Salt Point Timber, LLC v. Comm’r*, T.C. Memo. 2017-245 (Dec. 11, 2017); *Big River Development, L.P. v. Comm’r*, T.C. Memo. 2017-166 (Aug. 28, 2017); *310 Retail, LLC v. Comm’r*, T.C. Memo. 2017-164 (Aug. 24, 2017); *Ten Twenty Six Investors v. Comm’r*, T.C. Memo. 2017-115 (June 15, 2017); *McGrady v. Comm’r*, T.C. Memo. 2016-233 (Dec. 22, 2016)**

a) ***BC Ranch, II, L.P.* Permitting Parties to Change the Subject Properties May, in Some Cases, Be Allowed**

BC Ranch II, L.P. was general and tax matters partner of Bosque Canyon Ranch, L.P. Bosque Canyon Ranch bought a 3,729-acre tract of land for nearly \$5 million and began to sell limited partnership interests that entitled the owners to build on specific homesites. In 2005, Bosque Canyon gave a conservation easement over 1,750 acres of the land to the North American Land Trust (NALT), and it claimed an \$8.5 million charitable contribution deduction. In 2007, BC Ranch II claimed another \$7.5 million charitable contribution deduction for a second easement gift. The easement agreements stated that the encumbered property could not be used for residential, commercial, institutional, industrial, or agricultural purposes, but the donor retained, among other rights, the right to raise livestock, hunt, fish, trap, cut down trees, and construct buildings, recreational facilities, skeet shooting stations, deer hunting stands, wildlife viewing towers, fences, ponds, roads, trails, and wells. The easement agreements also stated that the donor and the donee could, by mutual agreement, modify the boundaries of the subject parcels, provided that any such modification could not “in the Trust’s reasonable judgment, directly or indirectly result in any material adverse effect on any of the Conservation Purposes” and “[t]he area of each Homesite parcel * * * [could] not be increased.” NALT prepared baseline documentation showing the encumbered property. The Service denied the deductions, and found that both taxpayers were liable for accuracy-related penalties.

The Tax Court (Judge Foley) held for the Service, finding that the deeds of easement did not constitute qualified conservation easements because they permitted the parties to change the land that would be the subject of the easement. The court stated that it was inadequate to assure perpetuity of the easements that any modifications to the boundaries of the parcels were subject to the reasonable judgment of the NALT, the exterior boundaries of the property subject to the easements could not be modified, and the overall amount of property subject to the easements could not be decreased. The court, relying on *Belk v. Comm'r*, 140 T.C. 1, 10-11 (2013), *supplemented by* T.C. Memo. 2013-154, *aff'd*, 774 F.3d 221 (4th Cir. 2014), stated that on the date of the gift, the easement was not a perpetual restriction on the property. The court also held that the baseline documentation provided by the charity "was unreliable, incomplete, and insufficient to establish the condition of the relevant property on the date the respective easements were granted." The court also noted that the taxpayers failed to make available to the NALT documentation satisfying Reg. § 1.170A-14(g)(5)(i), which provides that the donor of a conservation easement who reserves rights the exercise of which may impair the conservation interests associated with the property, must provide the donee, before the gift is made, with documentation sufficient to establish the condition of the property at the time of the gift. The taxpayers' reserved rights to conduct various activities (i.e., hunting, trapping, construction, etc.) had the potential to impair the easements' conservation interests, but the taxpayers did not provide the required documentation. The Tax Court also upheld imposition of gross valuation misstatement penalties under Section 6662(h).

On appeal, a divided Fifth Circuit reversed and remanded the case to the Tax Court. The majority opinion (Judge Wiener), held that the Tax Court wrongly relied on *Belk,* in which the Fourth Circuit and the Tax Court held that a provision which allowed the parties to substitute other land for the land originally restricted under the easement failed the perpetuity test of Section 170(h). The court distinguished the easement in *Belk,* which permitted a change in the boundaries of the subject property, from the easement in *BC Ranch,* which allowed only a reshuffling of the boundaries of the homesite parcels within the subject tracts, and precluded any increase in the acreage of the homesite parcels. The *BC Ranch easements* did not allow any change in the exterior boundaries of the easements or in their total acreages; only the lot lines of one or more the five-acre homesites could change and then only within the easements and with NALT's consent. The court noted that the government's own expert had stated that the unencumbered homesite parcels had roughly the same per-acre value as the rest of the ranch which is encumbered by the easements, and that changing the boundaries of some of the homesite parcels would not return any value to the taxpayers. Also, the charity's benefit was particularly assured by its discretion to withhold consent to any modifications in its "reasonable judgment," as long as its actions were not arbitrary or capricious. The court also reversed the Tax Court regarding the taxpayer's baseline documentation. The Tax court had held that (1) the baseline documentation was untimely, (2) some of the documents were created too early, (3) some of the documents were created too late, and (4) some of the documents were inaccurate. The Fifth Circuit, however, faulted the Tax Court for reaching this conclusion without considering significant information contained in the record, including: (1) aerial photographs and detailed maps, (2) photographs of the ranch taken by a NALT biologist on April 1, 2004, (3) the "Habitat Assessment" report prepared by IES, based on site surveys in April 2004 and December 2005, (4) photographs of the ranch taken by NALT's president in August 2003, (5) the NALT biologist's April 12, 2004 report on the presence and approximate habitat of the gold-cheeked warblers, and (6) a site plan BCR I sent to NALT in September 2005 depicting the location of homesite parcels in relation to the identified habitat areas. The court held that, together with the documents that the Tax Court acknowledged in its opinion, these documents were more than sufficient to establish the condition of the property prior to the donation.

b) ***RP Golf.*** **Unsubordinated Mortgages Cost Deduction; Subordination Must be in Place at Time of the Gift**

RP Golf, LLC, which operates two private golf courses, granted a conservation easement to the Platte County Land Trust, a qualifying charity. The easement's stated purpose was to "foster the preservation of open areas, conservation of the state's forest, soil, water, plant and wildlife habitats, and other natural and scenic resources." The property was 278 acres and the easement was appraised for $16.4 million, which amount the taxpayer deducted. The IRS denied the deduction.

The Tax Court (Judge Paris) held that the facts showed that the taxpayer did not actually own the entire property. Part of the property continued to be owned by a related entity that had never executed a written transfer of title to the partnership. Thus, that part of the deduction had to be denied on that grounds. With respect to the part of the property owned by the taxpayer, the court found that it was subject to pre-existing, unsubordinated mortgages on the date of the grant. The banks had agreed to subordinate their rights 100 days after the date of the gift. The land was not, therefore, protected in perpetuity and the gift was not a qualified and deductible contribution easement.

On appeal, the Eighth Circuit (Judge Benton) affirmed the denial of the deduction, finding that the taxpayer did not meet the requirements for a deductible conservation easement, because the banks that lent money to the company did not subordinate their mortgages to the donee before the easement was transferred. The court agreed with the Ninth and Tenth Circuits that Section 170 requires this subordination to be in place at the time of the gift. See *Minnick v. Comm'r*, 796 F.3d 1156, 1169 (9th Cir. 2015); and *Mitchell v. Comm'r*, 775 F.3d 1243, 1248 (10th Cir. 2015). The court rejected the argument that, even without contemporaneous subordination, the risk of a default was so remote as to be negligible. The court held that the "so remote as to be negligible" standard does not apply to the requirement of subordination; that requirement is absolute. The taxpayer also argued that it met the "protected in perpetuity" requirement under Section 170 even though the lender's rights were not subordinated until after the transfer, because the lender had orally agreed to subordinate its rights but the court agreed with the Tax Court that the taxpayer had failed to prove the existence of such oral agreements.

c) *Palmolive Building Investors, LLC.* Tax Court Insists on Subordination of Lender's Rights on Date of the Gift

The taxpayer, Palmolive Building Investors, LLC, owned "the Palmolive Building" on North Michigan Avenue in Chicago, Illinois, which it acquired for approximately $58.5 million in 2001. In 2004, Palmolive transferred a façade easement to the Landmarks Preservation Council of Illinois, a qualified charity. The building was subject to two mortgages, and before executing the easement deed, Palmolive obtained mortgage subordination agreements from the lenders. The deed, however, states that if the easement is ever extinguished through a judicial proceeding, the claims of the lending banks are superior to those of the donee organization with respect to the proceeds received from the condemnation, until the mortgage is satisfied. Palmolive claimed a charitable contribution deduction for more than $33 million, which the IRS disallowed, finding that the charity's interest was not protected in perpetuity because of the deed provisions in favor of the lender. The IRS also imposed a gross valuation misstatement penalty under Section 6662(h) and substantial understatement of tax or substantial misvaluation penalties under Section 6662(a) or 6662(b).

The Tax Court (Judge Gustafson) held for the government, finding that the easement deed did not satisfy the perpetuity requirements, because it provides the mortgagees with prior claims to extinguishment proceeds in preference to the donee. The taxpayer argued that the decision of the First Circuit in *Kaufman v. Shulman*, 687 F.3d 21 (1st Cir. 2012), *aff'g in part, vacating in part, and remanding in part Kaufman v. Comm'r*, 136 T.C. 294 (2011), *and* 134 T.C. 182 (2010) permitted a more lenient interpretation of the conflicting language in the deed and the transfer documents, and alternatively, that a savings clause in the deed resolved the question in favor of the charity. In *Kaufman v. Shulman,* the court rejected as mandatory the requirement in the regulations that the donee be entitled to a share of any disposition proceeds proportionate to its interest. See Reg. §§ 1.170A-14(g)(2) and 1.170A-14(g)(6)(ii). The First Circuit reasoned that, if any easement donor later fails to pay taxes, a lien on the property may arise in favor of the Government, and that such lien cannot be subordinated to the donee's interest. Thus, no easement contribution would ever be deductible if the regulation required that the donee always have a right to a share of the proceeds on termination of the easement. The Tax Court disagreed with this analysis, finding that the regulations analysis is based on the property rights extant when the easement is granted, not those that might later arise. The Tax Court noted that this case would be appealable to the Seventh Circuit, and that it would not follow *Kaufman v. Shulman* outside of the First Circuit. The Tax Court also held that the defects in the deed were not cured by a provision that purported to amend the deed retroactively to correct such errors, because the requirements of Section 170 must be satisfied on the date of the gift.

d) *Salt Point Timber, LLC.* No Deduction where Easement Transfer Deed Allowed Retransfer to Non-qualified Organization

Salt Point Timber, LLC sold a conservation easement over a 1,032-acre plot of land in Berkeley County, South Carolina (“the 1,000 acres”) to the Lord Berkeley Conservation Trust, a qualified charity, for $400,000. The deed of transfer included a “boundary line adjustment” clause stating that, (1) if Salt Point Timber transfers any part of the 1,000 acres to an owner of an adjacent property, and (2) the adjacent property is encumbered by a “comparable conservation easement”, and (3) the owner of the adjacent property and the holder of the adjacent easement agree to amend the terms of the adjacent easement to encumber the transferred portion of the 1,000 acres, then (4) the transferred portion of the 1,000 acres will be released from the original conservation easement. The easement does not define a “comparable conservation easement”. Salt Point claimed a $2.13 million deduction, all of which the IRS denied.

The Tax Court (Judge Morrison) held for the government, because the boundary line adjustment did not require that the organization to which the easement might be retransferred had to be a qualified charity. The court explained that Reg. § 1.170A-14(c)(2) provides that no deduction is allowed for a conservation contribution unless the instrument of transfer prohibits the donee from transferring the easement without requiring that the conservation purposes which the contribution was originally intended to advance continue to be carried out, and that the transfer be made to a qualified charity or other eligible donee, such as a governmental body. The taxpayer argued that the agreement did limit the transferees to qualified charities, but the court disagreed, noting that the boundary line adjustment clause did not expressly limit the holder of the replacement easement to a qualified organization and that the terms of that clause could be satisfied by a transfer to an organization that was not qualified. The court also held that there is a non-negligible possibility that the easement will be replaced under the boundary adjustment clause. The court also rejected the argument that the possibility that the easement might be replaced under the boundary line adjustment clause was negligible and should not result in the disallowance of the deduction, finding that there was no persuasive evidence that the three conditions for replacing the easement under the clause were so highly improbable or remote that they would be ignored.

e) ***Big River Development, L.P.*** **Easement Deed Itself Constitutes Contemporaneous Written Acknowledgement**

Big River Development, L.P. contributed a façade easement over a 1901-1902 factory building it owned in Pittsburgh, Pennsylvania that Big River had renovated into a luxury apartment complex known as the Cork Factory Lofts. The deed of easement, executed in favor of the Pittsburgh History and Landmarks Foundation (PHLF) provided, in relevant part, that Big River "grants and donates" the easement to PHLF pursuant to section 170(h) of the Internal Revenue Code, in perpetuity. It recognized that PHLF would monitor Big River's compliance with the easement restrictions and authorized PHLF to inspect the premises to ensure compliance, and it included a one-time $93,500 fee to help defray the costs of this monitoring. The deed did not reflect any valuable goods or services being furnished by PHLF to Big River, and it included a merger clause stating that the deed reflected the parties' entire agreement, and invalidating any "prior or simultaneous correspondence, understandings, agreements, and representations. . . ." Over two years later, PHLF gave Big River a written acknowledgement of the gift, stating that it had provided Big River with no goods or services in exchange for the contribution. Big River obtained an appraisal and deducted $7.14 million as a charitable contribution. The IRS disallowed the deduction, noting that Big River had received no contemporaneous written acknowledgement of the gift, as required by Section 170(f)(8).

The Tax Court (Judge Lauber) held for the taxpayer, that the deed itself constituted an adequate contemporaneous written acknowledgement. The court noted that it had repeatedly held that a deed of easement could satisfy the requirements of Section 170(f)(8), though not all such deeds did so. *See 310 Retail, LLC v. Comm'r*, T.C. Memo. 2017-164; *RP Golf, LLC v. Comm'r*, T.C. Memo. 2012-282; *Averyt v. Comm'r,* T.C. Memo. 2012-198. The court noted that Section 170(f)(8)(B) requires that a contemporaneous written acknowledgement include (i) the amount of cash and a description (but not value) of any property other than cash contributed; (ii) whether the donee provided any goods or services in consideration, in whole or in part, for the contributed property; and (iii) a description and good faith estimate of the value of any goods or services so provided. The court also noted that an acknowledgment is "contemporaneous" only if the donee provides it to the taxpayer on or before the date on which the taxpayer's return is filed or required to be filed. IRC § 170(f)(8)(C)(i) and (ii). In this case, the acknowledgement provided by PHLF was not contemporaneous, but the easement deed contained the required information. The court noted that the deed was similar to the deeds in *310 Retail, LLC* and *RP Golf, LLC*, and that the merger clause was an affirmative indication that PHLF had supplied no goods or services. The only references to consideration are an initial reference to "consideration of Ten Dollars ($10.00) * * * [and] other good and valuable consideration," which even the government agreed had not been actually provide and was merely boilerplate language with no legal effect for purposes of Section 170(f)(8). The monitoring services by PHLF were not a consideration provided, for this purpose, but rather the charity's discharge of its own responsibilities.

f) 310 *Retail, LLC.* Again, Easement Deed Itself Constitutes Contemporaneous Written Acknowledgement

310 Retail LLC's contributed a façade easement over a 1924 landmark building sometimes known as the Strauss Building, in Chicago, Illinois. 310 Retail contributed the easement to the Landmarks Preservation Council of Illinois (LPCI) in December 2005, by a deed of gift. The deed was executed contemporaneously with the gift of the easement. The deed stated that LPCI would monitor the donor's compliance with the easement restrictions and authorized LPCI to inspect the premises to ensure compliance. The deed contained no reference to any goods or services being furnished by LPCI to the donor and it recited no receipt by LPCI of any consideration for providing goods or services. The parties explicitly stated their understanding that "[t]his instrument, including the exhibits attached hereto, reflects the entire agreement of Grantor and Grantee" and that "[a]ny prior or simultaneous correspondence, understandings, agreements, and representations are null and void upon execution hereof unless set out in this instrument." The donor did not, however, receive a timely letter from LPCI acknowledging that LPCI had received the contribution and that no goods or services were transferred to the donor in exchange. (LPCI sent such a letter three years later.) The donor initially cited two tax returns filed by LPCI (Form 990), as together constituting a contemporaneous written acknowledgment, but it later agreed, in light of *15 W. 17th St., LLC v. Comm'r,* 147 T.C.___ (No. 19) (2016), that these returns did not meet the requirements of a contemporaneous written acknowledgment. The donor deducted $26.7 million, based on a qualified appraisal, but the IRS disallowed the entire deduction, claiming that the donor had no contemporaneous written acknowledgment.

The Tax Court (Judge Lauber) held that the deed itself satisfied the requirement of a contemporaneous written acknowledgement. The court noted that the deed of easement itself stipulated that the easement was given to LPCI in exchange for nothing, in order satisfy the charitable gift requirements of Section 170. The court agreed that a contemporaneous written acknowledgement need not take any particular form, and may, for example, be a letter, postcard, or computer-generated form. It may even, the court stated, be the deed of easement, though most deeds of easement do not often meet the requirements of a contemporaneous written acknowledgment. See *Simmons v. Comm'r*, T.C. Memo. 2009-208, *aff'd*, 646 F.3d 6 (D.C. Cir. 2011); *Schrimshher v. Comm'r*, T.C. Memo. 2011-71. The key is that the deed must state expressly that the donee furnished no consideration for the transferred easement. In this case, the court noted that easement's merger clause (stating that the writing constituted the entire agreement) and the statement that the easement was given without consideration met the requirements of a contemporaneous written acknowledgment.

g) *Ten Twenty Six Investors.* Failure to Record Deed Promptly Costs $11.4 Million Deduction

Ten Twenty Six Investors was a limited partnership that owned a ten-story New York City warehouse built in 1928. The warehouse was designed by Cass Gilbert, who also designed the Woolworth Building and the United States Supreme Court Building. The partnership contributed a façade easement over the building to the National Architectural Trust, Inc. (NAT). NAT accepted the deed of easement on December 30, 2004, but it did not record the deed until December 14, 2006. The taxpayer claimed an $11.4 million deduction for the contribution, which the IRS denied. The IRS also imposed an overvaluation penalty under Section 6662(a) and 6662(b).

The Tax Court (Judge Thornton) held that no deduction was allowed for the contribution, because the failure of the donee to record it meant that, in the year of the gift, the easement was not perpetual. Section 170(h)(5)(A) requires that the easement be perpetual. See also *Belk v. Comm'r*, 140 T.C. 1, 12 (2013), *aff'd*, 774 F.3d 221 (4th Cir. 2014). State law controls whether the restriction protecting the property was so granted in perpetuity. Applicable state law (New York) expressly provided that a conservation easement is created only when the deed is recorded. NYECL sec. 49-0305(4) (McKinney Supp. 2017); *Zarlengo v. Comm'r*, T.C. Memo. 2014-161; *Rothman v. Comm'r*, T.C. Memo. 2012-163 (reaching the same result), supplemented by T.C. Memo.

2012-218; and *Mecox Partners LP v. United States*, 117 A.F.T.R.2d 2016-593, 2016 WL 398216, at *5-*7 (S.D.N.Y. 2016). Thus, the failure to record it in the year of the gift meant that the gift was not then perpetual. The taxpayer argued that the deed created a restrictive covenant at common law, even without timely recording, but the court held that the perpetuity requirement of Section 170(h)(2)(C) and 170(h)(5)(A) requires enforceability by successors in interest, and without recordation, the risk of unenforceability was not so remote as to be negligible. Also, the court noted, NAT or its successors would not have been able to enforce the easement against a buyer who bought the property before the deed was recorded.

h) ***McGrady.*** **Easement Deductible Because of Charitable Motivation**

Phyllis McGrady and Christopher R. Antoniacci made two separate gifts of real property adjoining their residence in Bucks County, Pennsylvania. The taxpayers gave the Heritage Conservancy, a local charity, a fee simple interest in one parcel, and they gave the local Township a conservation easement over a second parcel. Both parcels adjoined the taxpayers' residence. The Township was committed to protecting land in its natural state and preserving as far as possible the agricultural heritage of Bucks County, and Heritage was dedicated to environmental conservation in Bucks County and adjoining areas. The taxpayers deducted $4.7 million over several years for the two contributions. The IRS timely disallowed the deductions and assessed accuracy-related penalties.

The Tax Court (Judge Lauber), sustained the deductibility of the two contributions, but reduced the amount of the contributions by $1 million. The IRS argued that the charitable deductions should be denied for lack of donative intent, and because they did not meet the substantiation requirements. In the alternative, the IRS argued that the gifts were substantially overvalued. The court refused to find any "quid pro quo exchange," noting that neither of the gifts were conditioned on any reciprocal benefit. The IRS stressed that the taxpayers motivated by a desire to protect their privacy and to prevent suburban development from spoiling the attractive views from their residence, but the court pointed out that nothing in the negotiated gifts gave the taxpayers any special right to control the future use of the property to achieve these goals, beyond the basic character of the conservation easement and the known present goals of the donees. The benefits to the taxpayers were merely incidental to the charitable gifts.

3. Owning 1,000 Acres of Farmland Not Enough to Make Taxpayers "Qualified Farmers" for Charitable Deduction Limitation Purposes. *Rutkose, Sr. v. Comm'r*, 149 T.C. ___ (No. 6) (Aug. 7, 2017)

Mark and Felix Rutkoske owned over 1,000 acres of farmland, through their wholly-owned Browning Creek, LLC. Browning Creek sold to Eastern Shore Land Conservancy, Inc., a public charity, the conservation rights restricting the development rights of 355 acres for just over $1.5 million. The taxpayers' appraisal stated that this was $1.33 million under the fair market value of the development rights, so that the taxpayers deducted the $1.33 million as a charitable contribution under Section 170(b)(1)(E). Browning Creek leased the land to Rutkoske Farms, a general partnership through which the taxpayers farmed the property and the six other parcels of land. In the year in question, the taxpayers each performed at least 2,500 hours of physical labor and management services in growing and harvesting corn, barley, wheat, and soybeans on all of their properties. They borrowed money when necessary and joined the U.S. Department of Agriculture's Farm Service Agency subsidy programs. Later the same year as the gift, Browning Creek sold the property to Quiet Acre Farm, Inc., an unrelated party, for just under $2 million. On their income tax returns, the taxpayers classified themselves as "qualified farmers" for charitable deduction purposes, because their gross income from the trade or business of farming was more than half of their total gross income for the year. Qualified farmers may deduct the value of a qualified conservation contribution of up to 100% of their contribution base, rather than being limited to the usual 50% of contribution base. The IRS denied the taxpayers status as qualified farmers.

The Tax Court (Judge Jacobs) granted partial summary judgment for the government, holding that the taxpayers were not qualified farmers for charitable contribution deduction purposes. Section 170(b)(1)(E) defines qualified farmers by reference to Section 2032A(e)(5) (special use estate tax valuation of family farm real estate). Section 2032A(e)(5) states that "farming purposes" means

> (A) cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training, and management of animals) on a farm;
> (B) handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or

operator of the farm regularly produces more than one-half of the commodity so treated; and

(C)

(i) the planting, cultivating, caring for, or cutting of trees, or

(ii) the preparation (other than milling) of trees for market.

The taxpayers argued that, notwithstanding the absence of these activities from the Section 2032A(e)(5) list, income from farming included the proceeds from the sale of the property and the charitable sale of development rights. The court explained that, under the partnership regulations, the taxpayers are treated as having personally conveyed the easement to the charity, so it is their personal status as qualified farmers must be established. Reg. § 1.703-1(a)(2)(iv). The court then held that the taxpayers were not "qualified farmers" under Section 170(b)(1)(E), because Section 2032A(e)(5) clearly does not treat either the sale of the property or the sale of development rights as part of the trade or business of farming. The court acknowledged that one engaged in the trade or business of farming "most likely will engage in activities beyond those enumerated in the statute," but that activities such as the sale of used equipment or land, but the statute clearly does not include the income from those activities in determining the status of a qualified farmer. Furthermore, the character of these items of income would have been determined at the partnership level, and Browning Creek was not in the business of farming; it was in the business of leasing real estate. Thus, the characterization of income from the sale of the property by Browning Creek would not be income from the trade or business of farming.

4. $33 Million Deduction Lost for Failure to Include Basis Information on Appraisal Summary. *RERI Holdings, LLC I v. Comm'r*, 149 T.C. 1 (July 3, 2017)

RERI Holdings, an LLC taxed as a partnership, bought for $2.95 million a remainder interest in a Hawthorne, California building that was rented to AT&T for use as a web hosting facility. Hawthorne Holdings, LLC owned all of the membership interests in RS Hawthorne, LLC, which owned the fee interest in the real estate. AT&T had a fifteen and one-half-year triple net lease, with three five-year renewal options. The remainder interest would become possessory in seventeen years. The agreement creating the remainder interest included extensive covenants designed to preserve the value of the property. The agreement, however, made immediate possession the sole remedy for breach of those covenants; other damages were precluded. Seventeen months after buying the remainder interest, RERI assigned it to the University of Michigan, and claimed a $33 million income tax deduction. An appraisal prepared for RERI valued the fee at $55 million, based on the projected rents, and valued the remainder interest at $33 million, based on the Section 7520 actuarial tables. The taxpayer's appraisal summary left blank the space for "Donor's cost or other adjusted basis." The IRS denied the entire deduction.

The Tax Court (Judge Halpern) held for the government, that the omission of basis information from the Form 8283 was material, and caused the contribution not to have been properly substantiated under Reg. § 1.170A-13(c)(4)(ii)(E). The doctrine of substantial compliance applies to some of the substantiation requirements, but it requires that all material information be provided. *Bond v. Comm'r*, 100 T.C. 32, 40-41 (1993). The disclosure of cost or other basis was material, because it would alert the IRS to a potential overvaluation. Thus, there was no substantial compliance. The taxpayers' experts at trial valued the property based on its cash flow, and the remainder interest actuarially, but the court held that the limitation on remedies in the original agreement did not adequately protect the remainder holder's interests, and made it inappropriate to value the remainder interest under the standard actuarial tables. Reg. § 1.7520-3(b)(2)(iii). The remainder thus must be valued based on all relevant facts and circumstances. Reg. § 1.7520-3(b)(1)(iii). On that basis, the remainder interest was worth $3,462,886 on the date of the gift. As the claimed valuation was more than 400% of the actual value, a 40% gross valuation misstatement penalty was imposed under Section 6662(e)(1)(A), 6662(h)(2). Any underpayment resulting from the disallowance of the charitable deduction is necessarily "attributable to" this gross valuation misstatement, to the extent that it exceeds the amount that would have been due had the deduction claimed been $3,462,886. The court also held that the penalty applied to the extent the underpayment relates to the disallowance of that portion of the deduction over $3,462,886. *AHG Invs., LLC v. Comm'r*, 140 T.C. 73 (2013); *885 Inv. Co. v. Comm'r,* 95 T.C. 156 (1990), overruled. The penalties were not avoided because RERI did not make a good faith investigation of the value of the remainder interest, and thus did not have reasonable cause for, or act in good faith with respect to its claim of a charitable contribution deduction. I.R.C. § 6662(c)(2)(B).

5. Failure to Comply with Special Contemporaneous Written Acknowledgement Requirements for Contribution of Qualified Vehicle Costs Taxpayer $338,080 Deduction. *Izen, Jr. v. Comm'r*, 148 T.C. ___ (No. 5) (March 1, 2017)

Joe Alfred Izen, Jr. contributed a 50% interest in a 1969 model Hawker-Siddley DH125-400A private jet to the Houston Aeronautical Heritage

Society, tax-exempt organization that operates an aircraft museum. Joe and an associate had together bought the plane in December 2007 for \$42,000, each paying one-half of the purchase price. Joe claimed a \$338,080 income tax deduction for the contribution on an amended income tax return for taxable year 2010. In 2012, the IRS mailed Joe a notice of deficiency. In April 14, 2016, Joe filed an amended income tax return that included (1) an acknowledgment letter addressed to Joe's co-owner, dated December 30, 2010, and signed by the donee's president; (2) a Form 8283 executed by the donee's managing director, and dated April 13, 2016; (3) a copy of an "Aircraft Donation Agreement" allegedly executed on December 31, 2010, by the donee's president , but bearing no other signatures; and (4) an appraisal dated April 7, 2011, opining that the fair market value of petitioner's 50% interest in the aircraft, as of December 30, 2010, was \$338,080.

The Tax Court (Judge Lauber) granted the IRS a summary judgment denying the deduction in full, finding that the taxpayer had failed to comply with the special substantiation requirements under Section 170(f)(12) that apply to contributions of "used motor vehicles, boats, and airplanes." Section 170(f)(12)(A)(i) denies a deduction for such a contribution of an asset valued at more than \$500, unless the taxpayer attaches to the return a contemporaneous written acknowledgment from the donee. Section 170(f)(12)(A)(ii) provides that, if the donee sells the vehicle without any significant intervening use or material improvement by the donee, the deduction cannot exceed the gross proceeds received from such sale. Section 170(f)(12)(B) states that the required contemporaneous written acknowledgement must include: (a) the donor's name and taxpayer identification number; (b) the vehicle identification number; (c) if the charity has already sold the vehicle, a certification that the vehicle was sold in an arm's length transaction between unrelated parties, the gross proceeds from the sale, and a statement that the deductible amount may not exceed the amount of such gross proceeds; (d) if the charity has not already sold the vehicle, a certification of the intended use or material improvement of the vehicle and the intended duration of such use, and that the vehicle would not be transferred in exchange for money, other property, or services before completion of such use or improvement; (e) a statement of whether the donee provided any goods or services in consideration, in whole or in part, for the vehicle, and a description and good faith estimate of the value of any such goods or services, or if such goods or services consist solely of intangible religious benefits, a statement to that effect. The court recognized that the substantiation requirements for a donation of a vehicle or aircraft are more stringent than those for other charitable gifts, requiring more extensive information and requiring that the taxpayer include the acknowledgement with his or her income tax return. Joe stated that he had not included the acknowledgement with his original 2010 return because the donee had not yet completed and filed its Form 1098-C for the gift, which was corroborated by the donee. The letter accompanying the amended return was not a contemporaneous written acknowledgement because it was not addressed to Joe (but, rather, to his co-owner), it did not include his name and identification number, and it did not state whether the donee provided goods or services in consideration for the gift vehicle. The aircraft donation agreement between the co-owners contained some of the required information, but it was not signed by either donor and did not include all of the required data, including the taxpayer's identification number. Also, there was no contemporaneous document filed by the donee that could be read together with this agreement to satisfy the requirements of the Code.

6. $64.49 Million Deduction Lost for Failing to Obtain Contemporaneous Written Acknowledgement; Charity Filing Insufficient Absent Treasury Regulations. ***15 West 17th Street LLC v. Comm'r*, 147 T.C. ___ (No. 19) (Dec. 22, 2016)**

15 West 17th Street LLC bought for $10 million certain Manhattan real estate, including a building built in 1903-04. The taxpayer initially planned to demolish the building, but on November 29, 2007, the building was placed on the National Register of Historic Places, making it a "certified historic structure." The following month, the taxpayer gave to the Trust for Architectural Easements (the "Trust") a perpetual conservation easement over the part of the property that included the building. On May 14, 2008, the Trust sent the taxpayer a letter acknowledging receipt of the easement, but not stating whether the Trust had provided any goods or services to the LLC, or whether the Trust had otherwise given the LLC anything of value, in exchange for the easement. Based on a qualified appraisal, the taxpayer deducted $64.49 million for the easement, despite having bought the entire property for only $10 million 2 ½ years earlier. On audit, the IRS denied the entire deduction for failure to obtain a contemporaneous written receipt, and assessed penalties for gross valuation misstatement under Section 6662(a) and 6662(h), or alternatively, for negligence, under Section 6662(a) and 6662(b)(1). The taxpayer filed a petition with the Tax Court. After the taxpayer filed its petition with the Tax Court, the charity submitted an amended return for the year in which the gift was made, describing the taxpayer's gift, identifying the taxpayer, and stating that the charity had provided no goods or services in consideration for that gift.

The Tax Court (Judge Lauber), denied the taxpayer's request for a partial summary judgment, finding that the contribution was not properly documented and that no deduction should be allowed. First, the court noted that the receipt issued by the Trust was contemporaneous (it was issued before the taxpayer filed its income tax return for the year of the gift), but did not indicate what, if any, consideration was provided by the Trust in exchange for the contribution. The court stressed that the requirements for a valid contemporaneous written acknowledgement is strict and that the rules on substantial compliance do not apply. *French v. Comm'r*, T.C. Memo. 2016-53, at *8; *Durden v. Comm'r*, T.C. Memo. 2012-140.

The court also rejected the taxpayer's argument that the charity's revised tax return met the statutory requirements. Section 170(f)(8)(D) states that the requirement for a contemporaneous written acknowledgement does "not apply to a contribution if the donee organization files a return, on such form and in accordance with such regulations as the Secretary may prescribe, which includes the information described in subparagraph (B) with respect to the contribution." The court traced the long legislative and administrative history of the contemporary written acknowledgement rules, and concluded that the exception for filings by the charity is not self-executing; it applies only if the Treasury promulgates regulations, which they are authorized, rather than directed, to do. Until Treasury promulgates such final regulations, filing by the charitable donees cannot be used to meet the requirements of Section 170(f)(8).

Judge Holmes filed a concurring opinion, agreeing with the majority, but stressing the problems that arise when Treasury or any agency declines Congress's invitation to promulgate regulations. Judge Holmes stated that, in some future case, he would be inclined to view provisions that demand the promulgation of regulations as never self-executing, because that requires the court to guess as to what the agency would have decided. Amandeep S. Grewal, "Substance Over Form? Phantom Regulations and the Internal Revenue Code," 7 Hous. Bus. & Tax L.J. 42, 45-46 (2006).

Judges Foley, Colvin, Vasquez, Gustafson, Paris, and Morrison dissented, with dissenting opinions written by Judges Foley and Gustafson. Judge Foley stressed that Section 170(f)(8)(D) states that no contemporaneous written acknowledgement is required "if the donee organization files a return, *on such form and in accordance with such regulations as the Secretary may prescribe*, which includes the information described in subparagraph (B) with respect to the contribution." (emphasis provided in the dissent). Judge Foley read this as first stating that Section 170(f)(8)(A) applies when the donee organization files a return, and second that Treasury may provide alternative rules detailing how the organization files the return. As Treasury already requires a tax return from charities, the Trust in this case was authorized to file the information required by Section 170(f)(8)(A) in any reasonable manner, in the absence of regulations that detailed how the return would be filed.

Judge Gustafson also filed a separate dissent, noting that the statute does not require that the Treasury issue regulations to implement the donee-reporting regime; it only requires that the Treasury issue regulations that state what return and form must be used by the charity.

Note. This case comes under the heading "be careful what you wish for." In 2015, the IRS and Treasury proposed regulations to implement the exception to the contemporaneous written acknowledgment requirement for charity submissions. 80 Fed. Reg. 55802 (Sept. 17, 2015). They received a substantial number of highly critical comments, mostly reflecting concern that, while the proposed regulations made it optional for the charity whether to file these statements, the requirement could later be made mandatory. In response, the IRS and Treasury withdrew the proposed regulations. Doc. 2016-189, 81 Fed. Reg. 882-01 (Jan. 8, 2016). At least one taxpayer would probably now like to suggest that the regulations should have been finalized, rather than withdrawn.

7. Value of Big Game Trophy Heads Reduced Significantly. *Gardner v. Comm'r*, T.C. Memo. 2017-165 (Aug. 24, 2017)

Paul A. Gardner, an avid hunter, who had hunted big game in Africa, Asia, Europe (including Russia), South America, and throughout the United States. Paul had an extensive collection of trophies – animal skins and taxidermied animals and animal heads and parts (skulls, antlers, hooves, etc.) from game he had shot. Paul kept his trophies in a specially designed trophy room, but he wanted to downsize his trophy collection by donating some of his less desirable specimens to a qualifying charity, the Dallas Ecological Foundation. Working with the appraiser, Paul selected as his contribution total of 177 items, including three shoulder mounts (one of which was a "European mount" featuring just the animal's head), 58 skins and hides, 72 skulls (39 with horns or antlers), 15 horns, 15 antlers, six tails, five sets of hooves, two ears, and one set of tusks. Paul obtained an appraisal from a professional appraiser of hunting trophies (for which he paid $22,125), and claimed a deduction of $1,425,900. On audit, the IRS reduced this deduction to $163,045, and assessed income tax deficiencies.
The Tax Court (Judge Lauber) held that the appraisal wrongly based the value on the replacement cost of the trophies, including the cost of mounting safaris to obtain similar trophies, rather than the amount that a hypothetical reasonable buyer would pay for them on the open market. The government urged that the court determine the fair market value of the specimens by considering market prices for comparable items, while the taxpayer argued that the items were museum-quality hunting specimens

with special value for study and research, and that they have no true comparables in the open market, allowing him to value them by replacement cost. The court explained that the proper valuation method depended upon whether the specimens were "collectibles," which may sometimes be valued at replacement cost, or "commodities," which are always valued using comparable market prices. Citing *Robson v. Comm'r*, T.C. Memo. 1997-176, *aff'd*, 172 F.3d 876 (9th Cir. 1999). A hunting trophy is a commodity, unless it has special provenance -- who shot the animal, where it was shot, and who owned it. The court held that the provenance of the contributed trophies did not make them collectibles. None of the items were of "record book" quality. The court noted that the donee did not even keep the contributed specimens, but instead sold them or gave them away. Also, because the taxpayer's appraiser did not testify at trial and the donated specimens had already been dispersed to unknown locations, none of the experts who testified at trial could conduct a physical inspection to assess the specimens' quality, and they had to rely on the appraiser's photographs, which were small and of poor resolution. Finding the government's appraisers far more persuasive than the taxpayer's appraiser, the court held for the government.

Note. Section 170(e)(1)(B)(iv), enacted after the time of this case, when someone contributes taxidermy property to charity, and the donor is either the person who prepared, stuffed, or mounted the property or who paid or incurred the cost of such preparation, stuffing, or mounting, the amount of the deduction is reduced by what would have been a long-term capital gain had the property been sold at its fair market value at the time of the contribution. Furthermore, for this purpose, the donor's basis includes only the cost of the preparing, stuffing, or mounting. IRC § 170(e)(15).

8. Strings on Charitable Gift Cost Taxpayer $3 Million Deduction. *Fakiris v. Comm'r*, T.C. Memo. 2017-126 (June 28, 2017)

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, at that time, dilapidated and in need of substantial repairs and restoration. Grou planned to raze the theater and construct a high-rise building, but those plans were opposed by the community. Instead, Grou decided 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. Grou then agreed to sell the theater to WEMGO, a qualified public charity that provided affordable housing and job training to abused women. WEMGO agreed to retransfer the property to Richmond Dance after it obtained tax-qualified status, and the sales contract prohibited WEMGO from transferring the property for five years, unless directed by Grou to transfer it to Richmond Dance. The actual deed of transfer, however, did not include any restriction on WEMGO's ability to retransfer the theater or grant Grou a power to direct a transfer. The only consideration for the transfer was WEMGO's assumption of $470,000 of debt on the property. Despite its agreement, WEMGO immediately transferred the property to Richmond Dance, which had not yet received its tax qualification. Richmond Dance did get 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 on its transfer and claimed a $3 million charitable deduction. The IRS disallowed the deduction.

The Tax Court (Judge Gale) held for the government, that no income tax deduction could be allowed for the bargain sale of the theater because of Grou's retained power to direct when WEMGO could thereafter transfer the property. The court explained that the retention by a donor of the right to direct the disposition or manner of enjoyment of transferred assets renders any gift incomplete and, therefore, nondeductible. *See 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 noted that the contract stated that its terms, including the 5-year prohibition on retransfer and Grou's right during that period to direct a transfer to Richmond Dance, "shall survive closing." T.C. Memo. 2017-126 at *17. The court concluded that, under applicable state law (New York), the contract terms survived, even though not included in the deed. The combination of WEMGO's agreement not to sell the theater for five years and Grou's retained right to direct the transfer of title to Richmond Dance if it ever got IRS qualification constituted the retention of dominion and control by Grou and, therefore, by George. The court also sustained a 40% gross overvaluation penalty under Section 6662(h).

9. **No Deduction for Unsubstantiated or Inadequately Substantiated Charitable Gifts. *Ohde v. Comm'r*, T.C. Memo. 2017-137 (July 10, 2017); *Luczaj & Associates et al. v. Comm'r*, T.C. Memo. 2017-42 (March 8, 2017); *Oatman v. Comm'r*, T.C. Memo. 2017-17 (Jan. 17, 2017)**

a) ***Ohde*. Substantiation Lacking for Gifts of More than 20,000 Items to Goodwill Industries**

Mark and Rose Ohde gave more than 20,000 distinct items to Goodwill Industries in 2011. They made dozens of separate trips to deliver these items to Goodwill. The gifts consisted of clothing and household furniture and accessories. The items were itemized, and they claimed a $145,250 deduction. For each delivery, the Ohdes received from Goodwill a one-page printed receipt. Each receipt stated that Goodwill had received items in one or more of the following categories: clothing, shoes, media, furniture, or household items, but they did not further describe any of the items, did not indicate how many items in any category were received, and did not indicate the items' condition. The receipts did state that "Goodwill does not return goods or services in exchange for donations of property." The IRS disallowed all but $250 of the deduction.

The Tax Court (Judge Lauber) held for the government. At trial, the taxpayers offered a TurboTax spreadsheet listing the types of items that they allegedly gave Goodwill on each trip (e.g., "boy's socks," "coffee cups," or "men's shirts"), the number of items of each type allegedly delivered, and the "quality" of each item. For every one of the 20,000 items, the quality was listed as "high." This spreadsheet was not prepared contemporaneously with the alleged gifts, and the taxpayers had no contemporaneous records to support the spreadsheet entries. The spreadsheet showed total values on each trip, but no values any individual item. The taxpayers had no evidence to support their basis in any item. The court found the taxpayers' testimony not to be credible. The court noted that no deduction is allowed for a charitable contribution valued at $250 or more, unless the taxpayer obtains a contemporaneous written acknowledgment from the donee that includes (among other things) a description of the contributed property. IRC §170(f)(8). Additional substantiation requirements are imposed for contributions valued at over $500 or over $5,000. IRC §170(f)(11)(B), 170(f)(11)(C). "Similar items of property" must be aggregated in determining whether gifts exceed the $500 and $5,000 thresholds. IRC §170(f)(11)(F). Moreover, a taxpayer must maintain reliable records for all contributions that include (among other things) a description of the property "in detail reasonable under the circumstances (including the value of the property)" and that establish "the fair market value of the property at the time the contribution was made * * * [and] the method utilized in determining the fair market value." Reg. § 1.170A-13(b)(2)(ii)(D). Here, the taxpayers did not maintain contemporaneous records establishing any of these facts, and the after-prepared TurboTax spreadsheet was not credible and did not show the value for individual items. The court also sustained a 20% penalty for negligence or disregard of rules or regulations. IRC § 6662.

b) ***Luczai & Assoc.*** **Donor Failed to Retain Records or Obtain Contemporaneous Written Acknowledgement**

The taxpayers claimed a charitable contribution deduction of $4,455 for 2011 (of which the IRS conceded $595), and of $4,025 for 2012, of which the IRS conceded $230. The taxpayers allegedly made donations of cash and food to various charities, but contended that their records for 2011 were lost in a household move, and the taxpayers could not for either year identify the charities to which they made the alleged gifts.

The Tax Court (Judge Lauber) held for the government. The court explained that, for all charitable contributions, the taxpayer must maintain bank records, a receipt or letter from the recipient charity, or other reliable written records showing the name of the donee and the date and amount of the gift. IRC § 170(f)(17); Reg. § 1.170A-13(a)(1). For all contributions of $250 or more, the taxpayer must obtain a "contemporaneous written acknowledgment" from the donee. IRC § 170(f)(8)(A). If a donee-charity provides goods and services in exchange for a contribution, the gift is not deductible to the extent of the goods and services. Reg. § 1.170A-1(h). In the absence of any such substantiation, the deductions were denied.

c) ***Oatman*****. No Contemporaneous Written Acknowledgement; Substantial Compliance Inadequate**

Shirley Ann Oatman and her husband, Stewart Thomas Oatman, claimed a $7,950 charitable income tax deduction for gifts made by cash or check. The IRS denied $4,290 of the deduction for lack of a cotemporaneous written acknowledgement.

The Tax Court (Judge Ashford) held for the IRS. Section 170(f)(8)(B) allows such a deduction (for contributions of $250 or more) only if the taxpayer receives a contemporaneous written acknowledgment of the contribution by the charity that states the amount contributed, whether the charity provided any goods or services in consideration, and that includes a description and good-faith estimate of the value of any goods or services provided by the charity. The taxpayer asserted that the *Cohan* rule should be available to establish the amount of the charitable gifts, but the Tax Court disagreed, noting that since 2006, the requirement of a contemporaneous written acknowledgement has been absolute and cannot be addressed by substantial compliance or the *Cohan* rule. *See* Pension Protection Act of 2006, Pub. L. No. 109-280, sec. 1217(a), 120 Stat. at 1080 (adding Section 170(f)(17)).

10. Conversion of Non-Grantor Charitable Lead Annuity Trust into Grantor Trust Yields No Income Tax Deduction. PLR 201730012 (July 28, 2017); 201730017- 201730018 (July 28, 2017)

Grantor created and was the initial trustee of Trust. Trust provides that, until X anniversary, an annuity amount will be distributed to Charity annually. Trust claimed and was allowed an income tax deduction under Section 642(c)(1) for its distributions to Charity. It was proposed that the trust instrument be amended under applicable state law, to grant one of Grantor's siblings, as Substitutor, a nonfiduciary power to exchange other assets for trust assets, without the approval or consent of any person in a fiduciary capacity. The objective is to create a grantor trust under Section 675(4), from the date of the amendment.

The IRS stated that the conversion of Trust into a grantor trust (assuming that Substitutor is found to hold the substitution power in a nonfiduciary capacity): (a) is not a taxable transfer of Trust's property to Grantor for income tax purposes, even though Grantor becomes taxed as the owner of the assets for such purposes under Section 671; (b) is not an act of self-dealing under Section 4941; and (c) does not result in an income tax charitable deduction for Grantor in the year of conversion. The IRS explained that Rev. Rul. 77-402, 1977-2 C.B. 222, holds that when the grantor and owner of a trust which holds a partnership interest subject to liabilities renounces all grantor trust powers over that trust during life, the grantor is treated as having transferred the interest, and will recognize gain or loss. Rev. Rul. 85-13, 1985-1 C.B. 184, the IRS noted, holds that a grantor who acquired the corpus of a trust in exchange for an unsecured promissory note was considered to have indirectly borrowed the trust corpus resulting in grantor trust treatment, and that as a result, the transfer of trust assets to the grantor was not a sale for federal income tax purposes and the grantor did not acquire a cost basis in the assets of the trust. The IRS interpreted these two rules as not treating the conversion of a trust from non-grantor to grantor trust status as a deemed transfer for income tax purposes. With respect to self-dealing, the IRS noted that Trust is a split-interest charitable trust under Section 4947(a)(2), and so is subject to the self-dealing rules of Section 4941. Self-dealing, however, requires that there be a transaction between a disqualified person and the trust, and Substitutor, as a sibling of Grantor, is not a disqualified person. Therefore, the exercise of the power of substitution would not be an act of self-dealing. Finally, the IRS pointed out that, while a transfer to a charitable lead annuity trust that is a grantor trust results in a current income tax deduction under Section 170(f)(2)(B), this requires that there be a transfer to a grantor trust, and the conversion of the trust from non-grantor to grantor trust status is not itself a transfer. Thus, Grantor cannot claim an income tax charitable deduction under Section 170(a) for this conversion.

Note. The IRS conclusion appears to be correct, but it may have gotten there by a slightly erroneous analysis. The suggestion that there is no deemed transfer appears to be incorrect. In Rev. Rul. 77-402, a grantor established a wholly-owned grantor trust the trustees of which acquired a limited partnership interest in a real estate investment partnership. After the basis of the partnership interest had been significantly reduced, the grantor renounced the powers that caused the grantor to be treated as the owner of the trust. Revenue Ruling 77-402 stated that the grantor recognized gain upon the renunciation of powers to the extent that the share of partnership liabilities attributable to the partnership interest exceeded the adjusted basis of that interest. The ruling explains that:

> When a transfer of an interest in a partnership occurs and the transferor's share of partnership liabilities is reduced or eliminated, the transferor is treated as having sold the partnership interest for an amount equal to the share of liabilities reduced or eliminated. . . [T]he amount realized by the transferor A includes the reduction in or elimination of such liabilities. . . .

1977-2 C.B. at 223.

In Reg. § 1.1001-2(c), Ex. 5, on facts substantially identical to those of Revenue Ruling 1977-402, Treasury concludes that “C [grantor] is considered to have transferred ownership of the interest in P to T, now a separate taxable entity, independent of its grantor C.” See also *Madorin v. Comm’r*, 84 T.C. 667 (1985). The termination of grantor trust status, therefore, seems to be a constructive transfer of the trust assets from the grantor to the trust, for income tax purposes, but gain or loss is not recognized, absent such special circumstances as debt in excess of basis.

The same analysis should logically apply when a nongrantor trust becomes a grantor trust, but while there should be a constructive transfer, it is not a constructive transfer by the grantor of the trust. Reg. § 1.671-2(e)(5) states that, "[i]f a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally will be treated as the grantor of the transferee trust." This rule, however, appears to apply only for purposes of determining whether a trust is a grantor trust; it does not create a deemed transfer from the original grantor to the new grantor trust. Rather, there is a deemed transfer by the nongrantor trust to the grantor trust, and the nongrantor trust is not the grantor of the grantor trust for income tax purposes. Thus, there should be no deduction for this constructive transfer.

11. Charitable Payments Under a Reformed Trust are not Deductible for Income Tax Purposes. CCM 201747005 (Nov. 24, 2017) and CCA 201651013 (Dec. 16, 2016)

Parent Trust directed the distribution of all income to Child 1 and Child 2 during their lives, and then be held for their descendants, subject to testamentary powers granted Child 1 and Child 2 to appoint the income among Grantor=s descendants, the spouses of those descendants, and charities. Child 1 died and appointed half of the income in favor of his descendants. The trustees and beneficiaries entered into a settlement agreement dividing the trust into Trust A, for the benefit of Child 1=s descendants, and Trust B, for the benefit of Child 2=s descendants. The settlement agreement approved by state court. The trustees obtained a court order that: (1) Child 2=s testamentary power of appointment be changed to an *inter vivos* power and (2) Child 2 be allowed to immediately exercise it to appoint c% of the income and principal to Foundation 1 and d% to Foundation 2 (two private foundations), causing Trust to terminate.

In Chief Counsel=s Advice 201651013, **t**he IRS denied an income tax deduction for the payments to the foundation. Section 642(c)(1) allows a trust or estate a charitable income tax deduction for "any amount of the gross income, without limitation, which *pursuant to the terms of the governing instrument* is, during the taxable year, paid for a purpose specified in § 170(c) . . . . [emphasis added]. In *Old Colony Trust Company v. Comm'r*, 301 U.S. 379 (1937), the Supreme Court held that the requirement that a distribution be mdae pursuant to the terms of a governing instrument were met where a trust document authorized but did not require that trustees make charitable payments. In *Crown Income Charitable Fund v. Comm'r*, 8 F.3d 571, 573 (7th Cir. 1993), *aff'g* 98 T.C. 327 (1992), the Seventh Circuit denied an income tax deduction for principal and income distributions in excess of those required by a charitable lead trust, despite the fact that the trust permitted commutation of the charitable interest. In *Brownstone v. United States*, 465 F.3d 525 (2nd Cir. 2006), the court held that distributions to charity made pursuant to a beneficiary's exercise of a general power of appointment were not distributions made pursuant to the governing instrument and were not deductible. In the ruling facts, the trust terms were unambiguous, and the court reformation did not resolve any actual dispute. The IRS also disallowed a distribution deduction under Section 661(a), because income distributions to charity are deductible only under Section 642(c). See Reg. § 1.663(a)-2; *Mott v. United States*, 462 F.2d 512 (Ct. Cl. 1972) *cert. denied,* 409 U.S. 1108 (1973); *O'Connor v. Comm'r*, 69 T.C. 165 (1977) (*en banc)*; *Pullen v. United States*, 1979 WL 1518, 45 A.F.T.R.2d 80-381 (D. Neb. 1980), *aff'd without op.,* No. 80-1034 (8th Cir., Sept. 29, 1980); and *U.S. Trust v. I.R.S.*, 803 F.2d 1363 (5th Cir. 1986), *rev'g* 617 F. Supp. 575 (S.D. Miss. 1985).

Trust filed protests to the proposed denials and the IRS expanded on its earlier analysis, while still disallowing the deductions. Trust first argued that the plain language of Section 642(c)(1) allows a deduction for any charitable distribution that is not ultra vires, but the IRS disagreed, and explained that Section 642(c)(1) requires that the distribution be made pursuant to the terms of the governing instrument. The IRS stated that a distribution made pursuant to a court order modifying a will, in the absence of a controversy involving the interpretation of the instrument, is not a distribution made Apursuant to the terms of the governing instrument.@ Trust also argued that the case law does not support a narrow interpretation of Section 642(c)(1), but the IRS responded that its interpretation of that provision is a plain language reading of the statute. The IRS stated that the key factor was that Parent Trust never provided for lifetime distributions or lifetime appointments of the trust income. Trust then argued that both the Supreme Court decision in *Comm'r v. Bosch=s Estate*, 387 U.S. 456 (1976) and Rev. Rul. 73-142, 1973-1 C.B. 405, require that the Service give effect to the state court decree, but the IRS explained *Bosch* requires that it follow only decrees of the highest state court, and that it had, as required, given the lower court decree due regard. The IRS did not claim that the Modification Order was invalid or that it was not binding on the parties; it merely held that it did not determine the federal tax consequences of the modification. Next, Trust argued that the IRS interpretation of Reg. ' 1.663(a)-2 is invalid under *Auer v. Robbins*, 519 U.S.452, 461 (1997). The IRS stated that the regulation, which states in part that A[a]mounts paid, permanently set aside, or to be used for charitable, etc., purposes are deductible by estates and trusts only as provided in section 642(c)@ was consistent with the statute. Finally, Trust argued that the IRS interpretation of Reg. ' 1.663(a)-2 is invalid under

Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), but the IRS stated that the regulation was valid under the two-part analyses in *Chevron,* because Congress has not Adirectly spoken to the precise question at issue@ and the regulation contains a Areasonable interpretation@ of the statute. The IRS also stated that the agency had met its obligations under the Administrative Procedure Act in promulgating this regulation.

Note. Section 642(c) is generous, in that it permits an unlimited deduction for a trust=s or estate=s distribution of income to charity. Unlike the rules for the individual income tax charitable deduction, however, it requires that the distribution be made pursuant to the governing instrument of the trust or estate. CCM 201747005 is but the latest instance in which the IRS has applied this requirement very strictly.

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

1. Taxpayer Entitled to Hardship Exception from 60-Day Rule on Retirement Plan Rollover. *Trimmer v. Comm'r*, 148 T.C. ___ (No. 14) (April 20, 2017)

John C. Trimmer was an officer with the New York Police Department for 20 years until his retirement on April 30, 2011, when he was 47 years old. Before retiring, John was offered a job as a security guard with the New York Stock Exchange, but after he retired, the new job fell through. John began experiencing symptoms of major depressive disorder; he became antisocial, irritable, and uncommunicative with his wife and two sons, rarely left his house, had trouble sleeping, lost weight, neglected his hygiene and grooming, stopped coaching his sons' sporting events and stopped attending their school events, and "kind of just didn't do much of anything." After his major depression had set in, John received from his retirement accounts distribution checks for $99,990 and $1,680. The checks lay on his dresser at home for over a month until he deposited them into his and his wife's joint bank account. John's wife, Susan, did not know what needed to be done with the retirement plan distributions and assumed that John was handling them, since he had customarily handled large investment decisions and taxes. The retirement plan issued Forms 1099-R, "Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc." reporting the distributions as taxable. After consulting with their tax return preparer, they transferred the distributions into an IRA, although the 60-day window for roll-overs had long-since passed. On examination, the IRS rejected the rollover and stated that the distributions were currently taxable, and imposed a 10%

early withdrawal penalty. John requested a hardship extension of the time within which to rollover the distributions, The operations manager of the IRS Center summarily denied the request, noting the 60-day rule and ignoring the possibility of a hardship waiver.

The Tax Court (Judge Thornton) held that (a) the IRS examination division had the authority to consider the request for a hardship waiver (b) the Tax Court had jurisdiction to review the denial of John's request for a hardship waiver; (c) in the facts and circumstances of this case, it would be "against equity or good conscience", under Section 402(c)(3)(B), to deny the requested hardship waiver; (d) the distributions were not currently taxable and the early distribution penalty was inappropriate. The court noted that the 60-day limitation on rollovers can be waived by the Secretary under Section 402(c)(3)(B), "where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement." Rev. Proc. 2003-16, 2003-1 C.B. 359 provides guidance about applying for hardship waivers, and requires that the taxpayer apply for it by submitting a request for a private letter ruling. Rev. Proc. 2016-47, 2016-37 I.R.B. 346, issued after the return examination in this case, also permits request of a hardship waiver during an audit, if the "taxpayer follows all procedures required by the financial institution for depositing the funds into an eligible retirement plan within the 60-day period . . . and, solely due to an error on the part of the financial institution, the funds are not deposited" within the 60-day period. The IRS argued that the hardship waiver provisions are inapplicable because John failed to request a private letter ruling and pay the associated fee. The court held that neither the Code nor Rev. Proc. 2003-16 precludes an IRS examiner from considering a hardship waiver during the course of an examination. Also, Revenue Manual (IRM) pt. 4.10.7.4(2) (Jan. 1, 2006) states: that "Examiners are given the authority to recommend the proper disposition of all identified issues, as well as any issues raised by the taxpayer." The 2016 modification of Rev. Proc. 2003-16 did not create a new authority for IRS examiners to consider hardship waivers during examinations, but rather clarified the existence of that authority. Notably, John's auditor never declined to consider the request or demand that John submit a private letter ruling; she only wrote to John that he need not do anything more and that the IRS would contact him. Thus, John's administrative request for a hardship waiver was sufficient and should have been considered. Furthermore, the court insisted that it had authority to review the denial of the requested extension, finding that nothing in the Code or the legislative history suggested otherwise. The court held that there had been an administrative determination, but that it had ignored the relevant facts and circumstances and that denial of the hardship waiver "would be against equity or good conscience.

2. **Reformation of Decedent's IRA Beneficiary Designation is Sometimes Effective, Sometimes Ineffective to Extend Distribution Period or Permit Rollover. PLRs 201736018 (Sept. 8, 2017); 201707001 (Feb. 17, 2017); 201706002 (Feb. 10, 2017)**

a) **PLR 201736018. Early Termination of Trust Results in Direct Payment to Spouse, which Can be Rolled Over**

Decedent maintained IRA X and died after age 70-1/2. Decedent designated his estate as the beneficiary of IRA X, and upon his death, IRA X became a part of Decedent's residuary estate, all of which was left to Trust X, an unfunded trust created during Decedent's lifetime, with Daughter as trustee. Trust X required that after Decedent's death, all income of the trust be paid to Surviving Spouse, together with certain principal distributions. At Surviving Spouse's death, five percent of the principal of Trust X would be distributed to Church A, and the balance would be distributed to the living issue of Decedent and of Surviving Spouse. Surviving Spouse was executor of Decedent's estate. After Decedent's death, Surviving Spouse and Decedent's three children petitioned State Court B to terminate Trust X and to distribute the assets of Decedent's estate outright to Surviving Spouse, relying on applicable state law that permits termination of a trust in certain circumstances. Court ordered that Trust X be terminated and that the executor of Decedent's estate pay all probate funds to Surviving Spouse.

The IRS stressed that the early termination of the trust was valid under applicable state law, and that, therefore, it treated the proceeds of IRA X to be received by Surviving Spouse should be treated as being paid directly from the IRA to her, and as a result, she will be treated as the payee or distributee of IRA X for purposes of section 408(d)(1). IRA X should not be treated as an inherited IRA with respect to Surviving Spouse, and Surviving Spouse should be eligible to roll over the distribution from IRA X into an IRA set up and maintained in her name.

b) **PLR 201707001. Court Reformation of Beneficiary Designation to Correct Scrivener's Error Permitted, along with Roll-Over**

Decedent died before reaching the required beginning date (age 70 ½). Decedent was survived by Spouse, who was Decedent's spouse, and by two adult children from a prior marriage. Spouse has one adult child from a prior marriage. All of Decedent's and Spouse's assets were community property. Decedent died owning seven Roth and one traditional IRA, which were listed as trust assets on the schedule to the couple's joint revocable trust. At Decedent's death, the revocable trust, of which Spouse was then the sole trustee, created a survivor's trust, a by-pass trust, and a marital trust. The survivor's trust received Spouse's separate property and part of her community property; the survivor's trust was revocable by Spouse. The bypass trust received an amount of Decedent's assets and his share of the community property sufficient to use Decedent's unified credit. The marital trust was deductible as a QTIP. The trust directs that Spouse shall receive any IRA distributions that are paid to the by-pass or the marital trusts. Spouse and Decedent communicated to their attorney that they wanted Spouse to have the flexibility to elect to treat the IRAs as her own if she survived. The attorney caused the death beneficiary designation forms for four of the Roth IRAs to name the trust as beneficiary, and Spouse understood that she could do a spousal rollover of these amounts by first allocating them to the survivor's trust. The other three Roth IRAs and the traditional IRA named the marital trust as the beneficiary. Spouse obtained a local court order reforming the marital trust beneficiary designations retroactively, to show the trust as the primary beneficiary, and Spouse then allocated four of the Roth IRAs to the survivor's trust and one-half of the other three Roth IRAs and one-half of the traditional IRA to the survivor's trust, with the rest of each of those IRAs being allocated to the marital trust. Spouse proposes establishing Roth and Traditional IRAs in her name to take a roll-over from the survivor's trust.

The IRS stated that (1) the IRAs rolled over to the survivor's trust are not inherited IRAs or inherited Roth IRAs for purposes of Section 408(d)(3); (2) Spouse will be treated as the payee or distribute of those accounts, even though she had not been individually designated as beneficiary; (3) the spousal rollover is a proper rollover pursuant to Section 408(d)(3) and constitutes a valid election to treat each of the survivor's trust retirement accounts as Spouse's own, under Regs. § 1.408-8, Q&A-5; (4) Spouse is not required to include any portion of the assets distributed pursuant to the rollover in her gross income for the year of the rollover; (5) starting the year after the rollover, Spouse is not required to withdraw the required minimum distribution from her Roth IRAs, under Section 408A(c)(5), but she will be required to take minimum required distributions from her regular IRA and be treated as its owner. The key was that the IRAs passed to the trust upon Decedent's death, that Spouse was sole trustee and had the sole authority to determine which trust assets were to be allocated to each of the subtrusts, that she allocated the entirety of four of the Roth IRAs as well a one-half of the traditional IRA and one-half of each of the three remaining Roth IRAs to the survivor's trust, and the remainder of the IRAs to the marital trust, and that under the terms of the survivor's trust, Spouse could withdraw all trust assets at any time. Under these circumstances, Spouse cannot treat Decedent's Roth IRAs or traditional IRA as her own, because the trust was named as the beneficiary of each of the IRAs, but her rights over the survivor's trust make her the individual for whose benefit the accounts are maintained. Accordingly, if Spouse receives a distribution of the proceeds of Decedent's Roth IRAs and Decedent's traditional IRA, she may roll over the distribution (other than those required minimum distribution amounts required to have been distributed or to be distributed in accordance with Section 401(a)(9)) into a Roth IRA and a traditional IRA established and maintained in her name.

c) PLR 201706002. Naming as Beneficiary a Trust that is Never Created Cannot be Fixed

Decedent named an *inter vivos* trust Decedent created as beneficiary of an IRA. It appears, however, that the trust was never created. Decedent died before the required beginning date. B was Decedent's surviving spouse and the sole beneficiary under his will. B wanted to roll-over the retirement benefits to an IRA, but the IRA custodian refused to accept her request, because the trust, rather than B, was named as beneficiary. B, as Decedent's executor, obtained a local court order approving the change in the beneficiary of the IRA from the non-existent trust to B. The IRA custodian had stated that this would be accepted as authority to distribute the benefits to B.

The IRS ruled that, because there was no designated beneficiary on the date of Decedent's death, B could not be the designated beneficiary. Reg. § 1.401(a)(9)-4, Q&A-4. There is, therefore, no designated beneficiary of Decedent's IRA. An IRA without a designated beneficiary cannot be an inherited IRA, as defined in Section 408(d)(3)(C)(ii). Thus, the entire IRA balance must be distributed by the end of the calendar year which contains the fifth anniversary of the date of Decedent's death. Reg. § 1.401(a)(9)-3, Q&A-2. The IRS also stated, however, that B was the distribute or payee of the IRA for income tax purposes, and as such any amounts payable from the IRA to B in the first four years after the year in which Decedent died are not required minimum distributions, and may be rolled over to B's own IRA.

Note. The requirement that the rollover can occur only in the first four years is the result of the application of the five-year rule, due to the absence of a designated beneficiary and the fact that the decedent died before the required beginning date. In essence, the IRS in this ruling describes an alternate way to obtain the same effect as in a spousal rollover, at least during the first four years after Decedent's death. The IRA may not be a spousal IRA, but it will be a rollover IRA, so that spouse can delay the first required minimum distribution until she reaches age 70 ½. It may also be noted that, in this case, Decedent's IRA must make its distribution directly to B, and may not be able to do a direct IRA to IRA transfer.

D. IRC § 664. Charitable Remainder Trusts

Foregoing Deductions for Contributions to Charitable Remainder Trust Retains Trust's Exempt Status, but Avoids Private Foundation Rules. PLR 201713003 (March 31, 2017)

Grantor created a charitable remainder unitrust and retained the sole noncharitable interest. The trust has a 20-year term, and the remainder is payable to Charity. Grantor has claimed no income, estate, or gift tax charitable deduction with respect to the Trust for any tax year.

The IRS stated that a charitable remainder trust is tax-exempt under Section 664(a), rather than 501(c)(3), and that if an income, gift, or estate tax deduction is allowable with respect to a gift to the trust, the trust is subject to the private foundation rules under Section 4947(a)(2), including Section 507 (relating to termination of private foundation status), Section 508(e) (relating to governing instruments), Section 4941 (relating to taxes on self-dealing), Section 4943 (relating to taxes on excess business holdings), Section 4944 (relating to investments which jeopardize charitable purpose), and Section 4945 (relating to taxes on taxable expenditures). Here, the trust is not exempt under Section 501(a), and no deduction has been claimed or allowed for income, estate, or gift tax purposes, though such deductions were allowable. In that situation, the IRS stated that the private foundation rules under Section 4947 are not applicable, as long as the taxpayer never claims an income, estate, or gift tax deduction with respect to any portion of the trust.

Note. This arrangement may be desirable where the primary purpose of a charitable remainder trust is to be able to liquidate appreciated assets contributed to the trust without paying current income taxes, and to reinvest the entire pre-tax proceeds. In such situations, there may be potential problems with self-dealing, excess business holdings, or even jeopardy investments, and avoiding these significant penalties may be far more important than obtaining the benefit of a current income tax charitable deduction. The problems raised by the lack of a gift tax charitable deduction can be avoided by having the grantor retain the testamentary right to select a different charity, rendering the remainder gift incomplete for gift tax purposes.

E. IRC §§ 671-679. Grantor Trusts

1. Transfers to Directed Trust Shift Income Without Taxable Gift – Transfers Are Incomplete Gifts and Trust is Probably not a Grantor Trust. PLRs 201751001 – 201751003 (Dec. 22, 2017); 201744006 (Nov. 3, 2017); 201742006 (Oct. 20, 2017); 201718012-201718013 (May 5, 2017); 201653001 – 201653009 (Dec. 30, 2016); 201650005 (Dec. 9, 2016)

Grantor created an irrevocable trust for the grantor's own benefit and that of certain other family members. During Grantor's lifetime, the trustee must distribute net income and principal to Grantor and the other beneficiaries as directed by the distribution committee and/or Grantor, as follows: (a) at any time, the trustee, pursuant to the direction of a majority of the distribution committee, with Grantor's written consent, must distribute to Grantor or the beneficiaries such net income or principal as directed by the distribution committee; (b) at any time, the trustee, as directed by all of the distribution committee members, other than Grantor, must distribute to Grantor or the beneficiaries such net income or principal as directed by the unanimous distribution committee; and (c) at any time, Grantor, in a nonfiduciary capacity, may distribute to any one or more of the beneficiaries such amounts of the principal (including the whole thereof) as Grantor deems advisable to provide for their health, maintenance, support, and education. The initial distribution committee is Grantor, her children (through guardians acting on until their majority), and her stepchildren. The distribution committee must always have at least two members other than Grantor.

The IRS stated that, as long as there is a distribution committee, the trust is not a grantor trust (absent application of Section 675, on which the IRS declined to rule), contributions of property to the trust are not a completed gift by Grantor, distributions of property by the distribution committee from the trust to Grantor will not be a completed gift by any member of the distribution committee, and distributions of property by the distribution committee from the trust to any beneficiary, other than Grantor, will not be a completed gift subject to federal gift tax, by any member of the distribution committee, other than Grantor. The IRS evaluated grantor trust status by considering the powers of the distribution committee under Section 674. It declined to rule about grantor trust status under Section 675, because the application of those rules depends upon the actual administration of the trust.

Note 1. The IRS also found that there was no completed gift by grantor because grantor had a right to veto distributions of income or principal to other persons during her lifetime, and a testamentary power to appoint the remainder among grantor's descendants. Reg. § 25.2511-2(e). For more on this technique for avoiding state income taxes on trust income, see also Akhavan, "DINGing State Income Taxes in Artwork Transactions," 153 Tr. & Est. 31 (June 2014); Blattmachr & Lipkind, "Fundamentals of DING Type Trusts: No Gift Not a Grantor Trust," 26 Prob. Pract. Rptr. 1 (April 2014); Pulsifer and Flubacher, "Eliminate a Trust's State Income Tax," 145 Tr. & Est. 30 (May 2006); Schaller, "Reduce State Tax with DINGs, NINGs, WINGs, and Other ThINGs," 41 Est. Plan. 23 (April 2014); Schoenblum & Schoenblum, "Avoiding State Income Tax with the Right Kinds of Trusts," 41 Est. Plan. 19 (May 2014); Steiner, The Accidentally Perfect Non-Grantor Trust, 144 Tr. & Est. 28 (Sept. 2005).

Note 2. In PLRs 201744006 and 201751001 – 201751003, the IRS also noted that the community property held by the trust remained community property at the grantor's death, and that basis would be determined under Section 1014(b)(6). The IRS did not analyze the community property law applicable to the trust, but noted that:

> Trust provides that all transferred property to Trust is community property or is being transmuted into community property. Moreover, any and all property transferred to Trust prior to the death of the Predeceased Grantor is and shall retain its character as community property.

See similar holdings in PLRs 201550005 – 201550012. It seems more correct that assets held in a non-grantor trust ought not to remain community property under either state law or for income tax purposes, regardless of the declaration made in the trust instrument. One should be careful about relying on this aspect of this ruling.

F. IRC §§ 1001 – 1022, 1041. Realization and Recognition of Gain and Determining Basis

1. Treasury Delays Until June 30, 2016 Compliance with Consistent Basis Rules. 81 Fed. Reg. 86953-02 (Dec. 2, 2016)

In Notice 2015-57, 2015-36 I.R.B. 294 (Sept. 8, 2015), Notice 2016-19, 2016-9 I.R.B. 362 (Feb. 29, 2016), and Notice 2016-27, 2016-15 I.R.B. 576 (April 11, 2016), the IRS delayed, first until February 29, and then until March 31, 2016, and then until June 30, 2016, the due date for filing or furnishing statements that an executor must provide under Section 6035 to the IRS and beneficiaries. The first two notices IRS stated that executors should wait for proposed regulations to prepare the required statements. Sources at Treasury have said that no further guidance will be issued before the June 30 filing date, so practitioners must meet the filing requirements based on the proposed regulations.

In 81 Fed. Reg. 86953-02 (Dec. 2, 2016), Treasury confirmed in regulation form the statement that it made in Notice 2015-57, that executors or other persons required to file Form 8971, reporting the basis of property passing from a decedent's estate, have until June 30, 2016 to do so.

2. That is So 2010 -- IRS Permits Late Election Out of the Estate Tax for 2010 Nonresident Alien Decedent. PLRs 201749003 (Dec. 8, 2017); and 201735015 (Sept. 1, 2017)

- **PLR 201749003.** Decedent, a non-resident alien, died in 2010, holding United States situs property that passed to Spouse. Spouse failed to file a Form 8939 before the filing deadline of January 17, 2012, so Decedent's executor failed to elect under Section 1022 to allocate basis among the assets of Decedent's estate, in lieu of paying estate taxes.

  The IRS explained that, with respect to the estate of a decedent dying in 2010, the estate tax did not apply, the basis of property acquired from the decedent would be determined under the gift tax rules, rather than the estate tax rules, as modified by Section 1022, and an aggregate $1.3 million of basis ($60,000 for a nonresident alien), with certain adjustments, could be allocated among the assets of the decedent's estate, together with a $3 million spousal property basis adjustment for property passing to a surviving spouse. The estate tax inapplicability and the basis allocations, however, must be elected by an executor on Form 8939, filed on or before January 17, 2012. The IRS granted discretionary relief under Reg. § 301.9100-3, permitting a late election, finding that the taxpayer acted reasonably and in good faith, and that the relief would not prejudice the interests of the government.

Note. The IRS did not state that the executor relied on advice of a competent tax professional, but it did state that such reliance would justify the extension.

- **PLR 201735015.** Decedent, a nonresident alien, died in 2010 and the executors of Decedent's estate hired Attorneys to administer the U.S. estate. Attorneys failed to prepare the Form 8939 to elect out of the estate tax and obtain a carryover basis. The executors requested an extension of time pursuant to Reg. § 301.9100-3 to file the Form 8939 to make the Section 1022 election and to allocate basis provided by Section 1022 to eligible property transferred as a result of Decedent's death.

  The IRS allowed the late election, noting that the estate of a decedent dying in 2010, whether U.S. citizen or nonresident alien, could elect not to have the estate tax apply to the estate, and instead obtain a modified carryover basis. Section 1022(a) provides that property acquired from a decedent who died in 2010 and whose estate makes this election is treated as transferred by gift, and the basis of the person acquiring the property from such a decedent is a modified carryover basis (the lesser of the decedent's adjusted basis or the fair market value of the property at the date of death, with certain adjustments, including an aggregate basis increase and a spousal property basis increase). The election into modified carryover basis is made by filing a Form 8939 on or before January 17, 2012. Notice 2011-76, 2011-40 I.R.B. 479. The Service will grant extensions of time to file a Form 8939 and will accept a Form 8939 filed after the due date only in four limited circumstances, one of which is where the requirements of Reg. § 301.9100-3 are satisfied. The Service stated that the executors had met those requirements and granted an extension of the time in which to file Form 8939.

3. IRS Reviews Tax Consequences of Property Settlement Trust Incident to Couple's Divorce. PLRs 201707008 and 201707009 (Feb. 17, 2017)

As part of the settlement agreement negotiated by H and W incident to their divorce, H proposes to transfer Company shares to an irrevocable trust for the benefit of W, in exchange for which W relinquishes all marital rights and property claims that she might have acquired while married to H. Under the trust terms, W will receive all net income during life and may, at the trustee's discretion, receive distributions of principal. The trustee may not, however, distribute Company shares to W or sell such shares to make cash distributions to W. At W's death, any remaining trust principal will be distributed to H, or, if he predeceased W, his estate. W also can withdraw the greater of greater of $a or b percent of the principal for the trust each year.

The IRS ruled that (a) neither spouse will recognize a gain or loss on the creation of the trust, under Section 1041, which provides that, in the case of any transfer of property incident to a divorce is treated as acquired by the transferee by gift, and the basis of the transferee in the property shall be the adjusted basis of the transferor; (b) Sections 2501 and 2702(c) will not cause either spouse to have made a taxable gift of an interest in the trust, because H is transferring property to the trust in exchange for W's relinquishment of her marital support and property rights, which constitutes a transfer for full and adequate consideration under Section 2516, and no member of H's family acquires an interest in the trust under Reg. § 25.2702-4(d), Ex. 5; (c) except to the extent of any unexercised withdrawal right held by W at her death, none of the assets of the trust will be included in W gross estate for federal estate tax purposes; and (d) the fair market value of the trust property on H's death (or the alternate valuation date, if elected), less by the fair market value of W's outstanding income interest, will be included in H's gross estate under Sections 2036(a)(1) and 2036(a)(2), because H retained a right to the property if he survives W.

G. Income Tax Procedures

Woes of the Undercompensated Fiduciary -- Government's Income Tax Lien Must be Satisfied Before Executor's Fees. *Matter of Simmons v. Spiekhout*, 2017 WL 3261781, 120 A.F.T.R.2d 2017-5368 (S.D. Ind. July 31, 2017)

Frederick Simmons married Deborah Scott, and the couple had one child, Erick. The couple divorced in 1998, and their divorce decree provided, in part, that Frederick would pay certain amounts for child support, maintenance, their child's health insurance benefits, and any of his uninsured health care costs. The agreement also required that Frederick hold Deborah harmless from any and all encumbrances on certain real property owned by the couple, the title to which Deborah quitclaimed to Frederick ("the Property"). Frederick later married Raelinn Spiekhout, who survived him and became personal representative of his estate, the principal asset of which was the Property. The estate was subject numerous claims, including Deborah's claim for past due child support, alimony, medical expenses, and insurance expenses, and federal claims for unpaid income and trust fund taxes. The state court approved sale of the Property and declared the estate insolvent, finding that it had only $266,873 of assets and over $1.8

million of claims. The state court ordered the estate closed as insolvent and ordered distribution of the proceeds from the sale of the Property. The United States removed the case to federal court and contested the state court's disposition of the tax lien, and the U.S. District Court for the Southern District of Indiana also approved the sale of the Property, and Raelinn moved to determine the priority of various claims. The District Judge referred the motion to a Magistrate Judge, who recommended allowing the Government priority interest for the proceeds from the sale of the Property. The personal representative objected.

The District Court (Judge Pratt) overruled the objection. Raelinn argued that her claim for fiduciary fees took priority over the government's tax claims, but the court held that the Government had properly filed notice of its federal tax liens and that the personal representative is not a "purchaser, holder of security interest, mechanics lienor, or judgment lien creditor," such as would provide priority over the government's tax lien. IRC § 6323. The court held that funeral and administrative expenses have no priority over a federal tax lien in the settlement of an estate, and that the Federal Tax Lien Act, rather than the Federal Priority Statute, governs whether the Government tax liens have preference to the proceeds from the Property. *United States v. Estate of Romani*, 523 U.S. 517 (1998) (Federal Tax Lien Act, rather than federal priority statute, under which a claim of United States Government "shall be paid first" when debtor's estate cannot pay all of its debts, is governing statute when Government claims preference in insolvent estate of delinquent taxpayer."). Accordingly, because Raelinn's interest did not fall under any of the enumerated exceptions in the Federal Tax Lien Act, 28 U.S.C. § 6323, the Government's tax liens had priority. The Government agreed, however, that, if documentation were provided evidencing payments made by Raelinn to maintain the Property, it would allow her unreimbursed expenses to be paid ahead of the federal tax liens.

H. Income Tax Judicial Doctrines

Tax Benefit Rule Trumped by Death -- Farm Widow Allowed to Deduct Costs Her Late Husband Had Already Deducted. *Estate of Backemeyer v. Comm'r*, 147 T.C. ___ (No. 17) (Dec. 18, 2016)

Julie Backemeyer's husband, Steve ran his Nebraska farming business as a sole proprietorship, though some of the land was titled in Steve's name and some of it in Julie's. In 2010, Steve bought seed, chemicals, fertilizer, and fuel ("farm inputs") to use in conjunction with his 2011 crops. Steve died in March 2011, before using most of the inputs, and they passed at his death to a family trust. Steve's 2010 joint income tax return with Julie included a deduction for the farm inputs. After Steve's death, Julie took up farming. The trust distributed the farm inputs to Julie and she used them in her 2011 planting. Julie sold the crops grown with these inputs, and deducted the value of the inputs from the gross proceeds.

The IRS denied Julie $235,693 of these deductions, and imposed a $15,684 accuracy-related penalty under Section 6662(a).

The Tax Court (Judge Laro) permitted the widow to deduct the full value of the inputs that she had expended, despite the prior deduction for the same items on her joint income tax return with her late husband. The IRS conceded that Julie's treatment of the inputs was correct; she received the assets with a stepped-up basis and contributed them to her sole proprietorship, entitling her to a deduction. The IRS relied on the Supreme Court's holding in *Bliss Dairy, Inc. v. United States*, 460 U.S. 3709 (1983), in which a cash-basis corporation deducted the cost of cattle feed, and then distributed its assets to its shareholders in a nontaxable liquidation. The shareholders operated the business in noncorporate form, and deducted their basis in the feed as an expense. The Supreme Court held that the liquidation converted the feed from a business to a nonbusiness use, which was inconsistent with the prior deduction, and it applied the tax benefit rule. The IRS argued that when Steve died and left the inputs to his trust, they were converted from business to nonbusiness assets. Julie took them with a stepped-up basis and reconverted them to business assets. The IRS argued that this entitles Julie to deduct her basis in the inputs, but also requires her recognize income related to the conversion. The Tax Court disagreed, noting that the tax benefit rule applies if: (1) an amount was deducted in a year prior to the current year, (2) the deduction resulted in a tax benefit, (3) an event occurs in the current year that is fundamentally inconsistent with the premises on which the deduction was originally based, and (4) a nonrecognition provision of the Code does not prevent the inclusion in gross income. The court explained that *Bliss Dairy* involved the nonrecognition of gain on a liquidating distribution by a corporation to its shareholders, whereas in this case the transfer occurred at death. The Supreme Court recognized in *Bliss Dairy* that its decision did not extend necessarily to transfers by gift or death. 460 U.S. at 386, note 20. The court concluded that "a transfer at death is not 'fundamentally inconsistent with the premise' on which the section 162 deduction is initially based" and, therefore, the tax benefit rule should not apply. The court explained that "[a] current event is considered fundamentally inconsistent with the premises on which the deduction was originally based when the current event would have foreclosed the deduction if that event had occurred within the year that the deduction was taken." *Frederick v. Comm'r*, 101 T.C. 35 at 41 (1993). Had Steve died and Julie inherited and used the farm inputs in the year in which Steve paid for them, the initial Section 162 deduction would not have been recaptured, because the estate tax effectively serves to recapture these expenses. Requiring recapture of the Section 162 deduction would result in double taxation of the value of the farm inputs. Furthermore, the court noted, the same result applies even if Steve's estate owes no estate tax because of the available unified credit and marital deduction. Furthermore, the court noted, the principle that inheritances are not included in gross income is one of the "strongest principles inherent in the income tax." Citing *Willging v. United States*, 474 F.2d 12, 13 (9th Cir. 1973) (cash basis farmer owning appreciated assets is not taxable on the unrealized appreciation, nor is his spouse, because of the section 1014 basis step-up).

IV. ESTATE TAXES

A. IRC § 2001. Estate Tax Reform

Estate Tax Repeal and Reform. H.R 198, 115th Cong., 1st Sess. (Jan. 3, 2017); H.R. 451, 115th Cong., 1st Sess. (Jan. 11, 2017); H.R. 631, 115th Cong., 1st Sess. (Jan. 24, 2017); H.R. 3886, 115th Cong., 1st Sess. (Sept. 28, 2017); S. 205, 115th Cong., 1st Sess. (Jan. 24, 2017)

In addition to the proposed estate tax changes in both the House and Senate versions of the "Tax Cuts and Jobs Act," other bills would have revised or reformed the wealth transfer taxes.

H.R. 631 and S. 205 both provided that:

- The estate tax will not apply with respect to estates of decedents dying after the date of enactment;
- The generation-skipping transfer (GST) tax will not apply with respect to taxable events after the date of enactment;
- The gift tax will be retained with the present exemption and annual exclusion, with continued indexing;
- The top gift tax rate is reduced to 35%, for aggregate taxable transfers above $500,000;
- The anti-estate freezing rules of Chapter 14 are retained, presumably because they are needed to protect the integrity of the gift tax;
- The present basis adjustment on the date of a decedent's death are preserved, even absent an estate tax.

S. 205, but not H.R. 631, would have provided that a transfer in trust shall be treated as a taxable gift, unless the trust is treated as wholly owned by the donor or the donor's spouse under the grantor trust rules.

See also H.R 198 (straight-up repeal of the estate, gift, and GST taxes and the estate freezing rules, leaving the present basis rules intact); H.R. 451 (straight-up repeal of the estate tax, leaving the gift tax, GST tax, anti-freezing rules, and present basis rules intact); and H.R. 3886 (raising the applicable exclusion amount to $50 million and reducing the estate tax rate to 20 percent).

B. IRC § 2010. Unified Credit; Portability

1. Tax Court Sustains IRS Broad Power to Re-Examine First Decedent's Estate to Determine Surviving Spouse's DSUE Amount. *Estate of Sower v. Comm'r*, 149 T.C. ___ (No. 11) (Sept. 11, 2017)

Frank Sower died in 2012 and his personal representative filed a timely estate tax return calculating Frank's deceased spousal unused exclusion (DSUE) amount at $1,256,033. This amount was incorrect, however, because it did not properly reflect nearly $1 million in lifetime taxable gifts. The IRS issued a no-change letter with respect to Frank's estate. Frank's widow, Minnie, died in 2013, and her personal representative filed an estate tax return that took advantage of the entire $1,256,033 DSUE amount received from Frank's estate. The IRS examined Minnie's estate and found that she, too, had failed correctly to account for nearly $1 million in lifetime taxable gifts. It also re-examined Frank's estate tax return, discovered the error, and recalculated the DSUE amount, assessing a deficiency against Minnie's estate.

The Tax Court (Judge Buch) held that the IRS was within its authority under Section 2010(c)(5)(B) to re-examine Frank's estate tax return, even though a no-change letter had been issued to his estate, because a no-change letter is not a closing agreement and does not preclude re-examination. The court rejected several other arguments made by Minnie's estate, finding that: (a) a review of the return and records already in the IRS's possession with respect to Frank's estate is not a second examination of Frank's return, for purposes of Section 7605(b), which requires a special notice before a second examination of the same return; (b) the portability effective date rules permit consideration of gifts made before 2010; (c) the re-examination of the earlier estate tax return is consistent with the Congressional intent of the portability rules, and it is expressly authorized by those rules; and (d) the statute of limitations on Frank's estate is not an issue, because no additional tax is being assessed with respect to Frank's estate – only with respect to Minnie's estate.

2. IRS Provides Simplified Means of Obtaining Extension of Time to Elect Portability on Nontaxable Estate. Rev. Proc. 2017-34, 2017-26 1282 (June 26, 2017)

The IRS simplified the way taxpayers can obtain an extension to elect portability of an estate tax exemption. Under the new method, a personal representative must file 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 (or by January 2, 2018, if that is later). The executor must state 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)." This relief is available only for personal representatives (either appointed or non-appointed, pursuant to Reg. § 20.2010-2(a)(6), if: (a) the decedent was survived by a spouse; (b) the decedent died after December 31, 2010; (c) the decedent was a citizen or resident of the United States on the date of death; (d) 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 (e) 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. A return filed in accordance with this new procedure is deemed to be timely filed for purposes of electing portability, and the DSUE amount is available to the surviving spouse with respect to all transfers made after the date of death, even if they were made before the return was filed under this procedure. If the DSUE amount increase in the surviving spouse's applicable exclusion amount results in an overpayment of gift or estate tax by the surviving spouse or his or her estate, this procedure does not extend the limitations period for claiming a refund. A protective claim for refund may be filed in anticipation of relief under this procedure. This revenue procedure is effective June 9, 2017, and it is the exclusive procedure for obtaining an extension of the time for electing portability, with respect to estates that qualify. An executor who has filed a request for a private letter ruling allowing a late portability election which request is pending on June 9, 2017, will receive a refund of the user fee, that request will be void, and that executor can take advantage of the new procedure.

Note. The IRS permitted such a late election in Rev. Proc. 2014-18, 2014-7 I.R.B. 513, but that was available only to the estates of decedents dying before December 31, 2014. The new procedure has no expiration date.

The two-year limitation appears to reflect two considerations. First, the IRS believes that it increases the likelihood that the portability election will be made before the surviving spouse (or his or her executor) is required to file a gift or estate tax return, eliminating the need to file such a return without claiming any DSUE amount and then, after the portability election has been made, having to file either a supplemental return or a claim for a credit or refund. Second, if the allowance of the portability election made pursuant to Rev. Proc. 2017-34, and the corresponding revised computation of the surviving spouse's applicable credit amount would result in a credit or refund of the surviving spouse's gift or estate tax, the availability of the simplified method during the two-year period may reduce the risk that the period under Section 6511 for filing a claim for that credit or refund (generally, extending three years from the date of filing or, if later, two years from the date of payment) would expire before the portability election could be made pursuant to this revenue procedure.

3. **Basic Exclusion Amount Adjusted for Inflation. Rev. Proc. 2017-58, § 3.35, 2017-45 I.R.B. 489 (Nov. 6, 2017)**

The IRS annual inflation adjustments include an increase of the basic exclusion amount to $5,600,000 in 2018.

4. **IRS Allows Recovery of Applicable Exclusion Amount Used in Transfers by Persons in Same Sex Marriage. Notice 2017-15, 2017-6 I.R.B. 783 (Feb. 6, 2017)**

The IRS stated that certain taxpayers and the executors of certain estates could recalculate a taxpayer's remaining applicable exclusion amount and remaining GST exemption, where exclusion or exemption (or both) were used for transfers made by a taxpayer who was married to a person of the same sex. The Defense of Marriage Act, Pub. L. 104-199, 110 Stat. 2419 (Sept. 21, 1996), required that the IRS treat persons as unmarried if they were married under state law to a person of the same sex. The Supreme Court overturned this statute in *United States v. Windsor*, 570 U.S. ___, 133 S. Ct. 2675, 186 L.Ed.2d 808 (2013). The statute of limitations has expired on transfers made more than three years ago, and the IRS now states that, despite this expiration, taxpayers can still recoup their applicable exclusion amount used on transfers made after the effective date of DOMA. In particular, the IRS stated:

- A taxpayer who made a transfer to a same-sex spouse which should have qualified for the gift or estate tax marital deduction can recover any applicable exclusion amount used on the transfer.

- If the marital deduction would require a QTIP, QDOT, or reverse QTIP election, however, the taxpayer must file a private letter ruling request to seek relief under Reg. § 301.9100-3.

- A taxpayer must recalculate his or her remaining applicable exclusion amount on a Form 709 (preferably, the first one required to be filed by the taxpayer after the issuance of this notice), on an amended Form 709 (if the limitations period under Section 6511 has not expired), or on the Form 706 for the taxpayer's estate, if the transfer was not reported on a Form 709. The taxpayer should include a statement at the top of the Form 706 or Form 709 that the return is "FILED PURSUANT TO NOTICE 2017-15." A taxpayer who is still alive need not file an amended or supplemental return solely to report the increased applicable exclusion amount, and may wait until a gift tax return is otherwise required.

- A taxpayer filing such a return must attach a statement supporting the claim for the marital deduction and detailing the recalculation of the taxpayer's remaining applicable exclusion amount as directed in forms and instructions issued by the IRS, which will provide on www.irs.gov a worksheet and instructions to the Form 706 and Form 709 to compute and report the recalculated applicable exclusion amount properly.

- Claims for refund or credit of gift or estate tax actually paid on such transfers will not be allowed after the statute of limitations has expired.

- These rules apply both to the recalculation of the remaining applicable exclusion amount of a taxpayer (whether living or deceased), and the recalculation of any deceased spousal exclusion amount allowed to be included in the applicable exclusion amount of that taxpayer's surviving spouse.

- These rules do not permit a late election to gift-split under Section 2513.

- Any unrefunded gift tax paid on a gift to a same-sex spouse, for which the statute of limitations has expired, will continue to be recognized as gift tax paid or payable for purposes of the computation of the estate tax under Section 2001.

Note. See also discussion of application of these rules to redetermination of the GST exemption, below.

5. **Discretionary Extension Granted to Make Portability Election. PLRs 201735006 – 201735008 (Sept. 1, 2017); 201735010 - 201735011 (Sept. 1, 2017); 201735013 – 201735014 (Sept. 1, 2017); 201735016 (Sept. 1, 2017); 201735018 (Sept. 1, 2017); 201736010 – 201736011 (Sept. 8, 2017); 201736014 (Sept. 8, 2017); 201737004 (Sept. 15, 2017); 201737009 (Sept. 15, 2017)**

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. A request for relief under Reg. § 301.9100-3 will be granted when the taxpayer establishes to the satisfaction of the IRS that the taxpayer (a) 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. In the context of 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, none of these rulings permitted a late portability election when the estate was over the filing threshold, but no tax was owed. Section 9100 relief will not currently be allowed in such cases.

See similar rulings in PLRs 201732001 – 203732005 (Aug. 11, 2017); 201732007 – 201732010 (Aug. 11, 2017); 201732014 (Aug. 11, 2017); 201732016 – 201732018 (Aug. 11, 2017); 201732022 – 201732023 (Aug. 11, 2017); 201732027 (Aug. 11, 2017); 201733005 – 201733006 (Aug. 18, 2017); 201733008 – 201733010 (Aug. 18, 2017); 201734002 (Aug. 25, 2017); 201734005 – 201734006 (Aug. 25, 2017); 201734008 (Aug. 25, 2017); 201730001 (July 28, 2017); 201730003 (July 28, 2017); 201730009 (July 28, 2017); 201730011 (July 28, 2017); 201730013 – 201730014 (July 28, 2017); 201729004 – 201729006 (July 21, 2017); 201729008 (July 21, 2017); 201729010 (July 21, 2017);

201729017 (July 21, 2017); 201728014 (July 14, 2017); 201728004 (July 14, 2017); 201725025 (June 23, 2017); 201725023 (June 23, 2017); 201725018 - 201725021 (June 23, 2017); 201725016 (June 23, 2017); 201725013 (June 23, 2017); 201725011 (June 23, 2017); 201724020 (June 16, 2017); 201724019 (June 16, 2017); 201724014 (June 16, 2017); 201724011 (June 16, 2017); 201724002 – 201724004 (June 16, 2017); 201722021 (June 2, 2017); 201722020 (June 2, 2017); 201722005 (June 2, 2017); 201721001 (May 26, 2017); 201721012 (May 26, 2017); 201720005 – 201720006 (May 19, 2017); 201719005 (May 12, 2017); 201719010 – 201719013 (May 12, 2017); 201719015 – 201719017 (May 12, 2017); 201719020 (May 12, 2017); 201719022 – 201719024 (May 12, 2017); 201718016 (May 5, 2017); 201718021 – 201718022 (May 5, 2017); 201718024 – 201818028 (May 5, 2017); 201718033 (May 5, 2017); 201717003 (April 28, 2017); 201717004 (April 28, 2017); 201717007 (April 28, 2017); 201717011 (April 28, 2017); 201717012 (April 28, 2017); 201717030 (April 28, 2017); 201717037 (April 28, 2017); 201716008 (April 21, 2017); 201716010 (April 21, 2017); 201716012 (April 21, 2017); 201716013 (April 21, 2017); 201716015 (April 21, 2017); 201716021 (April 21, 2017); 201714009 (April 7, 2017); 201714012 (April 7, 2017); 201714016 (April 7, 2017); 201714022 (April 7, 2017); 201714023 (April 7, 2017); 201714025 (April 7, 2017); 201714027 (April 7, 2017); 201713006 (March 31, 2017); 201713008-201713009 (March 31, 2017); 201712004 (March 24, 2017); 201712008 – 201712009 (March 24, 2017); 201710002 (March 10 2017); 201710010 – 201710011 (March 10 2017); 201710014 - 291710015 (March 10 2017); 201710020 (March 10 2017); 201709012 – 201709014 (March 3, 2017); 201709019 (March 3, 2017); 201709022 (March 3, 2017); 201706003 (Feb. 10, 2017); 201706008 (Feb. 10, 2017); 201706011 – 201706012 (Feb. 10, 2017); 201706015 – 201706016 (Feb. 10, 2017); 201704004 (Jan. 27, 2017); 201704006 (Jan. 27, 2017); 201704008 - 201704012 (Jan. 27, 2017); 201703001 (Jan. 20, 2017); 201703006 – 201703011 (Jan. 20, 2017); 201702020 (Jan. 13, 2017); 201702023 (Jan. 13, 2017); 201702025 – 201702026 (Jan. 13, 2017); 201702028 (Jan. 13, 2017); 201702030 – 201702033 (Jan. 13, 2017); 201701001 (Jan. 6, 2017); 201701006 – 201701008 (Jan. 6, 2017); 201601014 (Jan. 6, 2017); 201653010 – 201653012 (Dec. 30, 2016); 201653014 – 201653015 (Dec. 30, 2016); 201652007 – 201652010 (Dec. 23, 2016); 201652016 (Dec. 23, 2016); 201651007 (Dec. 16, 2016); 201651008 (Dec. 16, 2016); 201650004 (Dec. 9, 2016); 201650009 (Dec. 9, 2016); 201648003 (Nov. 25, 2016); 201648011 (Nov. 25, 2016); 201647004 (Nov. 18, 2016); 201645006 (Nov. 4, 2016); 201643007 (Oct. 21, 2016); 201642005 – 201642008 (Oct. 14, 2016); 201642014 – 201642018 (Oct. 14, 2016); 201642018 (Oct. 14, 2016); 201642020 (Oct. 14, 2016); 201642022 - 2091642024 (Oct. 14, 2016); 201642031 (Oct. 14, 2016); 201641003

(Oct. 7, 2016); 201641005 (Oct. 7, 2016); 201641008 (Oct. 7, 2016); 201641009 ; 201641010 (Oct. 7, 2016); 201641013 (Oct. 7, 2016); 201641017 (Oct. 7, 2016); 201640004 (Sept. 30, 2016); 201639004 (Sept. 23, 2016); 201638005 (Sept. 16, 2016); 201638013 (Sept. 16, 2016); 201638018 (Sept. 16, 2016); 201636040 (Sept. 2, 2016); 201634014 (Aug. 19, 2016); 201633002 (Aug. 12, 2016); 201633004 (Aug. 12, 2016); 201633008 (Aug. 12, 2016); 201633011 (Aug. 12, 2016); 201633012 (Aug. 12, 2016); 201633026 (Aug. 12, 2016); 201632018 (Aug. 5, 2016); 201632017 (Aug. 5, 2016); 201632005 (Aug. 5, 2016); 201632003 (Aug. 5, 2016); 201632001 (Aug. 5, 2016); 201631003 (July 29, 2016); 201631002 (July 29, 2016); 201631001 (July 29, 2016); 201630012 (July 22, 2016); 201630010 (July 22, 2016); 201630007 (July 22, 2016); 201630002 (July 22, 2016); 201630001 (July 22, 2016); 201626001 (June 24, 2016); 201626008 (June 24, 2016); 201626014-201626015 (June 24, 2016); 201626018-201626019 (June 24, 2016); 201626021-201626022(June 24, 2016); 201625002 (June 17, 2016); 201624002 (June 10, 2016); 201624014 (June 10, 2016); 201624017 – 201624019 (June 10, 2016); 201622026 - 201622027 (May 27, 2016); 201622024 (May 27, 2016); 201622009 (May 27, 2016); 201621007 – 201621009 (May 20, 2016); 201620008 (May 13, 2016); 201618004 (April 29, 2016); 201618005 (April 29, 2016); 201618009 (April 29, 2016); 201617003 (April 22, 2016); 201615010 (April 8, 2016); 201615009 (April 8, 2016); 201614030 (April 1, 2016); 201614028 (April 1, 2016); 201614027 (April 1, 2016); 201614023 (April 1, 2016); 201614021 (April 1, 2016); 201614020 (April 1, 2016); 201614005 (April 1, 2016); 201613010 – 201613011 (March 25, 2016); 201612008 – 201612010 (March 18, 2016); 201612004 – 201612005 (March 18, 2016); 201610013 (March 4, 2016); 201608008 (Feb. 19, 2016); 201608010 (Feb. 19, 2016); 201607024 (Feb. 12, 2016); 201606012 - 201606013 (Feb. 5, 2016); 201605008 – 201605011 (Jan. 29, 2016); 201604013 (Jan. 22, 2016); 201604014 (Jan. 22, 2016); 201604015 (Jan. 22, 2016); 201604016 (Jan. 22, 2016); 201603003 (Jan. 15, 2016); 201603007 (Jan. 15, 2016); 201603021 (Jan. 15, 2016); 201552010 (Dec. 24, 2015); 201551008 (Dec. 18, 2015); 201550032 (Dec. 11, 2015); 201549022 (Dec. 4, 2015); 201548004 (Nov. 27, 2015); 201544017 (Oct. 30, 2015); 201544003 (Oct. 30, 2015); 201544001 (Oct. 30, 2015); 201539021 (Sept. 25, 2015); 201537010 (Sept. 11, 2015); 201537012 (Sept. 11, 2015); 201536005 (Sept. 4, 2015); 201535004 (Aug. 28, 2015); 201532002 (Aug. 7, 2015).

6. Surviving Spouse Can Demand that Executor File Estate Tax Return and Elect Portability, if Spouse Pays the Costs of Filing. *Matter of the Estate of Vose v. Lee*, 390 P.3d 238, 2017 Ok. 3 (Ok. S. Ct. Jan. 17, 2017), *reh. denied* (Feb. 21, 2017)

The decedent, Anne S. Vose, and her fiancé, C.A. Vose, Jr., had entered into an antenuptial agreement (the "Prenup") under which each waived his or her individual right to be the personal representative of the other's estate, and C.A. waived his right to any distributions from Anne's estate (whether as a beneficiary under her Will, as an intestate heir, or by any spousal rights afforded under applicable state law law). Nine days later, the couple were married. Ten years later, Anne died and her son by a prior marriage, Robert E. Lee, III, applied to admit Anne's 1995 will to probate, and to designate him and his sister as co-personal representatives. C.A. then filed his own petition claiming that Anne's will had been revoked and that she had died intestate. Robert then withdrew his petition, but he did not know that his mother's Prenup had included C.A.'s waiver of his right to be the personal representative of and to share in Anne's estate. After a hearing, the Oklahoma District Court appointed C.A. as personal representative of Anne's. Thereafter, the Prenup was presented to the court, and C.A. agreed to be removed as personal representative and for Robert to be the new personal representative of Anne's estate. C.A. was concerned that Robert would not make a timely-filed portability election and about six and one-half months after Anne's death, he filed with the court an "Application to Compel Administrator to Timely Prepare and File Federal Estate Tax Return for the Purposes of Irrevocable Electing Portability of Decedent's Deceased Spousal Unused Exclusion Amount." 390 P.3d at 241.

After a hearing, the lower court entered an order that:

- denied C.A.'s request for a special administrator to file the federal estate tax return;
- ordered Robert to provide C.A. with a list of records that would be needed to prepare the return properly;
- ordered C.A. to provide the records that Robert requested;
- ordered that if the DSUE amount were available, that Robert would prepare a federal estate tax return electing portability and provide a review copy to C.A. at least 60 days before the return was required to be filed; and
- ordered C.A. to pay for "the filing" of the return, if the DSUE was available.

The Oklahoma Supreme Court affirmed. Robert argued that the district court lacked subject matter jurisdiction over his election of portability, because the federal tax laws had pre-empted the question. The

Court disagreed, and explained that the district court could determine how the federal estate tax provisions applied to a decedent's estate and what interest, if any, a surviving spouse might have in the DSUE amount. Robert also argued that because he is forced to make the election by a state court, where the election is discretionary under the Federal statute (i.e., IRC § 2010(c)(5)(A)), that such state courts actions "thwart the objectives and purposes of Congress." 390 P.3d at 247. The Court cited to Justice Sotomayor's concurring opinion in *Williamson v. Mazda Motor of America, Inc.,* 562 U.S. 323, 336, 131 S.Ct. 1131, 1139, 179 L.ed.2d 75 (2011), reasoning as follows:

> Absent an expressed Congressional purpose served by the DSUE election choice, the fact that the choice may be restricted on state law grounds does not implicate preemption. An examination of the relevant provisions does not reveal such a purpose.
>
> * * *
>
> In fact, the IRS leaves open the possibility that a state court could appoint the surviving spouse as the administrator for the limited purpose of making the election, thereby depriving the primary administrator of the ability to make the election, either to comply with an antenuptial agreement or on some other grounds.

390 P.3d at 248. The Court then held that C.A. had standing, because he had a pecuniary interest in the estate. Robert argued that since C.A. had waived his rights to "a distributive share under Paragraph 6.1(H) of the antenuptial agreement," he had no interest in the estate. The Court viewed the DSUE amount as the legal the equivalent of an asset, based on the impact that the ported exemption has on the surviving spouse. The Court stated:

> If reliance is not placed on any specific statute authorizing invocation of the judicial process, the question of standing depends upon whether the party has alleged a personal stake in the outcome. Ind. School Dist. No. 9 of Tulsa County v. Glass, 1982 OK 2, 8, 639 P.2d 1233. [The surviving spouse] has an obvious interest in the portability of the DSUE. The determinative question, then, is not whether the antenuptial agreement between [the surviving spouse] and Decedent bars him from being a legal heir, but whether the agreement bars him from claiming any interest in the portability of the DSUE.

390 P.3d at 249. The Court then held that C.A. had not waived his right to the DSUE amount, despite waiving under the prenup "to the fullest extent lawfully possible from any and all claims and rights, actual, inchoate, vested, or contingent, in law or equity, which he or she may aquire [sic] in or to the separate property, income, assets and liabilities of the other by reason of their marriage, under the laws of any state or the United States, …" 390 P.3d at 248, note 9. The Court stated that, because portability did not come to the Code before the Prenup existed, covering it by the waiver was impossible. The Court held that the lower court did not err when it ordered Robert to file an estate tax return and elect portability. The Court emphasized that a personal representative has the duty to "preserve the estate … from damage waste and injury." 390 P.3d at 250. In this way, the Court viewed the DSUE amount as an estate asset, even though it has value only to the surviving spouse.

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

1. Eleventh Circuit and Tax Court Reject Estate's Valuation of Controlling Interest in LLC Holding Liquid Assets. *Estate of Koons v. Comm'r*, 686 Fed. Appx. 779 (11th Cir. April 27, 2017), *aff'g* T.C. Memo. 2013-94

The decedent, John F. Koons, III, created Central Investments Corp., which established and ran a soft drink vending machine business. He made a large series of gifts of stock of Central to various family members, including his four children, his many grandchildren, and his three ex-wives. Less than three months before his death, the decedent sold the operations to Pepsi for $400 million, to settle a dispute with the soft-drink company. Central Investments then created Central Investments, LLC ("the LLC"), to hold and invest the sales proceeds. The shareholders of Central Investments entered into a Stock Purchase Agreement that required the company to distribute the LLC membership interests to the shareholders, required the redemption of the interests of several of the donees after the decedent's death, and limited discretionary distributions to 30% of "the excess of 'distributable cash,'" but permitted removal of the 30% limitation by a majority vote. The redemptions left the decedent's estate with a 70.42-percent voting interest in the LLC, which then held approximately $351 million of assets, of which $322 million was in cash, and had a net asset value, after liabilities, of approximately $318 million. The estate valued its interests in the LLC with a 31.7% discount (a 26.6% discount for lack of marketability, a four-percent discount for post-sale contingent liabilities, and a three-percent discount for the 75% vote required to transfer interests outside of the family).

The Tax Court (Judge Morrison) held for the IRS, finding that the appropriate discount was seven and one-half percent, rather than 31.7%, and that the loan interest was not deductible. The court strongly favored and adopted the views of the IRS's expert, Prof. Mukesh Bajaj, ignored the 30% discretionary distribution limitation, because a simple majority vote could remove it. He also noted that the LLC's underlying assets were overwhelmingly liquid, so a 70.42% owner could distribute most of these assets without liquidating the entity. These facts made the typical restricted stock transaction studies inapplicable, the IRS expert contended, leaving an appropriate discount of seven and one-half percent. The court noted that the estate's expert failed to consider that the discretionary distribution limitations could be overcome with a simple majority vote allowing the 70.42% owner to distribute much of the underlying liquid assets. The court stated that the IRS's expert's views were based on "experience and common sense," and that he arrived at the more accurate valuation, in part because (a) the estate's expert used a regression equation derived from an evaluation of 88 businesses engaged in mainly active businesses as opposed to holding cash assets; (b) the estate's expert explained only one-third of the variation in the discounts in the ownership interests in the 88 companies; (c) the estate's calculation involved ownership of minority interests; and (d) the estate's expert overestimated the relationship between block size and the valuation discount.

The U.S. Court of Appeals for the Eleventh Circuit (District Judge Reeves) affirmed both holdings. With respect to the valuation of the membership interests, the Eleventh Circuit held that the Tax Court had properly concluded that the redemptions would occur. The estate noted that, at Mr. Koons' death, the Revocable Trust's interest was not controlling, but the court noted that each of the children had signed an offer to redeem his or her interest and that, after these redemptions, the Revocable Trust would have over 70% of the voting interests. The court agreed that it was reasonable to assume that these redemptions would be carried out, because the testimony at trial suggested that the children were not interested in an ownership stake in the LLC, but instead wanted cash, and that the managers of the LLC did not want the children to remain. The children had raised objections to some of the terms of the redemptions, but then they had signed the agreement, effectively waiving those objections. The Eleventh Circuit also stated that the Tax Court had properly evaluated the fiduciary obligations under state law, in concluding that a hypothetical buyer of the Revocable Trust's interest in the LLC would be permitted to force a distribution of most of the LLC's assets. The estate argued that majority interest holders owe those holding a minority interest a heightened fiduciary duty under Ohio law, which would prevent them from frustrating the purposes for which the LLC was created. The appeals court held that, while Ohio imposes a heightened fiduciary duty on majority shareholders to prevent them from abusing their power at the expense of minority shareholders. *See Edelman v. JELBS*, 57 N.E.3d 246, 255 (Ohio Ct. App. 2015). It does not, however, require that majority shareholders' actions have a legitimate business purpose; it only obliges them to demonstrate that their action had a legitimate business purpose if the action breached a fiduciary duty. *See Crosby v. Beam*, 548 N.E.2d 217, 221 (Ohio 1989). Actions by a majority shareholder that benefit all shareholders equally cannot violate a fiduciary obligation, even if there is no business purpose. The Eleventh Circuit also held that the Tax Court properly gave controlling weight to the Commissioner's expert regarding his methodology and valuation determination. The court stated that the Tax Court had, essentially, viewed the LLC as a holding company only four percent of the assets of which were an operating business. Therefore, the LLC's value was properly determined by the value of its underlying assets.

2. Old Masters Artwork Substantially Undervalued – Informal Appraisal by Auction House Appraiser Rejected. *Estate of Kollsman v. Comm'r*, T.C. Memo. 2017-40 (Feb. 22, 2017)

Eva Franzen Kollsman died owning two 17th- Old Master paintings – "Village Kermesse, Dance Around the Maypole" (Maypole) by Pieter Brueghel the Younger, and "Orpheus Charming the Animals" (Orpheus) by Jan Brueghel the Elder or Jan Brueghel the Younger or a Brueghel studio. A vice president of Sotheby's (and cochairman of Sotheby's Old Master Paintings Worldwide), saw the paintings during a visit to decedent's residence, and near the date of death, outline proposed terms by which Sotheby's would auction the two paintings. The Sotheby's expert provided a pre-sale estimate of $500,000 for Maypole and $100,000 for Orpheus, "based on firsthand inspection of the property." The executor had the paintings cleaned and put in new frames by a leading art restorer, who stated that Orpheus had a slight bow along the bottom and possibly the top as well, that both paintings had heavy dirt, that one painting had discolored varnish, but that cleaning should be "relatively safe." Sotheby's sold Maypole for a hammer price of $2.1 million (total price of $2,434,500), against a presale estimate of $1,500,000 to $2 million. On the estate tax return, the estate valued Maypole at $500,000 and Orpheus at $100,000. The IRS asserted that the fair market values of Maypole and Orpheus were $2,100,000 and $500,000, respectively.

The Tax Court (Judge Gale) rejected the use of the informal appraisal by the Sotheby's expert as a basis for estate tax valuation, but did allow discounts from the IRS appraised value for the risks involved in cleaning both paintings and the disputed maker of Orpheus. The court valued the paintings under Reg. § 20.2031-1(b), at the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. *United States v. Cartwright*, 411 U.S. 546, 551 (1973). The court rejected the report of the Sotheby's expert, and relied instead on that of the IRS expert, a Ph.D. and art historian with extensive art appraisal experience. The Sotheby's appraisal cited no comparable sales and acknowledged that the dirtiness of the paintings made it difficult to know "for certain [the] inherent value." It attributed the substantial difference between the actual sales price of Maypole and the appraised value to the improved condition produced by the cleaning and an increased market demand from a large influx of Russian buyers of Old Masters, and it identified three problems with Orpheus, including the uncertain attribution, weaknesses in the "composition, such that some of the animal figures are barely visible and others appear disjointed from their surroundings," and the dirtiness of that painting. The court rejected the Sotheby's valuation, because (a) Sotheby's wanted to sell the paintings and might, therefore, be inclined to provide a tax-favorable low appraisal; (b) Sotheby's overstated the dirtiness of the paintings and the risks involved in cleaning them, in light of the testimony of the art conservator that the cleaning was reasonably safe, and the fact that the cleaning was actually done using only the mildest detergents used for cleaning paintings; and (d) Sotheby's included no comparables. The court stated that the price for which Maypole was actually sold was relevant, even though the sale occurred after the date of death. *Ithaca Tr. Co. v. United States*, 279 U.S. 151 (1929); *First Nat'l Bank of Kenosha v. United States*, 763 F.2d 891, 894 (7th Cir. 1985); *Estate of Jung v. Comm'r*, 101 T.C. 412, 431-432 (1993); *Estate of Newberger v. Comm'r*, T.C. Memo. 2015-246, at *6. The government's appraiser, on the other hand, valued Maypole at $2.1 million and Orpheus at $500,000, using comparative market data and denying discounts for the risks of cleaning. The court generally agreed with those values, but it allowed a five percent discount against each painting for the risk of cleaning, a ten percent discount for Orpheus for the fact that it was bowed, and a 25% discount for Orpheus for the questions about its attribution.

Note. The estate also noted the property casualty policy providing coverage for decedent's residence and its contents, including Maypole and Orpheus specifically, at insured values of $600,000 and $80,000, respectively. The IRS noted that the estate required that the art restorer maintain $1 million of insurance for Maypole and $500,000 for Orpheus.

3. IRS Provides Interest Rates for Valuing Farmland in Decedent Estates. Rev. Rul. 2017-16, 2017-35 I.R.B. 215 (Aug. 28, 2017)

This 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.

4. **Section 2032A Limitation Adjusted for Inflation. Rev. Proc. 2017-58, § 3.36, 2017-45 I.R.B. 489 (Nov. 6, 2017)**

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 $1,140,000 for estates of decedents dying in 2018.

5. **Late Alternate Valuation Date Election Permitted. PLR 201719014 (May 12, 2017)**

D's personal representatives hired Attorney to prepare the estate tax return, and Attorney failed to advise them to elect the alternate valuation date under Section 2032. The return was filed without the election. Later, Accounting Firm advised the personal representatives that they should file the alternate valuation date election, and they filed a supplemental estate tax return with the election.

The IRS allowed the late election, noting that the alternate valuation date may be elected on a supplemental or late return, as long as the return is filed within one year after the prescribed filing date. Reg. § 20.2032-1(b)(3). A discretionary extension of up to six months of the time to make this election will be allowed under Reg. §§ 301.9100-1 and 301.9100-3 if the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government. 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. In this case, the request for an extension was timely and the extension was granted.

D. **IRC § 2035. Adjustments for Certain Gifts Made Within Three Years of Decedent's Death**

Estate Tax Apportionment and Net Gifts – A Difficult Match. ***Estate of Sommers v. Comm'r*****, 149 T.C. ___ (No. 8) (Aug. 22, 2017)**

In 2001, Sheldon Sommers transferred to an LLC a dozen works of art by such artists as Buffet, Calder, Dali, Hopper, and Miro. Sheldon then assigned most of the LLC interests to his three nieces, making gifts over two years, to take advantage of multiple annual exclusions and the increase in the unified credit in the second year. The nieces became unhappy with the idea of co-owning the art with Sheldon's ex-wife, whom he planned to remarry. To satisfy his nieces, Sheldon modified the LLC interest transfer agreement to require that the nieces pay any gift taxes on the transfer, and to increase the number of units of LLC interest being transferred. The conversion of the transfer to a net gift reduced the size of Sheldon's taxable gifts and permitted him to give all of the LLC interests to the nieces. Sheldon died before the gift taxes had been paid. Sheldon's widow succeeded to property she owned jointly with Sheldon, and his will left her all of his estate remaining after payment of debts and expenses. The widow thus succeeded to or was entitled to receive all of the property included in Sheldon's gross estate, as defined in Section 2031(a). After Sheldon's death, the nieces honored the net gift agreement and paid the gift tax that was due. Sheldon's widow, as his executrix, sued in state court (New Jersey) to include the artwork in Sheldon's gross estate and to apportion estate taxes to the nieces. The state trial court held that the transfers were complete and irrevocable when made, and not includible in Sheldon's estate. The appellate division affirmed. See *Estate of Sommers v. Comm'r*, T.C. Memo. 2013-8. On audit, the estate tax examiner determined that the value of the LLC interests given by Sheldon was higher than that reported on the gift tax returns, and after negotiation, the parties agreed to a $273,990 gift tax deficiency, which the nieces paid. The examiner also assessed a $220,726 estate tax deficiency, in part reflecting the inclusion in Sheldon's gross estate of the tax on the net gifts. The estate tax deficiency also reduced the marital deduction, generating a further estate tax deficiency. Sheldon's executrix sought to apportion the estate taxes on the gift tax payments to the nieces, rather than to the marital share, to avoid reducing the estate tax marital deduction. The IRS disagreed.

The Tax Court (Judge Halpern) held for the government on three issues. First, it denied a deduction for the unpaid gift taxes. The executor argued that the estate should be able to deduct under Section 2053 the gift taxes for which Sheldon was primarily liable, to the extent unpaid on the date of death. The court acknowledged that unpaid gift taxes are typically deductible as a claim against a decedent's estate, but held that, because the nieces had agreed to pay the gift taxes, any gift tax payment by the estate would be recoverable from the nieces. Even if a Section 2053 estate tax deduction were allowed, therefore, there would be an offsetting estate asset for the claim against the nieces for their payment of the estate taxes. Thus, there would be no net change in the size of the taxable estate. See *Parrott v. Comm'r*, 7 B.T.A. 134 (1927), *aff'd*, 30 F.2d 792 (9th Cir. 1929); *Estate of Hendrickson v. Comm'r*, T.C. Memo. 1999-357. The court also explained that Section 2035(b), which includes in a decedent's gross estate the gift taxes paid on gifts made within three years of the date of death, was added to the tax law in 1976, in an effort to "eliminate any incentive to make deathbed transfers to remove an amount equal to the gift taxes from the transfer tax base. . . ." H. Rept. No. 94-1380, at 12, 94th Cong., 2d Sess. (1976). Allowing a deduction for the gift taxes paid by the nieces would entirely negate the effect of the gross-up under Section 2035(b), and frustrate the purpose for which that subsection was designed. Second, the court refused to grant a partial summary judgment regarding the effect of the estate debts and claims on the amount of the marital deduction, because it would depend upon the extent to which assets otherwise exempt from claims against the estate were actually used to pay the debts and expenses, and that evidence had not yet been presented. Any portion of a marital share used to pay estate debts, claims against the estate, or management expenses can be deducted under Section 2053, but there is no deduction for any of the marital share that is used to pay transmission expenses or federal estate taxes. An executor may be forced to sell marital assets that otherwise would be exempt from debts and expenses under applicable state law or the terms of a decedent's will, if nonmarital assets are insufficient to pay these items. *See, e.g., Martin v. United States*, 923 F.2d 504, 506 (7th Cir. 1991); *Murray v. United States*, 687 F.2d 386, 391-392 (Ct. Cl. 1982). The estate tax deduction under Section 2053 for estate expenses and claims is generally limited to the value of the property subject to claims, at the time of the decedent's death. IRC § 2053(c)(2). Claims and expenses paid from property not subject to claims are deductible only if they are paid before the estate tax return due date. The estate's entitlement to the marital deduction in the amount claimed turns on the factual question of to what extent assets otherwise exempt from claims against the estate are actually used to pay the reported debts and expenses. Thus, the court denied the motion seeking a determination of the amount of the marital deduction. Third, and most importantly, the court held that the state estate tax apportionment statute did not apportion the Federal estate taxes imposed on the gift taxes included in Sheldon's gross estate under Section 2035(b), against the nieces to whom those gifts were made. These taxes would be apportioned against the marital share and thus reduce the allowable estate tax marital deduction. The court noted that New Jersey's estate tax apportionment statute, like that in some other states, did not completely reflect the 1976 integration of the estate and gift taxes. It did not recognize that the amount of lifetime taxable gifts to persons who are not beneficiaries of a decedent's estate could still affect the amount of the estate tax on assets passing to those estate beneficiaries, either by inclusion in the gross estate of the gift tax paid on lifetime gifts that were made within three years of the decedent's death, or by increasing the estate tax rate by increasing the decedent's adjusted lifetime taxable gifts. The courts in Connecticut, Maryland, and Mississippi have approved apportionment of estate tax to recipients of lifetime gifts, even without clear statutory mandate, to avoid a perceived inequity. *See Bunting v. Bunting*, 760 A.2d 989 (Conn. App. Ct. 2000); *Shepter v. Johns Hopkins Univ.,* 637 A.2d 1223 (Md. 1993); *In re Estate of Necaise*, 915 So. 2d 449 (Miss. 2005). The New York courts, however, have declined to apportion estate tax to donees, despite an acknowledgement of the inequitable results. *See In re Metzler*, 579 N.Y.S.2d 288, 290 (App. Div. 1992); *In re Estate of Coven*, 559 N.Y.S.2d 798 (Surr. Ct. 1990). The New Jersey courts have yet to address the extent to which their statute provides for apportionment of estate tax to recipients of lifetime gifts, but the Tax Court held that the New Jersey courts were more likely to follow the New York model, which was unfair to the beneficiaries of a decedent's gross estate, but was compelled by the language of the state statutes. The decedent's estate also argued that part of what the nieces received as gifts "represent[ed] the gift tax that was added back to * * * [decedent's] estate." Therefore, the nieces received part of the gross tax estate, to the extent of the portion of the gifts that enabled them to pay the gift tax. The Tax Court rejected this argument, because it equated part of the gift with the gift tax itself, and none of the LLC units given away were actually included in the decedent's gross estate.

Note. Net gifts are a popular estate planning tool for a donor who wishes to give away a specific asset with a reduced gift tax cost, or who lacks the liquidity with which to pay the gift tax. In a net gift, the donee contractually agrees to assume and discharge the donor's legal obligation to pay the gift tax. The shifting of this obligation to the donee reduces the net amount being transferred and, thus, reduces the gift tax. This reduction in the gift tax then increases the net amount being transferred, and back-and-forth it goes, until the difference is less than $1.00 and the amount of the gift tax is established. See Rev. Rul. 75-72, 1975-1 C.B. 310; *Estate of Armstrong v. United States*, 277 F.3d 490, 495 (4th Cir. 2002). The net gift also poses a problem for donors who die within three years of the date of a gift on which the donee pays the gift tax, because Section 2035(b) includes the gift tax on such transfers in the donor's gross estate, even if it is paid by the donee. *Estate of Sachs v. Comm'r*, 856 F.2d 1158 (8th Cir. 1988), *aff'g* 88 T.C. 769 (1987). *Estate of Sommers* demonstrates importance of addressing estate tax apportionment expressly and clearly when a donor makes a net gift. If the donees are also beneficiaries of a significant portion of the decedent's gross estate, the decedent's testamentary instruments can expressly apportion these additional estate taxes against the donee's shares of the decedent's estate. That was not an option in *Estate of Sommers*, because the donees were not recipients of Sheldon's estate at his death.

A better approach in most instances is to make the transfer as a net-net gift, under which the donees agree to pay both the gift tax and also any estate tax that might be imposed under Section 2035(b). The Tax Court has recently held that the amount of a donor's taxable gift in such cases is reduced by both the donee's promise to pay gift taxes and the actuarial value of the donee's promise to pay the estate taxes under Section 2035(b). The value of the donee's promise to pay the estate taxes under Section 2035(b) is determined taking into account the actuarial likelihood that the donor will die in each of the three years following the date of the gift. See *Steinberg v. Comm'r*, 141 T.C. 258 (2013) and *Steinberg v. Comm'r*, 145 T.C. 184 (2015). The use of a net-net gift appears to be the best approach to this problem because it addresses the issues in the net gift agreement, which is signed by both the donor and the donees. Merely addressing this issue in the donor's testamentary instruments, without the knowledge of the donees, can lead to estate litigation when the donees find that they are responsible for taxes that they did not anticipate bearing. Furthermore, if the donor survives the three-year period under Section 2035(b), the amount of the taxable gift will have been reduced because of a contingent liability that never became a present liability.

E. IRC §§ 2036-2038. Retained Life Estate or Power to Alter Beneficial Enjoyment

1. *Strangi* Redux -- Assets Transferred to Family Partnership or LLC Included in Decedent's Gross Estate. *Estate of Powell v. Comm'r,* 148 T.C. ___ (No. 18) (May 18, 2017) (reviewed decision)

Nancy H. Powell's son, Jeffrey, acting for her under a durable power of attorney, created a family limited partnership (NHP). Two days later, he transferred $10 million in cash and marketable securities from Nancy's investment accounts to NHP, in exchange for a 99% limited partnership interest. Nancy's power of attorney authorized Jeffrey "[t]o grant, convey, sell, transfer, mortgage deed in trust, pledge and otherwise deal in all property real and personal, which the principal may own" and "[t]o make gifts on the principal's behalf, including, but not limited to, forgiveness of loans, to a class composed of the principal's children, any of such children's issue, or any or all to the full extent of the federal annual gift tax exclusion under Internal Revenue Code Section 2503(b) or any successor statute." Nancy's actual incapacitation was confirmed by two doctors who had examined her. NHP's limited partnership agreement gives Jeffrey, as general partner, sole discretion to determine the amount and timing of distributions, and allows for the partnership's dissolution with the written consent of all of the partners. Jeffrey thereafter assigned the limited partnership interests to a charitable lead annuity trust (CLAT), which required annuity payments to be made to the Nancy H. Powell Foundation, a charity, for the rest of Nancy's lifetime, with a terminating distribution to Nancy's two sons, in equal shares. Nancy died one week later. Her executor, Jeffrey, filed a gift tax return reporting the gift to the CLAT, based on the actuarial value of the remainder interest. The IRS argued that the underlying assets of the partnership were includible in Nancy's gross estate under Section 2036(a), and that the transfer to the CLAT were either void or revocable.

The Tax Court (Judge Halpern) held that the assets of the partnership were included in Nancy's gross estate, to the extent that they exceeded the value of the partnership interests themselves, and that the transfer to the CLAT was either void or revocable. With respect to the estate tax treatment, the IRS argued that Section 2036(a)(1) applies to the transfers to the partnership because Nancy, together with the other partners, had the right to dissolve the partnership and thus designate those who would possess the transferred property or the income from the property. The IRS also argued that the *bona fide* sale exception does not apply because the estate failed to demonstrate a significant nontax purpose for creating NHP, and because, in the light of the claimed valuation discount, the transfer was not made for full and adequate consideration. See *Estate of Bongard v. Comm'r*, 124 T.C. 95, 118 (2005). The estate conceded both that the right to liquidate constituted a retained power to alter beneficial enjoyment, and that the transfer of cash and securities was not a bona fide sale for adequate and full consideration, but argued that Nancy did not own the partnership interests at her death; they had been transferred to the CLAT. The court held that the transfer to the CLAT was voidable or void (as discussed below), but that even were it not, it would be a transfer within three years of Nancy's death, which would still cause estate inclusion under Section 2035(a). The estate had conceded that, had Nancy retained her NHP interest until her death, the value of the cash and securities transferred to the partnership would have been included in her gross estate under Section 2036(a)(2). The court also held that the retained right to compel liquidation of the partnership, exercisable together with the other partners, constituted a right to control beneficial enjoyment. *Estate of Strangi v. Comm'r*, T.C. Memo. 2003-145, *aff'd*, 417 F.3d 468 (5th Cir. 2005). The court noted that, like *Strangi*, in this case: (a) the partnership was created by an attorney-in-fact, who had a fiduciary duty to act for the benefit of the principal; and (b) the principal took back a 99% partnership interest, so that the interests of others were minimal. The court also held that the entire value of the partnership assets was not included in Nancy's gross estate; only the value of those assets in excess of the value of her partnership interests, which were includible under Section 2036(a)(2). See IRC § 2043(a). Including the entire value of the underlying assets and the partnership interests would create an illogical double taxation, which should not be permitted whether or not there is a substantial nontax purpose for forming the partnership. The court also held that, under applicable state law (California), the gift to the CLAT was either invalid or revocable, because it exceeded the authority granted under the power of attorney. See*, e.g, Estate of Swanson v. United States*, 46 Fed. Cl. 388, 392 (2000), *aff'd*, 10 F. App'x 833 (Fed. Cir. 2001). (under California law, power of attorney that gave an attorney-in-fact "significant powers to manage and convey" decedent's property "could not give him the power to make gifts without expressly doing so").

Note. Judges Vasquez, Thornton, Holmes, Gustafson, Morrison, Buch, and Ashford all agreed with this opinion. Judges Foley, and Paris concurred in the result only. Judge Lauber filed a separate concurring opinion, finding that there was also compelling reasons to question whether a valid partnership was ever formed, because Nancy's sons contributed only unsecured promissory notes, and Jeffrey was both the general partner (personally) and the limited partner (as attorney-in-fact and trustee of Nancy's revocable trust) in forming the partnership. Furthermore, the inclusion of the entire value of the underlying assets under Section 2036(a)(2) was reasonable and did not constitute double inclusion, because the partnership was really an empty vehicle to hold assets that were really still the property of Nancy. See *Estate of Thompson v. Comm'r*, T.C. Memo. 2002-246, aff'd, 382 F.3d 367, 379 (3d Cir. 2004); *Estate of Harper v. Comm'r,* T.C. Memo. 2002-121; *cf. Estate of Gregory v. Comm'r*, 39 T.C. 1012, 1020 (1963. Judges Marvel, Gale, Goeke, Kerrigan, Nega and Pugh agreed with this opinion.

This decision demonstrates several key points in planning with family limited partnerships or LLCs.

- Do not wait until just before death to create the entity. This undercuts badly the existence of a substantial nontax purpose.

- It is hard to avoid a retained beneficial enjoyment or control over beneficial enjoyment. In *Powell*, the agreement retained to the partners, all together, the right to liquidate the partnership, which the court found to be a right to control beneficial enjoyment. This right would exist in any partnership or LLC, unless expressly negated by the agreement and coupled with a prohibition against amending the agreement. Thus, it is crucial to focus on establishing eligibility for the *bona fide* sale exception.

- Try to avoid using a durable power of attorney to create the entity. The courts and the IRS always look negatively at this.

2. Deathbed Purchase of GRAT Remainder Interest Does Not Avoid Application of Section 2036 or Create Estate Tax Deduction. CCM 201745012 (Nov. 9, 2017)

On Date 1, Donor created Trust 1, an irrevocable discretionary trust for the benefit of Donor's first spouse and issue. Trust 1 terminates on the later of the death of Donor or his first spouse, at which time the principal and any accumulated income are distributed outright to Donor's issue *per stirpes*. Donor's first spouse predeceased him; Donor then married Spouse. On Date 2, Donor formed Trust 2, a grantor retained annuity trust for the benefit of Donor and his issue. Under the terms of Trust 2, an annuity is payable to Donor for the term of the trust, and the remainder is payable under the terms of Trust 1. On Date 3, Donor formed Trust 3, a grantor retained annuity trust for the benefit of Donor and his issue. Under the terms of Trust 3, an annuity is payable to Donor for the term of the trust, and the remainder is payable under the terms of Trust 1. On Date 4, before the expiration of the annuity terms of Trusts 2 and 3, Donor bought the remainder interests in Trusts 2 and 3 from the trustees of Trust 1. Donor paid the purchase price with two unsecured promissory notes. Donor died the following day. Donor's executor filed Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, and reported the purchases of the remainder interests as non-gift transfers, claiming that Donor received adequate and full consideration in money or money's worth in the form of the remainder interests in Trusts 2 and 3. Spouse elected to split gifts with Donor. Donor died before the expiration of the annuity terms of Trusts 2 and 3. Donor's executor filed Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, and included the corpus of Trusts 2 and 3 in the gross estate. IRC § 2036(a)(1); Reg. § 20.2036-1(c)(2). Donor's executor deducted the value of the outstanding promissory notes payable to the trustees of Trust 1 as claims against the estate.

The IRS Office of Chief Counsel stated that, where a purchase of the remainder occurs on the donor's deathbed during the annuity term of a GRAT, the remainder is not included in the donor's taxable estate, and therefore, does not constitute adequate and full consideration in money or money's worth for gift tax purposes. *Merrill v. Fahs*, 324 U.S. 308 (1945). The IRS also stated that a note given in exchange for property that does not constitute adequate and full consideration in money or money's worth for gift tax purposes is not deductible as a claim against the estate. The IRS explained that, as to any property, or part or interest in any property, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. Reg. § 25.2511-2(b). The IRS relied on *Comm'r v. Wemyss*, 324 U.S. 303 (1945) and *Merrill v. Fahs*, in which Supreme Court held that "adequate and full consideration in money or money's worth" has a different meaning for contracts law purposes then it does for gift tax purposes. The gift tax law requires consideration that is reducible to a money value and thereby replenishes the recipient's estate for the value of the property for which it was transferred. The right to decide how property shall be disposed of may have value for contract law purposes, but it does not replenish the transferor's estate and thus does not constitute adequate and full consideration for gift tax purposes. In the facts before the Chief Counsel's Office, Donor's liability on the promissory notes depleted his taxable estate, because the donor had retained a Section 2036 interest or power, which already caused the value of the remainder to be part of his estate. The receipt of the actual remainder interests did not increase the value of the donor's taxable estate, so receipt of the remainder interests could not constitute adequate and full consideration within for gift tax purposes. Rev. Rul. 98-8, 1998-1 C.B. 541 (reaching a similar conclusion for gift tax purposes in the context of Sections 2519 and 2044).

Note 1. The IRS also stated that the note was not deductible as a claim against Donor's estate under Section 2053(c)(1)(A), which provides, in part, that the deduction allowed in the case of claims against the estate, unpaid mortgages, or any indebtedness shall, when founded on a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth. See also Reg. § 20.2053-1(b)(2)(i). No deduction is permissible to the extent it is founded on a transfer that is essentially donative in character (a mere cloak for a gift or bequest). The regulations also state that factors indicative (but not necessarily determinative) of the bona fide nature of a claim or expense involving a family member of a decedent, or a beneficiary of a decedent's estate or revocable trust, may include, but are not limited to: (A) the transaction underlying the claim or expense occurs in the ordinary course of business, is negotiated at arm's length, and is free from donative intent; (B) the claim or expense is not related to an expectation or claim of inheritance; (C) the claim or expense originates pursuant to an agreement between the decedent and the family member or beneficiary, and the agreement is substantiated with contemporaneous evidence; (D) performance by the claimant is pursuant to the terms of an agreement between the decedent and the family member or beneficiary and the performance and the agreement can be substantiated; (E) all amounts paid in satisfaction or settlement of a claim or expense are reported by each party for Federal income and employment tax purposes, to the extent appropriate, in a manner that is consistent with the reported nature of the claim or expense. Reg. § 20.2053-1(b)(2)(ii). In *Merrill v. Fahs*, the Court held that adequate and full consideration should be deemed to have the same meaning in both the estate tax and the gift tax. 324 U.S. at 313 (1945). Consideration, therefore, is limited to something that replenishes the donor's taxable estate for transfer tax purposes. The IRS concluded that, where the purchase of the remainder occurs on the donor's deathbed while he is holding a Section 2036 "string" to the transferred property, the remainder does not increase the value of the donor's taxable estate, because the entire value of the transferred property, including that of the remainder, will be includible in the donor's gross estate pursuant to Section 2036(a)(1). See also *Estate of Goetchius v. Comm'r*, 17 T.C. 495, 503 (1951). The promissory notes in this situation are "a mere cloak for a gift." Reg. § 20.2053-1(b)(2)(i); *Estate of Tiffany v. Comm'r*, 47 T.C. 491 (1967); *Estate of Davis v. Comm'r*, 57 T.C. 833 (1972). Accordingly, no deduction is allowable for Donor's liability on the outstanding promissory notes.

Note 2. The same analysis would apply to the purchase of a remainder interest in a QPRT or, as discussed in Rev. Rul. 98-8, mentioned above, a QTIP. Moreover, it could be extended to the sale of a life insurance policy on the seller's life made within three years of the seller's death. Section 2035(a) states that a transfer of a life insurance policy by the insured within three years of death does not remove the proceeds from the insured's gross estate, but Section 2035(d) contains an exception for a bona fide sale for full and adequate consideration. The IRS analysis in CCM 201745012 would suggest that the payment of the current fair market value of the policy might be inadequate to remove the proceeds from the gross estate, because it would not replace the value of the asset in the gross estate. Arguably, this is incorrect, because it does replace the estate tax value of the asset on the date of the sale, but the IRS could well seek to extend the analysis applied in CCM 201745012 in this context.

F. IRC § 2053. Administrative Expenses

Courts Deny Deduction for *Graegin* Loan from Revocable Trust Because of Availability of Other Liquid Assets. *Estate of Koons v. Comm'r*, 686 Fed. Appx. 779 (11th Cir. April 27, 2017), *aff'g* T.C. Memo. 2013-94

The decedent, John F. Koons, III, created Central Investments Corp., which established and ran a soft drink vending machine business. He made a large series of gifts of stock of Central to various family members, including his four children, his many grandchildren, and his three ex-wives. Less than three months before his death, the decedent sold the operations to Pepsi for $400 million, to settle a dispute with the soft-drink company. Central Investments then created Central Investments, LLC ("the LLC"), to hold and invest the sales proceeds. The shareholders of Central Investments entered into a Stock Purchase Agreement that required the company to distribute the LLC membership interests to the shareholders, required the redemption of the interests of several of the donees after the decedent's death, and limited discretionary distributions to 30% of "the excess of 'distributable cash,'" but permitted removal of the 30% limitation by a majority vote. The redemptions left the decedent's estate with a 70.42% voting interest in the LLC, which then held approximately $351 million of assets, of which $322 million was in cash, and had a net asset value, after liabilities, of approximately $318 million. A year after the decedent's death, the LLC lent $10.75 million to the revocable trust to provide cash for paying estate and gift tax liabilities. The terms of the loan required annual repayments of $5.9 million in principal and interest from 2024 to 2031. The total interest due under the loan was $71,419,497. The estate deducted this amount of interest expense as an administrative expense.

The Tax Court (Judge Morrison) held for the IRS, finding that the interest was not deductible, because the loan was not necessary for the estate administration. The revocable trust could have compelled the LLC to distribute assets to the trust, rather than borrowing them. As such, the revocable trust had ready assets available that would not have required a sale of trust assets at a distressed price. Furthermore, the court noted, the estate would have to remain in position for 18 to 25 years to repay the loan, which would hinder the proper settlement of the estate.

The U.S. Court of Appeals for the Eleventh Circuit (District Judge Reeves) affirmed the nondeductibility of the interest paid by the estate on its promissory loan. The court noted that an interest deduction is properly denied if the estate can pay its tax liability using the liquid assets of an entity, but elects instead to obtain a loan from the entity and then repay the loan using those same liquid assets. *Estate of Black v. Comm'r*, 133 T.C. 340 (2009); and *Keller v. United States*, 697 F.3d 238 (5th Cir. 2012). In this case, the court held that the estate had sufficient assets to pay the tax liability. The court rejected the estate's contention that the trust could not have compelled the LLC to distribute liquid assets, because of the trustees' fiduciary duty to the other members of the LLC. The court held that the state law fiduciary duty would not prevent the trustees from compelling the LLC to make a pro rata distribution. The court explained that the LLC would be paying disbursements to the Revocable Trust, which would then return those amounts to the LLC in the form of interest and principal on the loan.

Note. *Graegin* loans are a useful estate tax planning device to get the government to help finance the payment of estate taxes, but they work only if you can show that there was a true liquidity problem. See Baltuch, "Estate Tax Deductions for Interest Paid on Loans Taken in Order to Pay Estate Taxes," 37 ACTEC L.J. 407 (Winter 2011).

G. IRC § 2055. Charitable Deduction

Estate's Charitable Deduction Reduced by Post-Death Events, Resulting in Substantial Estate Tax Deficiency. *Estate of Dieringer v. Comm'r*, 146 T.C. 117 (2016), *app. briefs filed,* Case 16-72640 (9th Cir., April 28, 2017)

At her death, Victoria Dieringer owned most of the voting and nonvoting stock of DPI, a real property management corporation. The decedent established the Victoria Evelyn Dieringer Trust and a family foundation. One of her sons was sole trustee of both the trust and the foundation, and three of her sons were the directors of DPI. The decedent's will left her estate to the trust, which provided $600,000 in specific charitable bequests, modest gifts to her family members, and left the residue of her estate, including the DPI stock, to the foundation. An independent professional appraisal obtained for estate tax purposes valued the DPI stock at over $14 million, with the voting stock valued at $1,824 per share (with no discounts), and the nonvoting stock at $1,733 per share (after a 5% discount for lack of voting power). Seven months after the decedent's death, the company elected S corporation treatment. The trustee then agreed with thte company for DPI to redeem the decedent's shares from the trust, in part to enable the foundation to avoid the excise taxes on excess business holdings and failure to pay required minimum distributions. DPI and the trust then amended the redemption agreement; DPI agreed to redeem all the voting shares but only some of the nonvoting shares, and to issue more shares to the three sons. DPI gave the trust a short-term promissory note for $2,250,000 and a long-term promissory note for $2,968,462. Three of the decedent's sons, including the one who was trustee of the trust and foundation, bought additional DPI shares. The promissory notes and remaining nonvoting DPI shares were then distributed to the foundation. An appraisal of the DPI stock obtained from the same appraiser who had valued it for estate tax return purposes, valued the voting shares at $916 per share (after discounts of 15% for lack of control and 35% for lack of marketability) and the nonvoting shares at $870 per share (after the same discounts and an additional 5% for lack of voting power at board meetings). The IRS assessed an estate tax deficiency based on lowering the charitable deduction to the value of the notes and the shares under the second appraisal, and imposed an accuracy-related penalty under Section 6662(a) for an underpayment attributable to negligence or disregard of rules or regulations.

The Tax Court (Judge Kerrigan), first held that the estate could not use the date-of-death fair market value of the DPI shares to determine the charitable deduction, because the decedent's sons' actions in redeeming the shares for promissory notes at a reduced value lacked a valid business reason. DPI's board's decision to redeem the shares to avoid the foundation excise taxes were valid business reasons for the redemption, but not for a reduced valuation for the stock. The court noted that the estate tax value of assets is usually used to measure a charitable deduction, but that the deduction is based on the amount passing to the charity. For example, if a trustee has the power to divert property to a noncharitable purpose, then the charitable deduction is reduced by the amount that the trustee could so divert, whether the trustee does so. Reg. § 20.2055-2(b)(1). The estate argued that the charitable deduction should not be affected by post death events, but the court disagreed, but the court noted that the law clearly allowed consideration of post death events if they reduced the value of the amount passing to charity. *Ahmanson Found. v. United States*, 674 F.2d 761, 767 (9th Cir. 1981) ("The statute does not [necessarily] ordain equal valuation as between an item in the gross estate and the same item under the charitable deduction."). The court acknowledged that there had been valid business reasons for the redemption and stock subscriptions, but that those events did not require a reduction in the value of the stock. The decline in per share value was primarily due to the specific instruction given to the appraiser to value decedent's majority interest as a minority interest with a substantial discount. The court also agreed with the IRS that the charitable residuary share bore a proportionate share of the estate tax and further reduced the charitable contribution deduction. The court also sustained imposition of an accuracy-related penalty under Section 6662(a) for an underpayment attributable to negligence. The estate knew that a significant percentage of the value of the bequeathed shares was not passing to the foundation and that the decedent's sons were acquiring a majority interest at a discount.

This case is currently on appeal to the Ninth Circuit. Both sides have filed briefs, raising the same arguments that were raised in the Tax Court. See *http://src.bna.com/osl* and *http://src.bna.com/osn.*

Note. The transaction in *Dieringer* seemed initially to be a reasonable effort at *post mortem* estate planning; it was appropriate for the family (who also were the trustees of the trust and the directors of the foundation) to convert stock of a closely-held C corporation into an asset that would be easier for the foundation to manage and that would provide a steadier source of income for the foundation. It was wrong, however, to attempt to shift part of the value of the stock that had been left to the foundation back to the corporation and the children, by reducing the amount that would be paid to the foundation. The fact that this was an attempt to ease the financial strain of the redemption on the corporation and its stockholders is hardly an excuse that the tax law would permit. It was the reduction in the amount received by the foundation that caused the IRS and the Tax Court to cut the estate tax charitable deduction, rather than the change in the character of the distributed assets. In some ways, the taxpayers are fortunate that the IRS did not disqualify the foundation entirely, because part of its earnings were inuring to the private benefit of the surviving children.

The estate would have had fewer tax problems had it initially valued the stock with full discounts for lack of marketability. Even after the issuance of additional voting stock, the trust's interest (before redemption) was still a majority of the voting control of the corporation, albeit less than the 80% that it had before the issuance of the additional shares and the redemption. The appraiser could as easily have valued the voting and nonvoting stock initially with a significant discount for lack of marketability, but it did not do so for whatever reasons the parties may have had. Had the parties thought through their planning earlier in the process of estate administration and made their S-election, stock subscription, and stock redemption before filing the estate tax return, they could have used the same valuation for both the gross estate and the redemption, and avoided the problems raised in this case.

H. Estate Tax Procedures

1. Fifth Circuit Allows Collection of Estate Tax. *United States v. Holmes*, 693 Fed. Appx. 299 (5th Cir. June 6, 2017), *aff'g* 2016 WL 4363398 (S.D. Tex., 2015)

Barbara and Kevin Holmes were the beneficiaries and fiduciaries of the estate of Shirley Bernhardt. They filed a timely estate tax return reporting an estate of $2.88 million and paying $700,000 in estate tax. On audit, the IRS assessed a deficiency of $1,225,577. The Holmeses filed a petition in the Tax Court and ultimately were held to owe an additional $215,264, which they also did not pay. The IRS placed liens on their assets and sent a Notice of Intent to Levy. The Holmeses filed a Request for a Collection Due Process or Equivalent Hearing, and sent it by certified mail. The IRS claimed that they had not received the request, but the Holmeses had a return receipt and insisted that they had timely requested the hearing. The IRS sued to foreclose its lien, and the Holmeses raised the defense of the statute of limitations. The U.S. District Court for the Southern District of Texas held for the IRS.

The Fifth Circuit (Judge Costa) affirmed. The court noted that the IRS has ten years from the date of the assessment in which to bring suit to collect the taxes. IRC § 6501(a)(1). The ten years had expired before it filed suit, but the court noted that the period of limitations is suspended during a hearing on the liability. The taxpayers argued that the hearing process was not actually initiated until Kevin sent his letter to prove that the Service had received the request in October. The court held that the taxpayer had a duty of consistency, and that estoppel prevented them from arguing that they had legitimately requested a hearing, as shown from their return receipt, and then later arguing that the return receipt was not adequate evidence of their request.

2. Heirs May Be Liable for Estate Tax Liability After a Decade. *Estate of Myers v. Comm'r*, T.C. Memo. 2017-11 (Jan. 10, 2017)

The executor of the estate of Ruben A. Myers elected to pay the estate taxes on the decedent's farm over 10 years, under Section 6166. The executor made timely installment payments for seven years, but became delinquent, due to the lack of liquid probate assets. The IRS filed a notice of federal tax lien. The executor asked that the IRS collect the remaining taxes from the persons who had received cash or liquid nonprobate assets included in the decedent's gross estate. They prioritized those assets, but declined to withdraw the lien notice. The special estate tax lien expired in 2015; the IRS had not taken any action to collect from the third parties. The executor asked the Tax Court to review the determination by IRS Appeals sustaining the lien notice and notice of proposed levy, arguing that the IRS abused its discretion during the 10-year period before the delinquency by not pursuing collection from nonprobate assets.

The Tax Court (Judge Halpern) sustained the IRS notice of federal tax lien against the probate assets, noting that the special estate tax lien under Section 6324(a)(1) attaches automatically on the date of death to the entire gross estate and lapses after ten years. The court also stated that, while the special estate tax lien had lapsed, the period for asserting transferee liability under Section 6324(a)(2) could still be open.

3. **Treasury Inspector General of Tax Administration Criticizes IRS Estate Tax Examination Process. Deputy Inspector General for Audit, "Improvements Are Needed in the Estate and Gift Tax Return Examination Process" (Sept. 26, 2017), 188 BNA Daily Tax Rpt. G-7 (Sept. 29, 2017)**

The Treasury's Inspector General of Tax Administration advised that the IRS procedures for selecting estate and gift tax returns for audit are inconsistent and that they lack managerial oversight. According to this report, a single employee prioritizes cases selected for examination and then assigns them to the field, without documented managerial review. The TIGTA: (a) found no evidence of bias in selecting returns for examination; (b) concluded that the use of a single person to do this creates a risk that extraneous factors apart from compliance risks would be involved; (c) found that documentation guidelines often were not being followed in case selection, based on a random sample of estate tax examinations; and (d) the IRS lacks clear standards or guidance on when deficiency notices should be issued. The IRS stated that it accepts these recommendations and will address them.

4. **New Directions for Processing an Application to Release the Estate Tax Lien on Estate Property. SBSE-05-0417-0011 (April 5, 2017)**

Until recently, the responsibility for processing Form 4422, "Application for Certificate Discharging Property Subject to Estate Tax Lien" was shared by the offices of the Director, Specialty Collection, Offers, Liens and Advisory, and the Director, Speciality Examination Estate & Gift Tax. Estate & Gift Tax processed applications when the federal estate tax return had not yet been filed or was under audit. Specialty Collection, Offers, Liens and Advisory processed applications when there was a balance due, when an estate tax closing letter had been issued, or when a special election allowing deferral of payment of the tax liability had been made. In June 2016, the IRS shifted responsibility for working all applications requesting a discharge of the estate tax lien to Specialty Collection, Offers, Liens and Advisory. Unfortunately, Specialty Collection, Offers, Liens and Advisory was not as familiar as Examination Estate & Gift Tax with the special issues raised in the context of an estate administration. For example, under Specialty Collection, Offers, Liens and Advisory, the IRS began to require that the entire net proceeds from a sale of property that was subject to an estate tax lien, must be deposited into an escrow account or the estate's estate tax account with the IRS, in order for the IRS to release the lien. This created serious cash flow problems for some estates, particularly when the estate might not otherwise owe any estate taxes because of the application of the unified credit and the marital deduction. In response to questions raised by practitioners and professional groups, the IRS has now issued new memorandum, providing guidance regarding how Specialty Collection, Offers, Liens and Advisory would process a request to discharge property subject to an estate tax lien. They key provisions of this new guidance include:

- **Purpose of Lien Discharge.** The memo explains that the primary purpose of the estate tax lien discharge is not to evidence payment or satisfaction of the estate tax, but to permit the transfer of property free from the lien in case it is necessary to clear title.

- **Protecting Interests of the Government.** In determining whether to grant an estate tax lien discharge, the IRS must consider whether the estate tax liability is adequately provided for, meaning that the government's interest in collecting the estate tax is secured under Section 6325(c) and the accompanying Treasury Regulations.

- **What to Consider.** Forms 4442 and the related documents submitted, internal and external records (such as market comparisons) to estimate or substantiate, and the tax liability should be considered in determining how much or if any of the sale proceeds must be held or paid over to the Government in exchange for a certificate of discharge.

- **No Return Required.** If Advisory or Examination Estate & Gift determines that the estate was not required to file an estate tax return, then no discharge certificate should be issued, but instead, Letter 1352, Request for Discharge of Estate Tax Lien, should be issued selecting the applicable paragraph for no estate tax return filing requirement.

- **Nontaxable Estate.** If the Form 4422 indicates that the estate tax return will be non-taxable, , then a discharge without an escrow may be appropriate. If a marital or charitable deduction is being claimed, additional documents should be obtained for review including the will and/or trust that authorize those deductions.

- **Estimated Additional Estate Tax.** If the Form 4422 shows an estimated estate tax greater than the net proceeds from the property being sold, and no estimated payment has been made, then the net proceeds should be paid or escrowed before granting the discharge. If the Form 4422 shows an estimated estate tax liability, and the estate has filed an extension to file the tax estate tax return (Form 4768) and paid the full estimated tax liability, then a discharge without an escrow may be appropriate. If the Form 706 is filed and the reported tax is paid, then a discharge without an escrow may be appropriate.

- **Property Double the Amount of the Liability.** Under Section 6325(b)(1), a certificate of discharge may be issued if it is determined that the remaining property of the estate subject to the estate tax lien has a fair market value that is at least double the amount of the unsatisfied liability secured by the estate tax lien and that the amount of all other liens upon such property which have priority over the estate tax lien.

- **Part Payment.** A certificate of discharge may be issued for any part of the property subject to the estate tax lien if the IRS determines that an adequate amount has been paid in partial satisfaction of the estate tax liability secured by the lien. The amount cannot be less than the value of the Service's interest in the property to be discharged.

- **No Value.** A certificate of discharge may be issued if it is determined that the government's interest in the lien property has no value, considering all facts and circumstances, including other liens and encumbrances with priority over the federal tax lien.

- **Substitution of Proceeds of Sale (Escrow Agreement).** A certificate of discharge may be issued if property subject to the estate tax lien is sold and the IRS determines that the sales proceeds should be held in escrow as a fund subject to the estate tax lien in the same manner and with the same priority as the estate tax lien had with respect to the discharged property. Whether to require an escrow and the amount of the escrow is within the IRS's discretion, based on all relevant facts and circumstances. Reasonable and necessary expenses incurred in connection with the sale of the property or administration of the sale proceeds will be paid from the proceeds of the sale before the satisfaction of any claims. The IRS has discretion to allow distributions from escrow for allowable expenses of administering the estate before the tax liability is determined.

- **Right of Substitution of Value.** An owner has the right under Section 6325(b)(4) to receive a certificate of discharge on any property subject to an estate tax lien if the owner deposits an amount equal to the value of the IRS's interest in the property, or furnishes an acceptable bond in a like amount sufficient to cover the IRS's interest in the property.

5. **Great (Or Lucky) Lawyering Award For 2016 -- Fiduciaries Not Liable for Unpaid Estate Taxes, Because Property Included in Gross Estate Under Section 2033 and Estate Obtained Special Lien Under Section 6324A. *United States v. Johnson*, 224 F.Supp.3d 1220 (C.D. Utah, Dec. 1, 2016), *app. filed* (10th Cir., June 7, 2017)**

The decedent's revocable trust held the stock of Hotel, a company that had a Nevada gaming license. Two of her children, Mary Carol S. Johnson and James W. Smith were the successor trustees and personal representatives of her estate. The residue of the estate was left to the trust. The trust made pre-residuary gifts, directed the payment of debts, expenses, and taxes, and left the balance to four family limited partnerships, one for the family of each of the decedent's children. The decedent's estate tax return showed a gross estate at nearly $16 million, and a federal estate tax liability of approximately $6.6 million, of which $4 million was paid with the return. The estate elected to pay the estate taxes on the Hotel interest in installments under Section 6166. At the suggestion of the IRS agent, Mary Carol S. Johnson furnished documents for a special lien under Section 6324A, to relieve the personal representatives and trustees of personal liability for the deferred estate taxes. Hotel later went bankrupt and was liquidated, with all proceeds going to its creditors. The IRS assessed the outstanding estate taxes against the executors and trustees.

The U.S. District Court for the Central District of Utah (Judge Waddoups) held executors and trustees had no personal liability for the unpaid estate taxes. The court explained that the trustees' liability extended only to assets that were included in the gross estate under Sections 2036 or 2038, but that the revocable trust assets were actually includible under Section 2033, because the decedent did not surrender her beneficial interest in the trust assets by transferring them to a trust that she could revoke and of which she was trustee. See Rev Rul. 75-553, 1975-2 C.B. 477. The executors, furthermore, were not personally liable for estate taxes under 31 U.S.C. § 3713(b), because the special estate tax lien under Section 6324A had relieved them of personal liability. The IRS claimed that there was no discharge under Section 2204, because the personal representatives never specifically requested a discharge. The court was not convinced that a separate written request for discharge was required, but even if it was the communications between the fiduciaries and the IRS satisfied that requirement. The court also held that the fiduciaries had validly requested a special lien under Section 6324A, because they had (a) made an election by applying to the IRS office (Reg. § 301.6324A-1(a)); (b) filed a proper agreement satisfying the requirements of Reg. 301.6324A-1(b); and (c) provided lien property (collateral) that satisfied the requirements of the statute, that it "can be expected to survive the deferral period, and are designated in the agreement" (Reg. § 6324A(b)(1)). The court disagreed with the IRS that the stock was not likely to survive the deferral period, noting that the defendants' expert at that time stated that the stock was likely to survive the deferral period. The government's expert report was found wanting, because it set forth no specific facts suggesting that Hotel's financial stability or history were not as represented.

Note. Procedural rules often seem boring and of little practical value, but a case like *Johnson* shows that, in their proper context, they can be truly and impressively dispositive. The decedent's estate in Johnson may have owed several million dollars in unpaid estate taxes, but the procedural issues resulted in no family member being liable for that deficiency. As noted initially, this reflects either exceptionally adept lawyering or extreme good luck.

6. Penalties Sometimes Waived, Sometimes Not Waived for Executors' Reliance on Advice of Counsel. ***Estate of Hake v. United States*****, 234 F.Supp.3d 626 (M.D. Pa. Feb. 10, 2017) (slip copy),** ***app. filed*** **(3rd Cir., May 4, 2017)**

Ricky and Randy Hake were the executors for the estate of their late mother, Esther Hake. At Esther's death, her five children were involved in a family dispute over her care and the value of her assets, which dispute impaired the executors' ability to administer the estate efficiently. As neither executor had any probate or related tax experience, they hired an estate attorney to advise them. The executors intended to file their estate tax return in a timely manner, but the disputes made it difficult to obtain appraisals and to value the estate assets. Their attorney obtained a one-year extension of the time to pay the tax and a six-month extension of the time to file the estate tax return. See Reg. § 20.6081-1. The attorney told the executors that they had a one-year extension for both. The executors paid the tax before the one-year extension had run, but they filed the return after the six-month extension (though before the one-year extension they thought that they had). The IRS assessed a $197,868.26 penalty for late filing, with $17,202.44 of interest.

The U.S. District Court (Judge Carlson) held that the executors had reasonable cause for filing their estate tax return late, because they had relied on their attorney to tell them when the return was due. The court noted that the case was not governed by *United States v. Boyle*, 469 U.S. 241, 245 (1985), because the executors did not rely on their attorney to file the return. Rather, they had relied on their attorney for legal advice on when the return was due, and then they had filed the return within the time they were told. The question, therefore, was whether reliance on an attorney for legal advice is reasonable cause for late filing. Relying on the prior holdings of the Third Circuit, the court held that it is. Citing *Estate of Thouron v. United States*, 752 F.3d 311, 314 (3d Cir. 2014); *Hatfried, Inc. v. Comm'r*, 162 F.2d 628, 633-35 (3d Cir. 1947); and *Girard Investment Co. v. Comm'r*, 122 F.2d 843, 848 (3d Cir. 1941)). It also noted that the Tax Court has held that reasonable cause may exist for late filing when the taxpayer relies on an expert's incorrect advice. *See Estate of La Meres v. Comm'r*, 98 T.C. 294, 318 (1992).

Note. The circuits are split on this issue. Compare*, Estate of Liftin v. United States*, 754 F.3d 975 (C.A. Fed., 2014), *aff'g* 111 Fed. Cl. 13 (Fed. Cl., 2013), reconsideration *denied* (2013); *Knappe v. United States*, 713 F.3d 1164 (9th Cir. 2013), *cert. denied*, 134 S. Ct. 422, 187 L. Ed. 2d 280 (2013) (reliance on advice of counsel is reasonable cause only if the advice itself is reasonable); with *Estate of Thouron v. United States*, 752 F.3d 311 (3d Cir., 2014), *vac'g & rem'g* 2012 WL 5431009, 110 A.F.T.R.2d 2012-6572 (E.D. Pa., 2012); *Sanderling, Inc. v. Comm'r*, 571 F.2d 174, 178-79 (3d Cir. 1978); *Hatfried, Inc. v. Comm'r*, 162 F.2d 628, 633-35 (3d Cir. 1947), and *Girard Investment Co. v. Comm'r*, 122 F.2d 843, 848 (3d Cir. 1941) (reliance on advice of counsel is inherently reasonable).

7. **Two Percent Interest Rate on Deferred Estate Taxes on Closely-Held Business Adjusted for Inflation. Rev. Proc. 2017-58, § 3.45, 2017-45 I.R.B. 489 (Nov. 6, 2017)**

The value of a closely-held business interest, the deferred estate taxes on which bear interest at a 2% rate, is increased to $1,520,000 for estates of decedents dying in 2018.

8. **IRS Provides Guidance on Use of Transcript Instead of Closing Letter for Estate Tax Return. Notice 2017-12, 2017-4 I.R.B. 742 (Jan. 30, 2017)**

The IRS now provides guidance on how to confirm the closing of an estate tax audit, and obtain an account transcript with a transaction code of "421" and explanation "Closed examination of tax return," to serve as the functional equivalent of an estate tax closing letter in confirming the closing of the audit. Estates and their representatives can request an account transcript by filing Form 4506-T, "Request for Transcript of Tax Return" by mail or facsimile, but such requests should be made no earlier than four months after filing the estate tax return.

Note. Attorneys representing a decedent's estate should include Form 4506-T on the list of specific authorizations when filling out an IRS Form 2848 "Power of Attorney."

9. **Estate Not Entitled to Attorneys' Fees after Defeating a Penalty Assessment, because its Net Worth was Too High and the Applicable Law Was Unsettled. *Estate of Hake v. United States*, 2017 WL 1550023, 119 A.F.T.R. 2d 2017-1654 (M.D. Pa, May 1, 2017)**

The estate of Esther M. Hake successfully obtained an abatement of penalties and interest for a late-filed estate tax return. The estate then sought attorney's fees under Section 7430.

The estate's net worth was nearly $8.2 million on the date of death, which significantly exceeded the $2 million net worth limitation for a claim of attorney's fees under Section 7430(c)(4)(D). Also, while the District Court had held that the penalties must be abated because the taxpayer relied on the incorrect advice of counsel, the circuits are split over whether this justifies abatement. The court noted that the IRS's position cannot have been "substantially justified" in order for attorney's fees to be awarded. The court stated that this means "justified to a degree that could satisfy a reasonable person" or having a "reasonable basis both in law and fact." *Pierce v. Underwood*, 487 U.S. 552, 563–65 (1988). The court held that the IRS's position drew substantial support from case law construing the Supreme Court's decision in *United States v. Boyle,* 469 U.S. 241 (1985), and, therefore, was both "justified to a degree that could satisfy a reasonable person" and had a "reasonable basis both in law and fact." *Id.* 2017 WL 1550023 at *3.

Note. The circuits are, indeed, split on this issue, but the position of the Third Circuit, in which this case lies, is quite well-settled. See discussion of the substantive decision, above.

V. GIFT TAXES

A. IRC § 2503. Gift Tax Annual Exclusion

Annual Exclusion Adjusted for Inflation. Rev. Proc. 2017-58, § 3.37, 2017-45 I.R.B. 489 (Nov. 6, 2017)

The gift tax annual exclusion is increased to $15,000 for transfers made in 2018. The annual exclusion for gifts to a non-U.S. citizen spouse was raised to $152,000 for gifts made in 2018.

Note. These figures may be adjusted to reflect the change in the CPI index used for wealth transfer tax purposes, as discussed above with respect to the BRA 2017.

B. IRC § 2514. Power of Appointment

Trust Reformed to Reduce General to Limited Power of Appointment. PLR 201737008 (Sept. 15, 2017)

Grantor created irrevocable Trust to benefit Grantor's spouse and descendants. Section 7.3 of Trust gives Spouse a testamentary power to appoint principal and income to "such persons, or charities" as Spouse selects. Section 7.3 did not specifically limit the exercise of the power of appointment to persons other than Spouse, the estate of Spouse, the creditors of Spouse or the creditors of Spouse's estate. It was represented that Grantor intended for the power of appointment to be a limited power of appointment, and Spouse's will stated that she held only a limited power of appointment entitling her to appoint to persons or charities other than myself, my creditors, my estate, or the creditors of my estate. On Grantor's petition, Court reformed section 7.3 of Trust to provide that the trustee is to distribute such amounts of principal and income as Spouse is to direct to such persons, or charities other than Spouse, the creditors of Spouse, the estate of Spouse, and the creditors of the estate of Spouse.

The IRS accepted the validity of the retroactive reformation of the power of appointment to correct a scrivener's error, that the power was not a general power and that the reformation was not itself an exercise or release of a general power of appointment under Section 2514. The IRS relied on *Comm'r v. Estate of Bosch*, 387 U.S. 456 (1967), which held that the decision of a state trial court as to an underlying issue of state law is not controlling on federal tax statutes, but absent a decision of the highest state court, the federal authority must apply what it finds to be state law after giving "proper regard" to the state court's determination. The applicable state statute in this case allows a court to reform the terms of a governing instrument, even if unambiguous, to conform the terms to the transferor's intention, if it is proved by clear and convincing evidence that the transferor's intent and the terms of the governing instrument were affected by a mistake of fact or law, whether in expression or inducement. Thus, the state court reformation was consistent with state law and given valid retroactive effect for federal tax purposes.

C. Gift Tax Procedures

1. Whose Ox is Gored? – IRS Can Rely on Taxpayer's Designation in Crediting Check. *Estate of Beckenfeld v. Comm'r*, T.C. Memo. 2017-25 (Jan 31, 2016)

Lillian Beckenfeld died in 2007 and her husband, Mickey, died in 2012. Each of their estates filed a gift tax return for 2007, showing a $1,324,650 gift tax liability and attaching a check for that amount. No election was made to gift-split. The IRS assessed approximately $950,000 in interest, late filing, and late payment penalties against each estate. The personal representative paid the interest and penalties for Mickey's estate, but not those for Lillian's estate. The personal representative later claimed that it had meant to pay the interest and penalties on Lillian's estate, rather than those on Mickey's estate, and that the interest and penalties on Mickey's estate should be abated for reasonable cause.

The Tax Court (Judge Chiechi) held for the government, that Lillian's estate owed the amount assessed for interest and penalties. The court noted that the check was specifically designated both on the check and the coverletter to relate to Mickey's liability, rather than Lillian's. While a taxpayer may designate a payment as he or she wishes, the IRS has the right to rely on that designation. Citing *Dixon v. Comm'r,* 141 T.C. 173, 185 (2013).

2. Gift Tax Statute of Limitations Never Runs on Gifts that were not Adequately Disclosed on a Gift Tax Return. CCM 20172801F (July 14, 2017)

Donor made gifts in years 1 – 6, but never filed gift tax returns for those years. Donor also made gifts in year 7 and filed a gift tax return, but did not report any of the property transferred in that year or the method by which such property was valued for gift tax purposes.

The IRS Office of Chief Counsel advised an Associate Area Counsel that the gift tax statute of limitations on gifts made over seven years never ran and the gift tax was still assessable, because the donor never filed gift tax returns adequately disclosing the transfers under Section 6501(c)(9). Gifts are adequately disclosed only if the return includes a description of the property transferred and the method used to determine the value of that property. No return or no adequate disclosure results in the running of the statute of limitations. See Treas. Reg. § 301.6501(c)-1(f)(1).

Note. Al Capone is said to have quipped that the only statute he respected was the statute of limitations. Failure to file a gift tax return that adequately discloses both the transferred property and the method of valuation produces the rather oxymoronic result of an unlimited statute of limitations.

VI. GENERATION-SKIPPING TRANSFER TAXES

A. IRC § 2601. Effective Date Protection

1. IRS States that Decanting Need Not Forfeit Effective Date Protection from the GST Tax. PLRs 201711002 (March 17, 2017) and 201718014 (May 5, 2017)

a) PLR 201711002. Decanting by Creating New Trusts and Merging Old Trusts into New Trusts Neither Shifts Beneficial Interest to Lower Generation Nor Extends Perpetuities Period

Before September 25, 1985, the settlor established Trusts A and Trust B. Trust A was created for the benefit of the settlor's granddaughter, her spouse (Spouse), her children, GGC1 and GGC2, and her more remote issue. Trust A provides that, during the granddaughter's life, the trustees shall distribute one-half of the net income to her, and may distribute the remaining net income to her or to any of her children or issue. The trustee may also distribute principal of Trust A to the granddaughter and any of her children or issue, but not to Spouse, for support, maintenance, and education. When the settlor's granddaughter dies, if Spouse predeceases her, the trustee may distribute Trust A's net income to the granddaughter's children or issue, until the death of the last survivor of the granddaughter, Spouse, GGC1, and GGC2, when the trust will be divided into equal shares for such of the granddaughter's children as are living, and the issue of any deceased children, *per stirpes.* Spouse died and Trust A was divided, pursuant to court order into Trust A1, for the granddaughter and her issue, Trust A2, for the granddaughter, GGC1, and the issue of GGC1, and Trust A3, for the granddaughter, GGC2 and the issue of GGC2's. After the granddaughter's death, pursuant to court order, Trust A2 was divided into six separate trusts, one for the benefit of GGC1, GGGC1, and GGGC1's issue, one for the benefit of GGC1, GGGC2, and GGGC2's issue, one for the benefit of GGC1 and GGC1's children and issue, and three for the benefit of GGC1's other children and their issue. The settlor also established Trust B, before September 25, 1985, with terms similar to those of Trust A, except that Spouse was neither a beneficiary nor a measuring life. Trust B was later divided into three separate trusts, and thereafter into six separate trusts, in a manner similar to Trust A. GGC1 and the trustee propose to establish six new trusts, Trusts 7 through 12, for the purpose of decanting Trusts 1 through 6 by merging them into the newly established trusts. The new trusts will have the same dispositive provisions, but will not terminate until GGGC1 dies, as opposed to upon the death of the last to die of GGC2 and GGC1. Also, the trusts for GGGC1 grant GGGC1 a testamentary general power of appointment to appoint the trust assets of these trusts to GGGC1's issue and the creditors of GGGC1, and the trusts for GGGC2 grant GGGC2 a similar power of appointment. Each of the trusts will terminate on the latest date required by the applicable state law rule against perpetuities.

The IRS stated that the decanting through merger would not jeopardize the GST exemption of the trusts under of the regulations. The IRS noted that a modification of an effective-date protected trust by valid judicial or nonjudicial reformation, will not cause the exempt trust to be subject to the GST tax, if the modification neither shifts a beneficial interest in the trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification, nor extends the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Reg. § 26.2601-1(b)(4)(i)(D). In this situation, the decanting by merger meets these requirements.

b) PLR 201718014. Decanting by Distribution to New Trust Meets Modification Test, if Not Discretion Test

Grantor executed Trust Agreement on a date before September 25, 1985. Trust Agreement created four separate irrevocable trusts, one for the benefit of each of Grantor's four children. Trust 1 benefits Daughter and her descendants. Daughter and Bank are the current trustees of Trust 1 and Daughter, Son 1, Son 2, and two of Son 2's minor children, are the current beneficiaries. The trustees are authorized to pay to Daughter or her descendants the net income of Trust 1, in their discretion. The trustees may also distribute principal to or among Daughter and her descendants, as necessary for their maintenance, education, accident, illness, to build a home, start a business or for any other financial transaction the trustee deems to be in a beneficiary's best interest. The distributive powers are vested solely in Bank; none of Grantor's descendants may hold distributive powers. After Daughter's 35th birthday, the trustees will consider whether to distribute to her all or a major portion of the trust principal of Trust 1. If the trustees do not then make such distributions, they must periodically review the basis for their determination in order to decide whether to make such distributions at a later date. On Daughter's death, the trustees shall distribute the trust principal, in equal shares, *per stirpes*, to Daughter's then-living descendants. Distributions to Daughter's descendants who are under 25 years of age may be held in further trust until such beneficiary reaches that age. Bank plans to resign as a trustee and, upon receipt of a favorable private letter ruling, the trustees will decant the assets of Trust 1 into new Trust 2, under applicable state law. Trust 2 will have the same beneficiaries and distributive provisions as those of Trust 1, and the decanting will not extend the time for vesting of any beneficial interest in the trust assets beyond the perpetuities period in Trust 1. Trust 2 also states that only a disinterested trustee (as defined in Trust 2) may make distributions from Trust 2 to the beneficiaries. Trust 2 will also modify the provisions governing resignation, removal and appointment of individual and corporate trustees. Trust 2 also adds provisions governing the appointment and service of a trust protector, who has the power to modify or amend the terms of the trust to achieve favorable tax status or to respond to changes in the Code, state law or the rulings and regulations implementing such changes, to take advantage of changes in laws governing restraints on alienation, or other state laws restricting the terms of the trust, the distribution of property, or the administration of the trust. The trust protector cannot amend or modify Trust 2 in a manner that will shift any beneficial interest in the trust assets to a beneficiary of a lower generation or extend the time for vesting of any beneficial interest in the trust assets beyond the time provided in Trust 2.

The IRS stated, in a private ruling, that the proposed transfer of Trust 1 assets to a successor trust, Trust 2, and the modifications to Trust 2 will not cause Trust 1 or Trust 2 to lose their exempt status for GST tax purposes. The IRS explained that distributions by and terminations of interests in a trust that was irrevocable on September 25, 1985, and to which no additions have been thereafter made, is protected from the GST tax by the Tax Reform Act of 1986. Pub. L. 99-514, title XIV, 1431, 100 Stat. 2717 (Oct. 22, 1986). The regulations provide that decanting an effective date-protected trust into a new trust will not forfeit the protection of the effective date rules, if either the "modification test" or the "discretion test" is satisfied. A trust decanting satisfies the modification test if the decanting: (a) does not shift a beneficial interest to a beneficiary occupying a lower generation than the person who holds that interest under the original trust; and (b) does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Reg. § 26.2601-1(b)(4)(i)(D). A trust decanting satisfies the discretion test if: (i) when the trust became irrevocable, distributions to a new trust were authorized either by the terms of the instrument itself or by local law (either statutory or common law); (ii) neither beneficiary consent nor court approval for decanting is required; and (iii) the new trust will not suspend or delay the vesting of an interest in the trust beyond the later of some life in being plus 21 years, or 90 years. Reg. § 26.2601-1(b)(4)(i)(A). The IRS explained that the decanting in this ruling met the modification test, but not the discretion test. With respect to the modification test, the IRS explained that one determines whether a modification will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, by comparing the effect of the instrument on the date of the modification with the effect of the instrument immediately before the modification. A modification that is solely administrative in nature is deemed not to shift a beneficial interest, even if it indirectly increases the amount transferred. Reg. § 26.2601-1(b)(4)(i)(E), Ex. 10. The changes in this case were, the IRS stated, administrative in nature. In addition, they did not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. On the other hand, the IRS noted, applicable state statutory law provides that an authorized trustee with unlimited discretion to invade trust principal may appoint part or all of such principal to a trustee of an appointed trust for, and only for the benefit of, one, more than one or all of the current beneficiaries of the invaded trust (to the exclusion of any one or more of such current beneficiaries). The proposed distribution of Trust 1 principal to Trust 2, however, does not satisfy the discretion test, because Trust Agreement does not authorize the trustee to distribute principal from Trust 1 to Trust 2, and the applicable state statute was enacted after the execution of the Trust Agreement.

Note. These rulings are odd because the IRS has formally declared that it will not rule on "[w]hether 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" and this is an area "under study." Rev. Proc. 2017-3, § 5.01(15), 2017-1 I.R.B. 130 (Jan. 3, 2017). Despite this position, the IRS has now issued two rulings providing that an irrevocable trust did not forfeit its effective date protection from the generation-skipping transfer (GST) tax by decanting the trust assets into a new trust. It is not clear why the IRS is now ruling on whether decanting imperils effective date protection of a trust for GST tax purposes. It is particularly odd because both rulings turned on the modification test, which is the only one of the two tests that involves a "change in beneficial interests."

2. Daughter's Erroneous Payment of Income Tax on Effective Date-Protected Trust is Not a Constructive Addition. PLR 201735005 (Sept. 1, 2017)

Trust was an irrevocable trust for Daughter and her issue, created by Grantor before September 25, 1985, and to which no additions have been made after that date. Trust requires Trustees to accumulate income for Daughter until she reaches a particular age, after which she is to receive all of the income semi-annually. Principal is to be paid to Daughter in the discretions of Trustees, and upon reaching specified ages. State law requires that the proceeds from the sale of an asset are allocated to principal, and that the taxes on the gains from such sale are to be paid by trust principal. Trustees sold stock and erroneously reported the income as taxable to Daughter, rather than paying it from principal, issuing Daughter a K-1 so indicating. Daughter paid the tax. In a later year, Trustees realized the error and distributed additional funds to Daughter to reimburse her for part of her incorrect tax payment. Daughter thereafter sought the remainder of her reimbursement, and upon a petition by Trustees, the state court ordered that the statute of limitations on Daughter's claim remained open, and that Trustees should pay her the rest of her reimbursement.

The IRS stated that neither Daughter's payment of the tax on the capital gains nor Trustees's reimbursement of that payment, together with interest and attorneys' fees, constituted a constructive addition to the trust for purposes of the GST tax effective date rules. The IRS explained that Reg § 26.2601-1(b)(1)(v)(C) does state that the relief of a trust's liability by someone after the GST tax effective date is a constructive addition to the trust in an amount equal to the liability. Where a trust that is not subject to the GST tax by reason of being irrevocable on September 25, 1985 is relieved of any liability properly payable out of the assets of such trust, the person or entity who actually satisfies the liability is considered to have made a constructive addition to the trust in an amount equal to the liability. The constructive addition occurs when the trust is relieved of liability (e.g., when the right of recovery is no longer enforceable). In this case, Daughter never waived her right to recover the taxes she incorrectly paid, so there never was a relief of Trustees's liability.

Note. The IRS also stated that Daughter's tax payments were not taxable gifts and that they did not result in any portion of the Trust assets being includible in her gross estate, because there was never a change in the beneficial enjoyment of the amount of the taxes.

B. IRC §§ 2631, 2632. The GST Exemption

1. GST Exemption Adjusted for Inflation. Rev. Proc. 2017-58, § 3.351, 2017-45 I.R.B. 489 (Nov. 6, 2017)

The GST exemption was adjusted for inflation to $5,600,000 for transfers made in 2018.

2. IRS Allows Recovery of GST Exemption Used in Transfers by Persons in Same Sex Marriage. Notice 2017-15, 2017-6 I.R.B. 783 (Feb. 6, 2017)

The IRS stated that certain taxpayers and the executors of certain estates could recalculate a taxpayer's remaining GST exemption (and applicable exclusion amount), where the exemption was used for transfers made by a taxpayer who was married to a person of the same sex. The Defense of Marriage Act, Pub. L. 104-199, 110 Stat. 2419 (Sept. 21, 1996), required that the IRS treat persons as unmarried if they were married under state law to a person of the same sex. The Supreme Court overturned this statute in *United States v. Windsor*, 570 U.S. ___, 133 S. Ct. 2675, 186 L.Ed.2d 808 (2013). The statute of limitations has expired on transfers made more than three years ago, and the IRS now states that, despite this expiration, taxpayers can still recoup the GST exemption used on transfers made after the effective date of DOMA. In particular, the IRS stated:

- Taxpayers who used GST exemption for transfers to someone whose generation-assignment would be higher had the taxpayer's same-sex marriage been recognized, can redetermine their inclusion ratio and remaining GST exemption, as if their marriage had been recognized, even if the statute of limitations on refund claims with respect to the transfer has expired. This could arise if the donor was more than 37 ½ years older than the donee-spouse, or if the donor made a gift to a descendant of the donee-spouse, which descendant was assigned to a younger generation than the donor because of age, without considering his or her relationship to the donor's same-sex spouse.

- These rules apply whether GST exemption was specifically allocated to a transfer or deemed to have been allocated to the transfer.

- A taxpayer who made a transfer to a same-sex spouse which should have qualified for the gift or estate tax marital deduction can recover any applicable exclusion amount used on the transfer.

- If the marital deduction would require a QTIP, QDOT, or reverse QTIP election, however, the taxpayer must file a private letter ruling request to seek relief under Reg. § 301.9100-3.

- A taxpayer must recalculate his or her remaining GST exemption on a Form 709 (preferably, the first one required to be filed by the taxpayer after the issuance of this notice), on an amended Form 709 (if the limitations period under Section 6511 has not expired), or on the Form 706 for the taxpayer's estate, if the transfer was not reported on a Form 709. The taxpayer should include a statement at the top of the Form 706 or Form 709 that the return is "FILED PURSUANT TO NOTICE 2017-15." A taxpayer who is still alive need not file an amended or supplemental return solely to report the increased applicable exclusion amount, and may wait until a gift tax return is otherwise required.

- A taxpayer filing such a return must attach a statement supporting the claim for the marital deduction and detailing the recalculation of the taxpayer's remaining applicable exclusion amount as directed in forms and instructions issued by the IRS, which will provide on www.irs.gov a worksheet and instructions to the Form 706 and Form 709 to compute and report the recalculated applicable exclusion amount properly.

- Claims for refund or credit of GST tax actually paid on such

- These rules do not permit a late election to gift-split under Section 2513.

Note. See also discussion above of the application of these rules to recovery of applicable exclusion amount.

3. **IRS Approves Allocation of GST Exemption Without a Notice of Allocation. PLRs 201731005 and 201731010 (Aug. 4, 2017)**

Husband created an irrevocable trust (Trust) for the benefit of his descendants and funded it with $a. Husband and Wife hired Attorney to prepare their gift tax returns for the year of the gift, and consented to gift-split on those returns. Each spouse elected out of the automatic allocation rules with respect to the gift to Trust, and Attorney correctly reported the transfer as an indirect skip on Schedule A, Part 3. Attorney also allocated GST exemption to the transfer on Schedule D, Part 2, Line 6. Attorney did not, however, attach a Notice of Allocation for this transfer to either return.

The IRS stated that both spouses had substantially complied with the requirements for making an allocation of GST exemption to the transfer to Trust. The IRS noted that each spouse elected out of the automatic allocation of GST exemption, but that each could still allocate GST exemption to the transfers by properly reporting the allocation on a timely filed gift tax return. By failing to attach a notice of allocation, each spouse failed literally to comply with the requirements in the regulations for allocating GST exemption to an indirect skip. Elections that fail to comply with the technical requirements of the regulations, however, may be treated as effective if the taxpayer complied with the essential requirements of a regulation (or the instructions to the applicable form). Citing *Hewlett-Packard Company v. Comm'r*, 67 T.C. 736, 748 (1977), *acq. in result,* 1979-1 C.B. 1. In this case, the IRS concluded that the gift tax returns contained sufficient information to constitute substantial compliance with the requirements of Section 2632(c) to allocate GST exemption to an indirect skip, and therefore each spouse did validly allocate GST exemption to the transfer to Trust.

4. IRS Approves Deemed Allocation of GST Exemption. PLR 201714008 (April 7, 2017)

After 2001, Donor created and funded Trust for the benefit of Brother, Brother's spouse, and Brother's descendants. Brother has a lifetime and testamentary limited power to appoint trust assets to Brother's spouse or lineal descendants, subject to an ascertainable standard, and a power to appoint trust assets to any charitable organization. Brother has no power to appoint assets in favor of himself, his estate, his creditors, the creditors of his estate, or to discharge any of his legal obligations. Brother also has a withdrawal power in an amount equal to any contribution to Trust and upon his death, the withdrawal power passes to Brother's spouse. The withdrawal power may not exceed the least of (i) the total amount of contributions to Trust during that year, (ii) the amount allowable at the time of the first contribution as an exclusion from gift tax under Section 2503(b)(3) (or twice this amount if the donor is married on the date of the last of all contributions made during that year), and (iii) the greater of

$5,000 or five percent of the value of Trust. Any unexercised right of withdrawal lapses at the end of each year or, if earlier, thirty days after the contribution to which it relates. Donor was advised by his lawyer that Trust was a GST trust and that GST exemption would automatically be allocated to the transfers to Trust. Thereafter, Donor was now advised by his lawyer that Trust may not be a GST trust, and Donor sought clarification from the IRS.

The IRS recognized that Trust could have a generation-skipping transfer with respect to the transferor, to the extent that distributions were made to Brother's grandchildren. Thus, it determined whether Trust was a GST trust for GST tax purposes. The IRS noted that a GST Trust does not include a trust that could have a generation-skipping transfer with respect to the transferor, if —

(i) the trust instrument provides that more than 25% of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons (I) before the date that the individual attains age 46, (II) on or before one or more dates specified in the trust instrument that will occur before the date that such individual attains age 46, or (III) upon the occurrence of an event that, in accordance with regulations prescribed by the Secretary, may reasonably be expected to occur before the date that such individual attains age 46;

(ii) the trust instrument provides that more than 25% of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than ten years older than such individuals;

(iii) the trust instrument provides that, if one or more individuals who are non- skip persons die on or before a date or event described in clause (i) or (ii), more than 25% of the trust corpus either must be distributed to the estate or estates of one or more of such individuals or is subject to a general power of appointment exercisable by one or more of such individuals;

(iv) the trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer;

(v) the trust is a charitable lead annuity trust or a charitable remainder annuity trust or a charitable remainder unitrust; or

(vi) the trust is a trust with respect to which a gift tax charitable deduction was allowed for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

IRC § 2632(c)(3)(B). The IRS also noted that Section 2632(c)(3)(B) also provides that the value of transferred property shall not be considered to be includible in the gross estate of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the amount referred to in Section 2503(b) with respect to any transferor, and it shall be assumed that powers of appointment held by non-skip persons will not be exercised. In this case, Trust provided withdrawal powers to beneficiaries who are non-skip persons, but because the amount of the annual withdrawal rights in Trust do not exceed the amount referred to in Section 2503(b), the amount subject to the withdrawal right shall not be considered to be includible in the gross estate of a non-skip person or subject to a right of withdrawal for purposes of the deemed allocation rules. Also, the withdrawal rights lapse each year in their entirety. Accordingly, none of the exceptions to the definition of a "GST trust" in Section 2632(c)(3)(B) applied Trust should be considered a GST trust and Donor's available GST exemption deemed allocated automatically to the transfer.

VII. SPECIAL VALUATION RULES

A. IRC § 2702. Special Valuation Rules for Transfers of Interests in Trust

IRS Approves Retroactive State Court Reformation of Irrevocable Trust to Comply with GRAT Rules of Section 2702. PLR 201652002 (Dec. 23, 2016)

Grantor retained Attorney to draft several irrevocable trusts, each of which stated on its first page that it was intended to be "an irrevocable Grantor Retained Annuity Trust, the retained interest of which is intended to constitute a qualified interest within the meaning of Section 2702(b)(1) of the Internal Revenue Code." Attorney failed to include in each trust the language required by Reg. § 25.2702-3(d)(6), prohibiting the trustee from issuing a note, other debt instrument, option or other similar financial arrangement in satisfaction of the annuity obligation. Grantor's son hired a new lawyer who noted the error, and they obtained a state court order reforming the trusts retroactively to include the required language.

The IRS stated that, as a result of the judicial reformation, Grantor's interest in each trust is and was a qualified interest under Section 2702, retroactive to the date the trust was established. The IRS noted that state law (Florida) permitted retroactive reformation of an irrevocable trust "to achieve the settlor's tax objectives." The IRS noted *Comm'r v. Estate of Bosch*, 387 U.S. 456 (1967) held that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. If there is no decision by the highest court in the state, then the federal authority must apply what it finds to be state law after giving proper regard to the state trial court's determination and to relevant rulings of other courts of the state. In this case, the state court order was permissible because the trust instruments declared that they were to create qualified annuity interests under Section 2702(b)(1), and Attorney's error caused the trusts not to do so.

Note. The IRS did not state that Attorney admitted the error or that the state court found that Attorney had made the error – it stated only that Attorney made the error. The IRS is likely to permit a retroactive reformation in cases of a scrivener's error, but it is reluctant to do so in cases of misjudgment or changed circumstances, even if the state court deems the reformation to be retroactive.

B. IRC § 2704. Treatment of Certain Lapsing Rights and Restrictions

Treasury Withdraws Section 2704 Proposed Regulations as Burdensome. Notice 2017-38, 2017-30 I.R.B. 147 (July 24, 2017); Dept. of Treas., "Second Report to the President on Identifying and Reducing Tax Regulatory Burdens," p 2-3 (Oct 2, 2017); 82 Fed. Reg. 48013 (Oct. 16, 2017)

Executive Order 13789, 82 Fed. Reg. 19317 (April 26, 2017) required the Treasury Secretary to review all significant tax regulations issued after January 1, 2016, and identify those that impose an undue financial burden on United States taxpayers, add undue complexity to the Federal tax laws, or exceed the statutory authority of the Internal Revenue Service. On July 8, 2017, the Internal Revenue Service issued Notice 2017-38, explaining that, of the 105 temporary, proposed, and final regulations promulgated after January 1, 2016, eight met the criteria described in Executive Order 13789. These include the proposed regulations under Section 2704, about which the Notice states that:

> Commenters expressed concern that the proposed regulations would eliminate or restrict common discounts, such as minority discounts and discounts for lack of marketability, which would result in increased valuations and transfer tax liability that would increase financial burdens. Commenters were also concerned that the proposed regulations would make valuations more difficult and that the proposed narrowing of existing regulatory exceptions was arbitrary and capricious.

Therefore, the IRS includes these regulations in the class of promulgations that must be reviewed and, presumably, revised to reduce their adverse impact. The Treasury requests comments on whether these regulations "should be rescinded or modified, and in the latter case, how the regulations should be modified in order to reduce burdens and complexity."

On October 2, 2017, the Treasury Department withdrew the Section 2704 proposed regulations as being unworkable. After reviewing these comments, Treasury and the IRS now believe that the proposed regulations' approach to the problem of artificial valuation discounts is unworkable. Treasury stated:

> In particular, Treasury and the IRS currently agree with commenters that taxpayers, their advisors, the IRS, and the courts would not, as a practical matter, be able to determine the value of an entity interest based on the fanciful assumption of a world where no legal authority exists. Given that uncertainty, it is unclear whether the valuation rules of the proposed regulations would have even succeeded in curtailing artificial valuation discounts. Moreover, merely to reach the conclusion that an entity interest

should be valued as if restrictions did not exist, the proposed regulations would have compelled taxpayers to master lengthy and difficult rules on family control and the rights of interest holders. The burden of compliance with the proposed regulations would have been excessive, given the uncertainty of any policy gains. Finally, the proposed regulations could have affected valuation discounts even where discount factors, such as lack of control or lack of a market, were not created artificially as a value-depressing device.

VIII. SELECTED ATTACHMENTS

A. Family Limited Partnership/Limited Liability Company Checklist

PLANNING AND DRAFTING

- **Create Partnership in a Good State.** Assure that the state whose law governs the partnership provides, as default rules:

  - No requirement that the partnership certificate state the time at which the limited partnership is to be dissolved;

  - Partnership does not terminate upon the withdrawal or death of a general partner (usually if there is another general partner or if a majority of the limited partners elect to continue the business);

  - Majority of the limited partners cannot remove the general partner and indirectly effect the dissolution of the partnership;

  - Transferee of a partnership interest becomes only an assignee, rather than a partner, without the vote of the remaining partners; and

  - A withdrawing partner is not entitled to his or her capital account. Often, the withdrawing partner is entitled to "fair value," but this should be based his or her right to share in reasonably anticipated future distributions from the continuing entity. Alternatively, state law may not permit a partner to withdraw without the consent of the other partners. The Tax Court and Fifth Circuit have held that a right to withdraw is not a right to liquidate under Section 2704(b), but it is just as well that the partners have no specific right to withdraw.

- **Have and Document Nontax Purposes.** Carefully document in the agreement or collateral instruments or letters the various nontax purposes for which the partnership is created. Among the nontax purposes that the courts may accept are:

  - Avoiding likely creditors, such as spouses of children, if there is a realistic basis for worrying about creditor claims, such as prior divorces by some of the children;

  - Assuring the continued management of assets according to a specific and definite investment philosophy, whether or not it is one that the donor espouses. This may also be combined with teaching this philosophy to the various family members;

- Forcing the children to work together to manage key family assets, but the children must then actually work together to manage these assets;

- Dividing key assets among children through the use of separate partnerships, to reduce family discord; and

- Consolidating assets of various family members (or dividing interests in gifts from donor among various family members) to facilitate purchase of investments with minimum entry costs, such as hedge funds that require that the investors have at least $10 million in net worth, though it is important to show that there were actual purchases of such investments or that they were under serious consideration.

- **Consider Annual Exclusion**. Avoid undue restrictions on transfer, or give a donee partner the right to withdraw up to the annual exclusion from the partnership at the time of the gift, to assure that such gifts qualify for the gift tax annual exclusion.

- **Create Partnership ASAP**. The partnership should be created and funded while the donor is in good health and as young as practicable. Once the donor is terminally ill, the chances of the partnership being respected for tax purposes drops precipitously.

- **Fund Partnership with Active Management Assets**. Fund the partnership with assets that require active management, though favorable cases do exist regarding partnerships that hold solely passive assets.

- **Do Not Fund Partnership with Personal Use Assets.** Do not transfer personal use assets to the partnership, even if the donor then leases them from the partnership. This includes, among other things, the donor's residences.

- **Donor Should Not Control Partnership Distributions.** The donor should not be the general partner, if possible. Family members or trusts to whom the client wishes to pass the bulk of the partnership assets should themselves be general partners and participate in the operations of the enterprises. There are several ways to limit or avoid control by the donor of the partnership distributions.

  - A corporate or LLC general partner could be named in which the donor has only a minority interest;

  - You can have two classes of general partnership interests, one of which has control over distributions, and the other which manages the partnership assets. The donor can then transfer the former, retaining the latter; and

  - The partnership can prohibit all distributions during the donor's lifetime.

- **Each Partner Should Have Separate Representation.** All prospective partners should be represented by legal and financial counsel and should have input into the terms of the governing instruments.

- **Avoid Participation Via Powers of Attorney.** Consider a provision that precludes voting for a general partner through a power of attorney.

- **Assure that Significant Interests Are Held by Others.** Give or sell significant limited partnership interests to others, particularly including trusts with independent trustees. The retention of 99% of the partnership interests will encourage a court to ignore the transaction.

- **Assure that Limited Partners Pay for Their Interests.** Limited partners should pay for their partnership interests with their own assets. If they do not have assets, the donors should make gifts and let the gifts gather some age, before creating the partnership.

- **Reserve Adequate Assets.** Never put too much of the donor's wealth in the partnerships; the donors should retain enough assets on which to live comfortably and pay any expected estate taxes or claims. The donor should retain sufficient liquid assets, as well as sufficient wealth. It is not a bad idea if the other family member partners only contribute excess assets, too.

- **Have A Charitable Partner.** Consider giving at least a 1% interest to a charity or other unrelated person, to make it impossible for the family to remove any restrictions on liquidation in the agreement.

- **Use Independent Trustees.** Each trust that holds a partnership interest should have an independent trustee.

- **Use Good Timing to Avoid Step Transaction and Indirect Gift Doctrines.**

- **Do Not Plan Specific Gifts at Start of Transaction.** The attorney and client should not make definite plans to make gifts until they have formed the partnership and obtained an independent professional appraisal of the value of the limited partnership interests. Only then will they have enough financial data to make intelligent gift plans.

- **Form the Entity in a No-Gift Situation**. The client should first form the partnership in a non-gift environment, such as having the client and his or her U.S. spouse as the only initial owners, or having the client and a controlled corporation as the only initial owners. Similarly, you can form the entity by having each prospective partner contribute a proportionate share of the nominal initial consideration. Thus, any constructive gifts would not produce a gift tax.

- **Do All Paperwork to Form Entity.** Make sure that the client signs the partnership agreement and that the partnership certificate is promptly filed. The client (and spouse, if relevant) should then transfer to the entity whatever assets they want the entity to hold.

- **Reflect the Transfers in the Donor's Capital Account.** The contributions to the partnership must be reflected in the donor's capital account. This will mean that the donor has a substantial increase in his or her (or their) proportionate partnership interest. Assure that capital accounts determine distributions on liquidation or termination.

- **Get Appraisal.** Next, obtain the best professional appraisal the client can afford. The appraiser makes an independent judgment, and the amount of gifts (or the existence of gifts at all) depends upon the judgment of the appraiser. This usually puts at least several weeks between the formation and funding of the entity and any gifts. Two or three months is even better.

- **Then Make Transfers**. Once you have an appraisal, and a reasonable time has passed, meet with the client and decide whether gifts will be made, to whom they will be made and the amount of the gifts. Execute a document of transfer and make all necessary amendments to the partnership or operating agreement, including any required waivers of buy-sell restrictions.

- **Adjust Capital Accounts**. Reduce the capital accounts of the donor and transfer the capital to the donees.

- **File a Timely Gift Tax Return.** File the gift tax return and, where appropriate, allocate GST exemption.

ADMINISTRATION

- **Have Partnership (or GP) Stationery**. The partnership should have stationery that identifies precisely who the general partners are, to assure that the general partner never acts in a different capacity.

- **Have Partnership Bank and Security Accounts.** The partnership must have its own bank and securities accounts, accessible only by the general partners.

- **Hold Regular Partners' Meetings.** The general partners should meet at least quarterly to discuss partnership activities. If possible, the attorney or paralegal should be present.

- **Keep Good Records.** The general partners should keep books of account and detailed records of their decisions and activities.

- **Inform Limited Partners**. The general partners should send copies of the minutes of the partnership meetings to the limited partners.

- **Avoid Commingling.** Never, never, never commingle partnership and personal assets.

- **Avoid Paying Personal Expenses**. Never, never, never pay personal expenses from the partnership assets, even if capital account adjustments are made.

- **Avoid Paying Estate Expenses.** Generally, the partnership should not pay estate expenses for the principal partner.

- **Avoid Non-Pro Rata Distributions.** Generally, the partnership should avoid making non-pro rata distributions.

- **Avoid Loans to the Donor or Donor's Estate**. Generally, the partnership should not make loans to the principal partner or his or her estate.

- **Do Not Unwind Partnership (Even Partially) After Donor's Death**. The partnership should not be unwound or make large distributions after the death of the donor partner.

B. IRS/Treasury Priority Guidance List for 2017-2018 (Oct. 23, 2017) -- Issues Related to Estate Planning

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

* * * *

OFFICE OF TAX POLICY AND
INTERNAL REVENUE SERVICE

2017-2018 PRIORITY GUIDANCE PLAN

Updated as of October 12, 2017

Released October 20, 2017

PART 1. E.O. 13789 - IDENTIFYING AND REDUCING REGULATORY BURDENS

1. Withdrawal of proposed regulations under §2704 regarding restrictions on liquidation of an interest for estate, gift, and generation-skipping transfer taxes. Proposed regulations were published on August 4, 2016.[3]

* * * *

PART 2. NEAR-TERM BURDEN REDUCTION

4. 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.

5. Guidance under §170(e)(3) regarding charitable contributions of inventory.

* * * *

PART 4. GENERAL GUIDANCE

[3] See 82 Fed. Reg. 48013 (Oct. 16, 2017).

GENERAL TAX ISSUES[4]

14. Final regulations under §170 regarding charitable contributions. Proposed regulations were published on August 7, 2008.

20. Final regulations under §1411 regarding issues related to the net investment income tax. Proposed regulations were published on December 2, 2013.

GIFTS AND ESTATES AND TRUSTS[5]

1. Guidance on basis of grantor trust assets at death under §1014.

2. Final 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.

3. Guidance under §2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate.

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[4] Deleted from last year's Priority Guidance List under General Tax Issues are:

22. Guidance under § 170 regarding charitable contributions of appropriative water rights.
23. Guidance under § 170 regarding charitable contributions of conservation easements.
33. Guidance regarding material participation by trusts and estates for purposes of §469.

[5] Deleted from last year's Priority Guidance List on Gifts and Estates and Trusts are:

2. Guidance on definition of income for spousal support trusts under § 682.
6. Guidance on the valuation of promissory notes for transfer tax purposes under §§ 2031, 2033, 2512, and 7872.
9. Guidance on the gift tax effect of defined value formula clauses under §§ 2512 and 2511.
10. Guidance under §§ 2522 and 2055 regarding the tax impact of certain irregularities in the administration of split-interest charitable trusts.
12. Guidance under § 2801 regarding the tax imposed on U.S. citizens and residents who receive gifts or bequests from certain expatriates. Proposed regulations were published on September 10, 2015.

C. IRS No-Rulings – Domestic - List for 2017 -- Estate, Gift, GST Tax and Related Issues. Excerpts from Rev. Proc. 2017-3, 2017-1 I.R.B. 130 (Jan. 3, 2017)

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

.01 Specific Questions and Problems.

* * * *

(8) 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.)

* * *

(10) 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.

(11) Section 83.—Property Transferred in Connection with Performance of Services.—Whether a restriction constitutes a substantial risk of forfeiture, if the employee is a controlling shareholder. Also, whether a transfer has occurred, if the amount paid for the property involves a nonrecourse obligation.

* * *

(13) 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.

(14) 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.

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

* * *

(30) 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).

(31) 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.

* * *

(38) 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.

* * *

(44) 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.

(45) 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.

(46) 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.

(47) 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.

* * *

(59) Section 409A.—Inclusion in Gross Income of Deferred Compensation Under Nonqualified Deferred Compensation Plans.—The income tax consequences of establishing, operating, or participating in a nonqualified deferred compensation plan within the meaning of §1.409A–1(a); whether a plan is described in §1.409A–1(a)(3)(iv) or (v); whether a plan is a bona fide vacation leave, sick leave, or compensatory time plan described in §1.409A–1(a)(5); and whether a plan provides for the deferral of compensation under §1.409A–1(b).

* * *

(73) 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.

* * *

(79) 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.

(80) 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.

(81) 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.

(82) Section 664.—See section 3.01(73), above.

(83) 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.

* * *

(88) 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.

* * *

(93) 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.

* * *

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

(100) 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).

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

(102) 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).

(103) 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).

* * *

(120) 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.

* * *

(124) 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.

* * *

SECTION 4. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED[6]

.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.

* * *

(18) 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).

(19) 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).

(20) 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.

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[6] 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."

* * *

(24) 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.

(25) Section 302(b)(4) and (e).—Redemption from Noncorporate Shareholder in Partial Liquidation; Partial Liquidation Defined.—Whether a distribution will qualify as a distribution in partial liquidation under §302(b)(4) and (e)(1)(A), unless it results in a 20 percent or greater reduction in (i) gross revenue, (ii) net fair market value of assets, and (iii) employees. (Partial liquidations that qualify as §302(e)(2) business terminations are not subject to this provision.)

* * *

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

(39) 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.

(40) 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.

(41) Sections 671 to 679.—Grantors and Others Treated as Substantial Owners.—In a nonqualified, 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) Sections 671 to 679.—Grantors and Others Treated as Substantial Owners.—Whether an Indian tribe (as defined in 25 U.S.C. §2703(5)) that establishes a trust to receive and invest per capita payments for its members under the Indian Gaming Regulatory Act (25 U.S.C. §§ 2701–2721) is the grantor and owner of the trust.

(43) 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.

* * *

(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.

* * *

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.

* * *

(9) 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.

(10) 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.

(11) 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.

(12) 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.

(13) 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.

(14) 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.

(15) 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 8. EFFECTIVE DATE

This revenue procedure is effective January 3, 2017.

D. IRS No-Rulings – International - List for 2017 -- Estate, Gift, GST Tax and Related Issues. Excerpts from Rev. Proc. 2016-7, 2017-1 I.R.B. 269 (Jan. 3, 2017)

SECTION 4. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED[7]

.01 Specific Questions and Problems.

* * * *

(28) 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).

(29) 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 3, 2017.

[7] 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."

E. Net Net Gift Agreement

NET GIFT AGREEMENT[8]

THIS AGREEMENT is entered into on [*date*], by me, *Donor*, of [*locality, state*] (referred to in the first person), and by *Donee*, of [*locality, state*] (referred to as the "donee").

RECITALS

A. I own a parcel of real estate located at [*address*] and described in Schedule A (the "property"), the value of which is [*amount*].

B. I want to give the property to the donee, conditioned upon *his/her* payment of all taxes imposed on this transfer under Chapter 12 of the Internal Revenue Code of 1986, as amended (the "Code"), and any similar taxes imposed under applicable state law (the "gift taxes"), and all of taxes imposed on this transfer on account of my death within three (3) years of the date of this transfer under Chapter 11 of the Code, and any similar taxes imposed under applicable state law (the "estate taxes").

AGREEMENTS

The parties now agree as follows:

1. Gift. I will give the property to the donee on or before [*date of gift*].

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[8] KEY:

Donor	—	Full name of the donor
Donee	—	Full name of the donee
his/her	—	"his" or "her," referring to the donee
Spouse	—	Full name of the donor's spouse

2. Gift Tax Return. I will prepare (or cause to be prepared) and sign a federal gift tax return for the year in which the gift is made, reporting this transfer and any other taxable transfers made by me during that year. I will deliver the said return to the donee at least thirty (30) days before the date on which that return is legally required to be filed. I will also compute (or cause to be computed) the gift taxes on this separate transfer, and report this amount to the donee at the same time as I give *his/her* the said gift tax return.

3. Donee Pays Gift Tax. The donee will accept the gift of the property and, in consideration, will timely file the gift tax return and pay the federal and state gift taxes on the transfer. The donee will also pay any additional gift taxes that may later be correctly assessed with respect to this transfer, including any interest and penalties. All costs of contesting such assessment shall be borne solely by the donee. If the donee declines to contest any such assessment, I shall have the option of contesting it at my own expense, and the donee shall still be liable for any gift taxes beyond the amount originally assessed, including any interest and penalties.

4. Donee Pays Estate Tax.

4.1 Obligation to Pay. The donee hereby agrees to assume, pay and indemnify the executor of my estate (the "executor") against all liability for the estate taxes with respect to this transfer, if I do not survive for three (3) years following the date of this gift, including all penalties and interest which accrue upon such estate tax liability except such penalties and interest that are directly attributable to actions or delays committed by the executor. For purposes of determining and allocating the estate taxes, (i) the value of all additional tax shall be as finally determined for federal estate tax purposes with respect to my estate, and (ii) the only gift tax taken into account in the calculation shall be the gift tax on my transfers of the gift property to the donee under this instrument.

4.2 Payment of Estate Tax Liability. The donee shall deliver to the executor an amount equal to the estate taxes, by certified check made payable to the United States Treasury, no later than thirty (30) days before the due date for payment of the estate taxes, or, if later, as soon thereafter as the executor notifies the donee of the amount of the estate taxes. If the executor determines that the donee is in default, the executor shall give notice to the donee that the donee is in default (the "estate tax default notice"). The date such notice is received by the donee shall be referred to as the "estate tax default notice date"). If the donee fails within ten (10) business days after the estate tax default notice date to deliver to the executor, the remaining balance of the estate taxes, all cash distributions otherwise distributable to the donee from my estate shall be delivered directly to the executor of my estate. The donee agrees to perform any and all acts necessary, whether individually or as a shareholder, partner, member, manager or director of any entity, to effect the payment of the estate tax liabilities to the executor.

5. Miscellaneous and Definitions.

5.1. Governing Law. This agreement and the rights and duties of the parties thereunder will be determined in accordance with the laws of [*state*].

5.2. Integration. This agreement sets forth the entire understanding and agreement of the parties with respect to the property. Any change or modification of this agreement shall be valid only if it is in writing and signed by all of the parties.

5.3. Successors-In-Interest. This agreement shall inure to the benefit of the parties and be binding upon them and their legal representatives, successors, and assigns.

Dated: ___________________

____
[*signature*]
Donor

____
[*signature*] (Seal)
Donee

[*notary clause*]

[*Schedule A omitted*]

WAIVER OF CERTAIN RIGHTS

I, *Spouse*, waive all of my right, title, and interest in any property transferred to the donee, by *Donor*. This waiver shall apply both to current and inchoate interests that I may have, including, but not limited to, rights to an intestate share of *Donor*'s estate, to a statutory share of *Donor*'s estate, to a share as an omitted spouse, and to a share in the nature of dower or curtesy. This waiver shall constitute a third-party beneficiary contract for the benefit of the donee and the donee may enforce this waiver by appropriate legal action.

Dated: ___________________

____
[*signature*]
Spouse

Accepted:

____
[*signature*], *Donor*

F. Sample Nonreciprocal Trust Forms

The following trusts are nonreciprocal and provide for both the donee spouse during his or her lifetime. One trust also provides for descendants during the spouse's lifetime, and gives the donee spouse a limited lifetime power of appointment. *Crummey* powers are included in each trust.

Both trusts are grantor trusts under Section 677(a), but to assure that grantor trust status continues after a donee spouse's death, each donor retains the nonfiduciary right to substitute assets, as described in Section 675(4)(C).

It is recommended that:

(a) the trusts be funded as far apart in time as possible;

(b) the trusts have different assets; and

(c) the trusts have different trustees.

It is also suggested that the trusts be created in a state that recognizes self-settled spendthrift trusts, such as Alaska, Delaware, Nevada, or Virginia, but if the trusts are created under the law of a state that does not recognize the validity of self-settled spendthrift trusts, care must be taken to avoid any suggestion that the trusts are created in consideration of each other. In such a case, for example, each spouse should have separate counsel, the first trust should be created before the donee spouse even meets with counsel to consider creating a second trust, and there should be no documentation of a common plan to create the two trusts.

1. Trust One. Created for Sole Lifetime Benefit of Donee Spouse[9]

The Irrevocable Trust for *Spouse*

On [date], I *Grantor*, of [address] (sometimes referred to in the first person and sometimes as the Agrantor") and *Trustee*, of [address] (sometimes referred to as the Atrustee"), agreed to make this trust.

Article 1. My Family

I am married to *Spouse* (sometimes referred to as my A*husband/wife*") and any reference to my *husband/wife* shall be to *him/her*. I have [number of children] children, *Children*.

Article 2. I Cannot Revoke or Amend this Trust

The trust is irrevocable and I shall have no power to alter, amend, revoke, or terminate it in any way, except as may be expressly provided later in this instrument.

Article 3. Transfers to the Trust

[9] **KEY:**

Grantor	C	Full name of the grantor
Trustee	C	Full name of the initial trustee
spouse	C	Full name of the grantor's spouse
Husband/Wife	C	Ahusband" for female grantor; Awife" for male grantor
him/her	C	Ahim" or Aher" referring to the grantor's spouse
Children	C	Full name(s) of the grantor's child(ren)
2dTrustee	C	Full name of the successor trustee
Protector	C	Full name of trust protector who can terminate grantor trust powers
2ndProtector	C	Full name of alternate trust protector

The trustee (defined below) shall hold certain property transferred to the trust by me, which may be listed in Schedule A, to be administered according to the terms of this trust instrument.

A. Trustee May Accept Additional Transfers. I and anyone else may transfer additional property (including life insurance proceeds, where appropriate), to the trustee, and the trustee may refuse to accept such transfers if the trustee deems acceptance not to be in the best interests of the trust and the beneficiaries. The trustee shall hold all transfers to the trust by me that are accepted by the trust, to be held and administered according to the terms of the trust instrument.

B. Transfers During My Lifetime by Someone Other than Me. The trustee shall hold all transfers to the trust by someone other than me, if made during my lifetime, in a segregated fund, as a separate and independent trust from the trust created by assets transferred by me. Such a separate and independent trust shall be held for the benefit of the same beneficiaries and on the same terms and conditions as the trust created and funded by transfers by me, but the assets of such separate and independent trust shall not be commingled or otherwise mixed with those assets contributed by or attributable to contributions by me. Such separate and independent trust shall not be deemed owned by me for Federal income tax purposes, notwithstanding any other provisions of this instrument.

Article 4. Annual Withdrawal Power

Each of my then-living children and each of my then-living more remote descendants, shall have the right to withdraw an amount equal to a proportionate share of each contribution to the trust (other than a contribution by reason of a transferor's death), subject to the guidelines described below.

Article 5. Trust for My *Husband/Wife*

The trustee shall hold all of the trust assets for the benefit of my *husband/wife*, during *his/her* lifetime, and thereafter for the benefit of my children and my more remote descendants, as provided in this article.

A. Distributions of Income and Principal During My *Husband/Wife*'s Lifetime. During the lifetime of my *husband/wife*, the trustee shall distribute to or expend for the benefit of my *husband/wife all of the trust's net income and so much of its principal as the trustee deems appropriate for my *husband/wife*'s health, education, support, or maintenance, annually adding to principal any undistributed income. A disinterested trustee (defined below) may also distribute to my *husband/wife* as much of the principal of the trust as the disinterested trustee shall deem appropriate for any purpose.

1. Other Resources. The trustee shall determine the amount and timing of all distributions from the trust made for health, education, support, or maintenance, taking into account other resources available to my *husband/wife* from all sources, including all other trusts created by me.

2. Support. The trustee shall not distribute principal in a manner that discharges my legal obligation to support my *husband/wife*.

B. Upon My *Husband/Wife*'s Death. Upon the death of my *husband/wife*, the trustee shall distribute the remaining trust funds to my then-living descendants, per stirpes, outright and free of trust, but subject to the provisions of the article entitled AContingent Trust for Certain Beneficiaries."

Article 6. Trust for Certain Beneficiaries

If a beneficiary is entitled to receive any trust funds outright, and the beneficiary is under the age of *TerminationAge* years, the trustee may retain those trust funds in a separate trust for that beneficiary.

A. Until the Vesting Date. Until the vesting date (defined below), the trustee shall distribute to or for the benefit of the beneficiary as much of the net income and principal as the trustee shall consider appropriate for the beneficiary's health, education, support, or maintenance, annually adding to principal any undistributed income.

B. Upon the Vesting Date. Upon the vesting date, the trustee shall distribute the remaining assets to the beneficiary if the beneficiary is then living or otherwise to the beneficiary's estate to be distributed as part of that estate.

C. ?Vesting Date" Defined. ?Vesting date" is the earliest of (1) the date on which the beneficiary dies; (2) the date on which the beneficiary reaches the age of *TerminationAge* years; and (3) the date twenty-one (21) years after the death of the last to die of me, my *husband/wife*, and those of my descendants alive on the date of this trust.

Article 7. My Right to Substitute Assets

A. Right Reserved. I reserve and shall have the right, exercisable at any time and from time to time, to demand that the trustee transfer to me any or all of the trust assets in exchange for assets of equivalent value. This power shall be exercisable by me solely in a nonfiduciary capacity, and without the consent or approval of any other person who has a fiduciary duty. This power shall enable me to determine the occurrence and timing of any such exchange, but the trustee shall have the sole and absolute right to ascertain and determine, in the exercise of the trustee's fiduciary duties to the beneficiaries, the equivalent value to the trust assets transferred to me. For purposes of this article, Aequivalent value" shall have the same meaning given that phrase in Code Section 675(4)(C) of the Internal Revenue Code of 1986, as amended (the ACode").

B. No Application to Certain Voting Stock. Notwithstanding the provisions of paragraph A, I shall have no right to require that the trustee transfer to me any shares of the voting stock of any corporation in which I have directly or indirectly, including ownership by attribution under Code Section 318, the right to vote stock constituting at least twenty percent (20%) of the total combined voting power of all classes of the said corporations' stock.

C. Exercise. I may exercise this power only by an instrument in writing signed by me and delivered to the trustee and to each then-living current adult beneficiary of the trust.

1. Certification of Value. In the writing by which I exercise this power, I shall certify to the trustee the value of the assets transferred by me to the trust in exchange for trust assets, to the extent that the assets I transfer are not cash, cash equivalents, or stock or other securities that is regularly listed on a major U.S. stock exchange.

2. Effective Date. Such writing shall state the date on which such exchange shall occur, but not earlier than thirty (30) days after the date on which such instrument is received by the trustee.

D. Trustee's Fiduciary Duties. In addition to all other fiduciary duties imposed upon the trustee under local law and this instrument, the trustee shall have the following duties.

1. Assure Equivalence. The trustee shall have a fiduciary obligation to ensure my compliance with the terms of this power by the trustee being satisfied that the properties acquired and substituted by me are in fact of equivalent value.

2. Impartiality. The trustee shall have the power to invest and reinvest the trust corpus and a duty of impartiality with respect to the trust beneficiaries.

E. I Cannot Shift Beneficial Enjoyment. I shall not be able to exercise this power in any manner that shifts benefits among the trust beneficiaries. The trustee shall not honor an attempt to exercise this power if the trustee believes that such effectuation of my attempted exercise of this power would shift benefits among the trust beneficiaries.

F. Cancellation of Substitution Power. *Protector* may cancel my power under this article by a writing delivered to me and to the trustee, designating the effective date of the cancellation. *Protector* shall act in all matters without any fiduciary duty of impartiality or fairness to any beneficiaries.

If *Protector* shall be unable or unwilling to serve under this article, *2dProtector*, of [address] shall hold and exercise the power granted first to *Protector* under this article. If both *Protector* and *2dProtector* are unable or unwilling to serve under this article, the trustee shall name as the holder of this power an individual who is neither related nor subservient to me, as defined in Code Section 672(c).

Article 8. The Trustees

A. Named Trustees. *FirstTrustee* is the initial trustee of this trust. No trustee named in this instrument or by the trustee shall be required to provide surety or other security on a bond.

B. Successor Trustees. *SecondTrustee*, of [locality, state], shall be the successor trustee, to serve if *FirstTrustee* is unable or unwilling to serve or to continue serving.

C. Bond. No trustee named by me or by another trustee shall be required to provide surety or other security on a bond.

D. Additional Trustee. The trustee may appoint any person as an additional trustee, to serve at the pleasure of the appointing trustee.

E. Delegation. The trustee may delegate to another trustee any power or authority granted by me to the trustee, to continue at the pleasure of the delegating trustee, unless otherwise agreed. Any person dealing in good faith with a trustee may rely on that trustee's representation that a delegation has been made and remains in effect under this paragraph.

F. Resignation. A trustee may resign by giving written notice specifying the effective date of the resignation to the designated successor. If no successor is designated, the resigning trustee shall give notice to the then-living adult beneficiaries to whom income is or may then be distributed.

G. Vacancies. A corporation no substantial portion of the stock of which is owned by me or by beneficiaries of this trust, may be named as successor trustee to fill any vacancy, by the majority vote of the then-living adult beneficiaries to whom income is or may then be distributed.

H. Responsibility of Successors. No trustee shall be responsible for or need inquire into any acts or omissions of a prior trustee.

I. Compensation. In addition to reimbursement for expenses, each individual trustee is entitled to reasonable compensation for services. Each corporate trustee is entitled to compensation based on its written fee schedule in effect at the time its services are rendered or as otherwise agreed, and its compensation may vary from time to time based on that schedule.

J. Management Powers. The trustee may exercise the powers described below, in a fiduciary capacity.

1. Invest and Reinvest. The trustee shall invest and reinvest the trust assets (or leave them temporarily uninvested) in any type of property and every kind of investment, in the same manner as a prudent investor would invest his or her own assets.

2. Sell or Exchange. The trustee may sell or exchange any real or personal property contained in the trust, for cash or credit, at public or private sale, and with such warranties or indemnifications as the trustee may deem advisable.

3. Borrow. The trustee may borrow money (even from the trustee and from any beneficiary of the trust), for the benefit of the trust and secure these debts with assets of the trust.

4. Grant Security Interests. The trustee may grant security interests and execute all instruments creating such interests upon such terms as the trustee may deem appropriate.

5. Compromise and Adjust Claims. The trustee may compromise and adjust claims against or on behalf of the trust on such terms as the trustee may deem appropriate.

6. Taking Title Through Nominee. The trustee may take title to any securities in the name of any custodian or nominee, without disclosing this relationship.

7. Principal and Income. The trustee may determine whether receipts are income or principal and whether disbursements are to be charged against income or principal, to the extent not established clearly by state law. Determinations made by the trustee in good faith shall not require equitable adjustments.

8. Tax Elections. The trustee may make all tax elections and allocations the trustee may consider appropriate; however, this authority is to be exercised only in a fiduciary capacity and may not be used to enlarge or shift any beneficial interest except as an incidental consequence of the discharge of fiduciary duties. All tax elections and allocations made by the trustee in good faith shall not require equitable adjustments.

9. Distributions to Minors. The trustee may distribute any of the trust assets to a minor by distributing them to any appropriate person chosen by the trustee (who may be a trustee), as custodian under any appropriate Uniform Transfers (or Gifts) to Minors Act, to be held for the maximum period allowed by law. The trustee may also sell any asset that cannot legally be held under this custodianship and invest the sales proceeds in assets that can be held under this custodianship.

10. Hiring Advisers. The trustee may employ such lawyers, accountants, and other advisers as the trustee may deem useful and appropriate for the administration of the trust. The trustee may employ a professional investment adviser in managing the investments of the trust (including any investments in mutual funds, investment trusts, or managed accounts), delegate to this adviser any discretionary investment authorities, and rely on the adviser's investment recommendations without liability to any beneficiary.

11. Distributions in Kind. The trustee may divide and distribute the trust in kind or in cash, or partly in each, without regard to the income tax basis of any asset and without the consent of any beneficiary. The decision of the trustee in dividing any portion of the trust between or among two or more beneficiaries shall be binding on all persons.

K. Life Insurance.

1. Paying Premiums. The trustee may use some or all of the net income and principal of the trust to buy and maintain policies of life insurance on my life. The trustee may pay any such premiums or other charges from income or principal. If the trust funds are inadequate to pay such premiums or charges, the trustee may (after receiving written notice that a premium or charge has not been paid), do one or more of the following: (a) use any automatic premium loan feature, (b) borrow against any policy cash reserves (whether or not on the policy for which premium or charges shall be paid), or (c) elect any automatic nonforfeiture feature.

2. Contingent Marital Gift. If my *husband/wife* survives me, the trustee shall distribute the proceeds of any life insurance policies on my life that are included in my gross estate for federal estate tax purposes, to my *husband/wife*, outright and free of trust, notwithstanding the provisions of the article entitled ADynasty Trust for My *Husband/Wife*, Children, and Descendants".

3. Incidents of Ownership. The trustee may exercise all incidents of ownership over any life insurance policies held as part of the trust funds.

4. Litigation. The trustee may decline to enter into or maintain any litigation, endorse policy payments, or take other action respecting any trust insurance policies, until the trustee shall have been indemnified against all expenses and liabilities involved in such action.

5. Beneficial Designation. Upon receipt of written notice that the trustee or the trust is a beneficiary of life insurance policy death or other benefits, the trustee shall take all actions to assure the collection of such funds. Otherwise, the trustee may decline to inquire whether the trustee or the trust shall have been designated beneficiary of any insurance policy or other death benefit, until receipt of written notice that the trustee or the trust may be a beneficiary.

6. Liabilities. The trustee shall not be liable to anyone for buying or maintaining any insurance policies on my life, even if that investment represents an overconcentration, does not meet the applicable standard of prudence, or is inferior to another investment that the trustee might have made. The trustee shall not be responsible for any loss resulting from the failure of any insurer to pay its claims under any policy held by the trust, or because of the exercise or nonexercise of any benefit, option or privilege under any life insurance policy, including the ability to borrow against the cash values to obtain a higher investment yield outside the policy.

L. Disabled Trustee. A trustee may not serve during a disability.

1. ADisabled” and ADisability”. An individual trustee is ?disabled” or ?under a disability” if: (a) he or she is determined to be legally incompetent by a court of competent jurisdiction; (b) a conservator or guardian for such person has been appointed, based upon his or her incapacity; (c) two (2) physicians licensed to practice medicine in [state] certify in writing to another trustee or a person who would become the successor trustee upon such disability, that in the opinion of such physicians, such individual trustee, as a result of illness, age or other cause, no longer has the capacity to act prudently or effectively in financial affairs; or (d) thirty (30) days after any other trustee or a person who would become the successor trustee upon such disability, requests that such individual trustee provide a certificate from a physician licensed to practice medicine that, in the opinion of such physician, such individual trustee has the capacity to act prudently or effectively in financial affairs and such individual trustee fails to provide such certification. The effective date of such incapacity shall be the date of the order or decree adjudicating the incapacity, the date of the order or decree appointing the guardian or conservator, the date of the certificate of incapacity of the two (2) physicians described above, or thirty (30) days after other trustee or any person who would become the successor trustee upon such disability requests a certificate of capacity and one is not provided, whichever first occurs.

2. Liability. No person is liable to anyone for actions taken in reliance on these certifications or for dealing with a trustee other than the one removed for disability based on these certifications. This trust shall indemnify any physician for liability for any opinion rendered in good faith as to the existence or recovery from any disability.

M. Special Limits on Interested Trustee. No interested trustee (defined below) may participate in the exercise of any discretion to distribute principal to himself or herself, except as is appropriate for his or her health, education, support, or maintenance. No interested trustee may participate in the exercise of any discretion to distribute or expend principal or income in a manner that would discharge that trustee's personal obligation to support the beneficiary to whom such distribution is or may be made. No interested trustee may participate in the exercise of any incident of ownership over any policy owned by the trust insuring the life of such interested trustee.

1. Disinterested Co-Trustee. A disinterested trustee who is serving as a co-trustee with an interested trustee, may exercise those discretions granted under this instrument the exercise of which by an interested trustee is precluded.

2. Multiple Trustees. The number of trustee who must consent to the exercise of a power granted under this instrument, as determined under this article shall be determined by treating the interested trustee who are not entitled, under this article, to participate in the exercise of the power or discretion, as if they were not then serving. If this article precludes every then-serving trustee from exercising a power otherwise granted to my trustee under this instrument, the then-serving trustee shall appoint a disinterested trustee who may exercise such power (or decline to exercise it) as if that disinterested trustee were the sole then-serving trustee.

3. AInterested Trustee" Defined. An Ainterested trustee" is a trustee who is also (a) a beneficiary of the trust of which he or she is a trustee or the insured under a policy of insurance owned by a trust of which he or she is a trustee; (b) married to and living together with a beneficiary of the trust of which he or she is a trustee; (c) the father, mother, issue, brother or sister, of a beneficiary of the trust of which he or she is a trustee; (d) an employee of a beneficiary of the trust of which he or she is a trustee; (e) a corporation or any employee of a corporation in which the stock holdings of my trustee and the trust are significant from the viewpoint of voting control; or (f) a subordinate employee of a corporation in which such trustee is an executive.

4. ADisinterested Trustee" Defined. A Adisinterested trustee" means a trustee who is not an interested trustee.

Article 9. Tax Purposes

This article states some of my purposes in creating this trust, and all provisions of this trust shall be construed so as best to effect these purposes. No trustee shall exercise any discretion in a manner that could reasonably be expected to frustrate the effectuation of these purposes.

A. Income Tax. The trust, to the extent attributable to transfers by me, shall be a grantor trust deemed owned by me for federal income tax purposes, unless and until the powers under the article entitled AReserved Right to Substitute Assets" is removed and not re-granted and my *husband/wife* ceases to be a beneficiary of this trust.

B. Gift Tax. All transfers to the trust shall be completed gifts for federal gift tax purposes and shall be gifts of a present interest that will qualify for the gift tax annual exclusion.

C. Estate Tax. The assets of the trust shall be excluded from my gross estate for Federal estate tax purposes.

D. Generation-Skipping Transfer Tax. I intend that no distributions from or terminations of interests in this trust or any trust under this instrument shall be subject to the federal tax on generation-skipping transfers.

E. Right to Amend. A disinterested trustee may, without the consent of any other person, amend the trust to the extent required for the sole purpose of ensuring that the trust meets these tax objectives.

Article 10. Trust Administration

A. Accountings. The trustee shall not be required to file annual accounts with any court or court official in any jurisdiction.

B. Disabled Beneficiaries. The trustee may distribute income, principal, or both to a minor or disabled beneficiary to his or her parent, guardian, personal representative, or the person with whom the beneficiary resides, without looking to the proper application of those payments.

C. Change of Situs. The trustee may change the situs of any trust (and to the extent necessary or appropriate, the trust assets) to a state or country other than the one in which the trust is then administered, if the trustee believes it to be in the best interests of the trust or the beneficiaries. The trustee may elect that the law of such other jurisdiction shall govern the trust to the extent necessary or appropriate under the circumstances.

D. Spendthrift Clause. No interest in the trust shall be subject to the beneficiary's liabilities or creditor claims, assignment, or anticipation, voluntary or involuntary. If the trustee determines that a beneficiary would not benefit as greatly from any outright distribution of trust income or principal because of the availability of the distribution to the beneficiary's creditors, the trustee shall instead expend those amounts for the benefit of the beneficiary. This direction is intended to enable the trustee to give the beneficiary the maximum possible benefit and enjoyment of all of the trust income and principal to which the beneficiary is entitled.

E. Multiple Trusts and Shares. The trustee may invest the assets of multiple trusts in a single fund if the interests of the trusts are accounted for separately. The trustee may merge or consolidate any trust into any other trust that has the same trustee and substantially the same dispositive provisions. The trustee may divide any trust into multiple separate trusts.

F. I am Liable for Certain Trust Income Taxes. The trustee shall not pay or reimburse me for the payment of any incremental income taxes imposed upon me with respect to income or gains received by the trustee and not distributed to me, notwithstanding any requirement of state law that I be paid or reimbursed for such tax payments.

Article 11. Annual Withdrawal Power: Guidelines

This article applies to the annual withdrawal power created in Article 4 of this instrument.

A. Immediate Power. This withdrawal power shall arise immediately after each contribution to the trust (defined below).

B. Shares. Each child's or descendant's proportionate share of a contribution is the amount of such contribution, divided by the number of my then-living children and more remote descendants.

C. Annual Limit. The maximum amount that any child or descendant may withdraw with respect to all contributions made by the same donor in a single calendar year shall be the lesser of (1) the total amount of the donor's contributions to this trust during that year and (2) the amount of the federal gift tax annual exclusion in effect on the date of the earliest of such contributions or twice the gift tax annual exclusion if the donor is married on the date of the last of all contributions made during that year.

D. Priority. This withdrawal power takes precedence over any other power or discretion granted the trustee or any other person.

E. Exercise. Each child or descendant can exercise this withdrawal power by a written request delivered to a trustee. The legally authorized personal representative of any person unable to exercise a withdrawal power because of a legal disability, including minority, may make the demand on the child's or descendant's behalf. If there is no legally authorized personal representative, the trustee shall designate an appropriate adult individual (who may be a trustee but may not be me) who may make the demand on such child's or descendant's behalf.

F. Notice. The trustee must reasonably notify the person who would exercise a child's or descendant's withdrawal power of its existence and that of any contributions made to the trust that are subject to the power.

G. Lapse. The unexercised withdrawal power of each child or descendant shall lapse on the last day of each calendar year or, if earlier, sixty (60) days after the contribution to which it relates, but it shall then lapse only in an amount equal to the greater of that sum referred to in Code Section 2514(e)(1) (currently, five thousand dollars ($5,000)) or that percentage referred to in Code Section 2514(e)(2) (currently, five percent (5%)) of the trust corpus out of which, or the proceeds of which, the exercise of this withdrawal right could be satisfied. These rights of withdrawal that do not lapse at the end of a calendar year shall continue to be exercisable by the child or descendant subject to this same limited annual lapse. These rights of withdrawal respecting a contribution made fewer than sixty (60) days before the end of a calendar year shall not then lapse but shall remain exercisable until the end of the term otherwise designated in this instrument, without respect to the fact that it occurs during the following calendar year.

H. ?Contribution" Defined. ?Contribution" means any cash or other assets transferred to the trustee to be held as part of the trust funds, and any payment of premiums on life insurance policies owned by the trust. The amount of any contribution is its federal gift tax value, as determined by the trustee at the time of the transfer.

Article 12. Definitions and Miscellaneous

A. Definitions.

1. AChildren" and ADescendants." AChildren" and Adescendants" include those now living and those later born, subject to the following rules:

a. AChildren" and Adescendants" include an adopted person and that adopted person's descendants if, that adopted person is adopted before reaching eighteen (18) years of age.

b. AChildren" and Adescendants" includes those born outside of wedlock, if, during such child's or descendant's lifetime, his or her parent through whom such child or descendant claims hereunder, has acknowledged such person as his or her child in a writing duly signed and notarized during such parent's lifetime; and

c. AChildren" and Adescendants" include a child produced before the parent's death by donor artificial insemination, in vitro fertilization or other form of surrogate parenthood, whether or not such child was legally adopted by such parent before such parent's death.

2. ACode." Any reference to the ACode" or to the AInternal Revenue Code" means the U.S. Internal Revenue Code of 1986, as amended, or any similar successor provision of Federal tax law.

3. AMy *Husband/Wife*". I am currently married to *Spouse*, but any reference to my A*husband/wife", whether or not it includes a reference to *Spouse* by name, shall refer to the person to whom I am married at the time of any distribution or event for which the identity of my *husband/wife* is relevant, or if it relates to an event that would occur on or after the date of my death, it shall refer to the person to whom I am married on the date of my death, whether or not such person later remarries.

4. ATrust." The Atrust," without further qualification or specification, shall refer to all trusts under this instrument.

5. ATrustee." The Atrustee" shall include each trustee, multiple trustee, and any successor trustees.

B. Absence of Trust Beneficiaries. If all of the beneficiaries of the trust should die before the trust assets have vested in them, the trustees shall distribute all of the remaining assets of that trust as follows:

1. My Heirs and Distributees. One half (2) (or all, if there are no persons to take under item 2 of this paragraph) to the heirs and distributees who would have inherited my personal estate, and in such shares as they would have inherited it, had I died unmarried and without a valid will, determined on the later of the date of my death or that of the death of the last of the beneficiaries to die; and

2. My *Husband/Wife*'s Heirs and Distributees. One-half (2) (or all, if there are no persons to take under item 1 of this paragraph) to the heirs and distributees who would have inherited the personal estate of my *husband/wife*, and in such shares as they would have inherited it, had my *husband/wife* died unmarried and without a valid will, determined on the later of the date of my death or that of the last of the beneficiaries to die.

C. Tax-Related Terms. All tax-related terms shall have the same meaning in this instrument that they have in the Internal Revenue Code of 1986, as amended.

D. Number. Whenever the context requires, the singular number includes the plural and the plural, the singular.

E. Applicable Law. The trust shall be governed by and construed according to the laws of the state of [state].

F. Copies. There is only one signed original of this instrument. Anyone may rely on a copy of this instrument certified by a notary public or similar official to be a true copy of the signed original (and of any amendments) as if that copy were the signed original. Anyone may rely upon any statement of fact certified by the person who appears from the original document or a certified copy to be a trustee.

DECLARED AND AGREED on the date indicated above.

[Insert signatures, notary clauses, and schedule omitted from this exemplar]

WAIVER OF CERTAIN RIGHTS

I, *husband/wife*, waive all of my right, title, and interest in any property transferred to the attached trust, dated [date] (the trust), by *Grantor*. This waiver shall apply both to current and inchoate interests that I may have, including, but not limited to, rights to an intestate share of *Grantor*'s estate, to a statutory share of *Grantor*'s augmented estate, to another statutory share of *Grantor*'s estate, to a share as an omitted spouse, and to a share in the nature of dower or curtesy. The waiver shall constitute a third-party beneficiary contract for the benefit of all the beneficiaries of the trust, and these beneficiaries or the trustee of this said trust may enforce this waiver by appropriate legal action.

Dated: [date]

[Signature and notary clauses omitted from this exemplar]

2. **Trust Two. Created for Joint Lifetime Benefit of Donee Spouse and Descendants; Donee Spouse Has Lifetime Limited Power to Appoint (à la Levy v. Comm'r)** [10]

The *Grantor* Irrevocable Trust

On [date], I *Grantor*, of [address] (sometimes referred to in the first person and sometimes as the Agrantor"), and *Trustee*, of [address] (sometimes referred to as the Atrustee"), agreed to make this trust.

Article 1. My Family

I am married to *husband/wife* (sometimes referred to as my A*husband/wife*") and any reference to my *husband/wife* shall be to *him/her*. I have [number of children] children, *Children*.

Article 2. I Cannot Revoke or Amend this Trust

The trust is irrevocable and I shall have no power to alter, amend, revoke, or terminate it in any way, except as may be expressly provided later in this instrument.

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[10] **KEY:**

Grantor	C	Full name of the grantor
Trustee	C	Full name of the initial trustee
spouse	C	Full name of the grantor's spouse
Husband/Wife	C	Ahusband" for female grantor; Awife" for male grantor
him/her	C	Ahim" or Aher" referring to the grantor's spouse
Children	C	Full name(s) of the grantor's child(ren)
2dTrustee	C	Full name of the successor trustee
Protector	C	Full name of trust protector who can terminate grantor trust powers
2ndProtector	C	Full name of alternate trust protector

Article 3. Transfers to the Trust

The trustee (defined below) shall hold certain property transferred to the trust by me, which may be listed in Schedule A, to be administered according to the terms of this trust instrument.

A. Trustee May Accept Additional Transfers. I and anyone else may transfer additional property (including life insurance proceeds, where appropriate), to the trustee, and the trustee may refuse to accept such transfers if the trustee deems acceptance not to be in the best interests of the trust and the beneficiaries. The trustee shall hold all transfers to the trust by me that are accepted by the trust, to be held and administered according to the terms of the trust instrument.

B. Transfers During My Lifetime by Someone Other than Me. The trustee shall hold all transfers to the trust by someone other than me, if made during my lifetime, in a segregated fund, as a separate and independent trust from the trust created by assets transferred by me. Such a separate and independent trust shall be held for the benefit of the same beneficiaries and on the same terms and conditions as the trust created and funded by transfers by me, but the assets of such separate and independent trust shall not be commingled or otherwise mixed with those assets contributed by or attributable to contributions by me. Such separate and independent trust shall not be deemed owned by me for Federal income tax purposes, notwithstanding any other provisions of this instrument.

Article 4. Annual Withdrawal Power

Each of my then-living children and each of my then-living more remote descendants, shall have the right to withdraw an amount equal to a proportionate share of each contribution to the trust (other than a contribution by reason of a transferor's death), subject to the guidelines described below.

Article 5. Dynasty Trust for My *Husband/Wife*, Children, and Descendants

The trustee shall hold all of the trust assets for the benefit of my *husband/wife*, my children and my more remote descendants, as provided in this article.

A. Distributions of Income and Principal. Until the termination date (defined below), the trustee shall distribute to or expend for the benefit of my *husband/wife*, *spouse*, my then-living children and my then-living more remote descendants, as much of the net income and principal of this trust as the trustee deems appropriate for any purpose, annually adding to principal any undistributed income.

1. Unequal Distributions Permitted. The trustee may distribute income and principal of the trust unequally and may make distributions to some beneficiaries and not to others.

2. Long-Term Operations are Primary Concern. The trustee shall make distributions recognizing that my primary concern in establishing the trust is the conservation and management of its principal and accumulated income for as long as shall be practicable. The trustee shall, therefore, lend trust assets to beneficiaries or hold them for the personal use of beneficiaries, rather than making outright distributions, to the greatest extent that the trustee deems it practicable.

3. Other Resources. The trustee shall determine the amount and timing of all distributions from the trust, taking into account other resources available to each beneficiary from all sources, including all other trusts created by me.

4. Support. The trustee shall not distribute income or principal in a manner that discharges my legal obligation to support any beneficiary of this trust.

B. Limited Power of Appointment. My *husband/wife* may appoint all or any portion of the trust fund, to one (1) or more members of a class that includes only my descendants. My *husband/wife* may exercise this limited power of appointment at any time and from time to time, by a written instrument delivered to a trustee. My *husband/wife* may appoint the trust assets outright or in further trust, and on such terms as *he/she* may deem appropriate.

C. Upon the Termination Date. Upon the termination date, the trustee shall distribute the remaining trust funds to my then-living descendants, per stirpes, outright and free of trust, but subject to the provisions of the article entitled AContingent Trust for Certain Beneficiaries".

D. ATermination Date' Defined. The termination date for the trust maintained under this article shall be the date twenty (20) years after the death of the last to die of me, my *husband/wife*, and my descendants alive on the date this trust is created.

Article 6. Trust for Certain Beneficiaries

If a beneficiary is entitled to receive any trust funds outright, and the beneficiary is under the age of *TerminationAge* years, the trustee may retain those trust funds in a separate trust for that beneficiary.

A. Until the Vesting Date. Until the vesting date (defined below), the trustee shall distribute to or for the benefit of the beneficiary as much of the net income and principal as the trustee shall consider appropriate for the beneficiary's health, education, support, or maintenance, annually adding to principal any undistributed income.

B. Upon the Vesting Date. Upon the vesting date, the trustee shall distribute the remaining assets to the beneficiary if the beneficiary is then living or otherwise to the beneficiary's estate to be distributed as part of that estate.

C. ?Vesting Date" Defined. ?Vesting date" is the earliest of (1) the date on which the beneficiary dies; (2) the date on which the beneficiary reaches the age of *TerminationAge* years; and (3) the date twenty-one (21) years after the death of the last to die of me, my *husband/wife*, and those of my descendants alive on the date of this trust.

Article 7. My Right to Substitute Assets

A. Right Reserved. I reserve and shall have the right, exercisable at any time and from time to time, to demand that the trustee transfer to me any or all of the trust assets in exchange for assets of equivalent value. This power shall be exercisable by me solely in a nonfiduciary capacity, and without the consent or approval of any other person who has a fiduciary duty. This power shall enable me to determine the occurrence and timing of any such exchange, but the trustee shall have the sole and absolute right to ascertain and determine, in the exercise of the trustee's fiduciary duties to the beneficiaries, the equivalent value to the trust assets transferred to me. For purposes of this article, Aequivalent value" shall have the same meaning given that phrase in Code Section 675(4)(C) of the Internal Revenue Code of 1986, as amended (the ACode").

B. No Application to Certain Voting Stock. Notwithstanding the provisions of paragraph A, I shall have no right to require that the trustee transfer to me any shares of the voting stock of any corporation in which I have directly or indirectly, including ownership by attribution under Code Section 318, the right to vote stock constituting at least twenty percent (20%) of the total combined voting power of all classes of the said corporations' stock.

C. Exercise. I may exercise this power only by an instrument in writing signed by me and delivered to the trustee and to each then-living current adult beneficiary of the trust.

1. Certification of Value. In the writing by which I exercise this power, I shall certify to the trustee the value of the assets transferred by me to the trust in exchange for trust assets, to the extent that the assets I transfer are not cash, cash equivalents, or stock or other securities that is regularly listed on a major U.S. stock exchange.

2. Effective Date. Such writing shall state the date on which such exchange shall occur, but not earlier than thirty (30) days after the date on which such instrument is received by the trustee.

D. Trustee's Fiduciary Duties. In addition to all other fiduciary duties imposed upon the trustee under local law and this instrument, the trustee shall have the following duties.

1. Assure Equivalence. The trustee shall have a fiduciary obligation to ensure my compliance with the terms of this power by the trustee being satisfied that the properties acquired and substituted by me are in fact of equivalent value.

2. Impartiality. The trustee shall have the power to invest and reinvest the trust corpus and a duty of impartiality with respect to the trust beneficiaries.

E. I Cannot Shift Beneficial Enjoyment. I shall not be able to exercise this power in any manner that shifts benefits among the trust beneficiaries. The trustee shall not honor an attempt to exercise this power if the trustee believes that such effectuation of my attempted exercise of this power would shift benefits among the trust beneficiaries.

F. Cancellation of Power. *Protector* may cancel my power under this article by a writing delivered to me and to the trustee, designating the effective date of the cancellation. *Protector* shall act in all matters without any fiduciary duty of impartiality or fairness to any beneficiaries. If *Protector* shall be unable or unwilling to serve under this article, *2dProtector*, of [address] shall hold and exercise the power granted first to *Protector* under this article. If both *Protector* and *2dProtector* are unable or unwilling to serve under this article, the trustee shall name as the holder of this power an individual who is neither related nor subservient to me, as defined in Code Section 672(c).

Article 8. The Trustees

A. Named Trustees. *FirstTrustee* is the initial trustee of this trust. No trustee named in this instrument or by the trustee shall be required to provide surety or other security on a bond.

B. Successor Trustees. *SecondTrustee*, of [locality, state], shall be the successor trustee, to serve if *FirstTrustee* is unable or unwilling to serve or to continue serving.

C. Bond. No trustee named by me or by another trustee shall be required to provide surety or other security on a bond.

D. Additional Trustee. The trustee may appoint any person as an additional trustee, to serve at the pleasure of the appointing trustee.

E. Delegation. The trustee may delegate to another trustee any power or authority granted by me to the trustee, to continue at the pleasure of the delegating trustee, unless otherwise agreed. Any person dealing in good faith with a trustee may rely on that trustee's representation that a delegation has been made and remains in effect under this paragraph.

F. Resignation. A trustee may resign by giving written notice specifying the effective date of the resignation to the designated successor. If no successor is designated, the resigning trustee shall give notice to the then-living adult beneficiaries to whom income is or may then be distributed.

G. Vacancies. A corporation no substantial portion of the stock of which is owned by me or by beneficiaries of this trust, may be named as successor trustee to fill any vacancy, by the majority vote of the then-living adult beneficiaries to whom income is or may then be distributed.

H. Responsibility of Successors. No trustee shall be responsible for or need inquire into any acts or omissions of a prior trustee.

I. Compensation. In addition to reimbursement for expenses, each individual trustee is entitled to reasonable compensation for services. Each corporate trustee is entitled to compensation based on its written fee schedule in effect at the time its services are rendered or as otherwise agreed, and its compensation may vary from time to time based on that schedule.

J. Management Powers. The trustee may exercise the powers described below, in a fiduciary capacity.

1. Invest and Reinvest. The trustee shall invest and reinvest the trust assets (or leave them temporarily uninvested) in any type of property and every kind of investment, in the same manner as a prudent investor would invest his or her own assets.

2. Sell or Exchange. The trustee may sell or exchange any real or personal property contained in the trust, for cash or credit, at public or private sale, and with such warranties or indemnifications as the trustee may deem advisable.

3. Borrow. The trustee may borrow money (even from the trustee and from any beneficiary of the trust), for the benefit of the trust and secure these debts with assets of the trust.

4. Grant Security Interests. The trustee may grant security interests and execute all instruments creating such interests upon such terms as the trustee may deem appropriate.

5. Compromise and Adjust Claims. The trustee may compromise and adjust claims against or on behalf of the trust on such terms as the trustee may deem appropriate.

6. Taking Title Through Nominee. The trustee may take title to any securities in the name of any custodian or nominee, without disclosing this relationship.

7. Principal and Income. The trustee may determine whether receipts are income or principal and whether disbursements are to be charged against income or principal, to the extent not established clearly by state law. Determinations made by the trustee in good faith shall not require equitable adjustments.

8. Tax Elections. The trustee may make all tax elections and allocations the trustee may consider appropriate; however, this authority is to be exercised only in a fiduciary capacity and may not be used to enlarge or shift any beneficial interest except as an incidental consequence of the discharge of fiduciary duties. All tax elections and allocations made by the trustee in good faith shall not require equitable adjustments.

9. Distributions to Minors. The trustee may distribute any of the trust assets to a minor by distributing them to any appropriate person chosen by the trustee (who may be a trustee), as custodian under any appropriate Uniform Transfers (or Gifts) to Minors Act, to be held for the maximum period allowed by law. The trustee may also sell any asset that cannot legally be held under this custodianship and invest the sales proceeds in assets that can be held under this custodianship.

10. Hiring Advisers. The trustee may employ such lawyers, accountants, and other advisers as the trustee may deem useful and appropriate for the administration of the trust. The trustee may employ a professional investment adviser in managing the investments of the trust (including any investments in mutual funds, investment trusts, or managed accounts), delegate to this adviser any discretionary investment authorities, and rely on the adviser's investment recommendations without liability to any beneficiary.

11. Distributions in Kind. The trustee may divide and distribute the trust in kind or in cash, or partly in each, without regard to the income tax basis of any asset and without the consent of any beneficiary. The decision of the trustee in dividing any portion of the trust between or among two or more beneficiaries shall be binding on all persons.

K. Life Insurance.

1. Paying Premiums. The trustee may use some or all of the net income and principal of the trust to buy and maintain policies of life insurance on my life. The trustee may pay any such premiums or other charges from income or principal. If the trust funds are inadequate to pay such premiums or charges, the trustee may (after receiving written notice that a premium or charge has not been paid), do one or more of the following: (a) use any automatic premium loan feature, (b) borrow against any policy cash reserves (whether or not on the policy for which premium or charges shall be paid), or (c) elect any automatic nonforfeiture feature.

2. Contingent Marital Gift. If my *husband/wife* survives me, the trustee shall distribute the proceeds of any life insurance policies on my life that are included in my gross estate for federal estate tax purposes, to my *husband/wife*, outright and free of trust, notwithstanding the provisions of the article entitled ADynasty Trust for My *Husband/Wife*, Children, and Descendants".

3. Incidents of Ownership. The trustee may exercise all incidents of ownership over any life insurance policies held as part of the trust funds.

4. Litigation. The trustee may decline to enter into or maintain any litigation, endorse policy payments, or take other action respecting any trust insurance policies, until the trustee shall have been indemnified against all expenses and liabilities involved in such action.

5. Beneficial Designation. Upon receipt of written notice that the trustee or the trust is a beneficiary of life insurance policy death or other benefits, the trustee shall take all actions to assure the collection of such funds. Otherwise, the trustee may decline to inquire whether the trustee or the trust shall have been designated beneficiary of any insurance policy or other death benefit, until receipt of written notice that the trustee or the trust may be a beneficiary.

6. Liabilities. The trustee shall not be liable to anyone for buying or maintaining any insurance policies on my life, even if that investment represents an overconcentration, does not meet the applicable standard of prudence, or is inferior to another investment that the trustee might have made. The trustee shall not be responsible for any loss resulting from the failure of any insurer to pay its claims under any policy held by the trust, or because of the exercise or nonexercise of any benefit, option or privilege under any life insurance policy, including the ability to borrow against the cash values to obtain a higher investment yield outside the policy.

L. Disabled Trustee. A trustee may not serve during a disability.

1. Defining ADisabled" and ADisability". An individual trustee is ?disabled" or ?under a disability" if: (a) he or she is determined to be legally incompetent by a court of competent jurisdiction; (b) a conservator or guardian for such person has been appointed, based upon his or her incapacity; (c) two (2) physicians licensed to practice medicine in [state] certify in writing to another trustee or a person who would become the successor trustee upon such disability, that in the opinion of such physicians, such individual trustee, as a result of illness, age or other cause, no longer has the capacity to act prudently or effectively in financial affairs; or (d) thirty (30) days after any other trustee or a person who would become the successor trustee upon such disability, requests that such individual trustee provide a certificate from a physician licensed to practice medicine that, in the opinion of such physician, such individual trustee has the capacity to act prudently or effectively in financial affairs and such individual trustee fails to provide such certification. The effective date of such incapacity shall be the date of the order or decree adjudicating the incapacity, the date of the order or decree appointing the guardian or conservator, the date of the certificate of incapacity of the two (2) physicians described above, or thirty (30) days after other trustee or any person who would become the successor trustee upon such disability requests a certificate of capacity and one is not provided, whichever first occurs.

2. Liability. No person is liable to anyone for actions taken in reliance on these certifications or for dealing with a trustee other than the one removed for disability based on these certifications. This trust shall indemnify any physician for liability for any opinion rendered in good faith as to the existence or recovery from any disability.

M. Special Limits on Interested Trustee. No interested trustee (defined below) may participate in the exercise of any discretion to distribute principal to himself or herself, except as is appropriate for his or her health, education, support, or maintenance. No interested trustee may participate in the exercise of any discretion to distribute or expend principal or income in a manner that would discharge that trustee's personal obligation to support the beneficiary to whom such distribution is or may be made. No interested trustee may participate in the exercise of any incident of ownership over any policy owned by the trust insuring the life of such interested trustee.

1. Disinterested Co-Trustee. A disinterested trustee who is serving as a co-trustee with an interested trustee, may exercise those discretions granted under this instrument the exercise of which by an interested trustee is precluded.

2. Multiple Trustees. The number of trustee who must consent to the exercise of a power granted under this instrument, as determined under this article shall be determined by treating the interested trustee who are not entitled, under this article, to participate in the exercise of the power or discretion, as if they were not then serving. If this article precludes every then-serving trustee from exercising a power otherwise granted to my trustee under this instrument, the then-serving trustee shall appoint a disinterested trustee who may exercise such power (or decline to exercise it) as if that disinterested trustee were the sole then-serving trustee.

3. AInterested Trustee" Defined. An Ainterested trustee" is a trustee who is also (a) a beneficiary of the trust of which he or she is a trustee or the insured under a policy of insurance owned by a trust of which he or she is a trustee; (b) married to and living together with a beneficiary of the trust of which he or she is a trustee; (c) the father, mother, issue, brother or sister, of a beneficiary of the trust of which he or she is a trustee; (d) an employee of a beneficiary of the trust of which he or she is a trustee; (e) a corporation or any employee of a corporation in which the stock holdings of my trustee and the trust are significant from the viewpoint of voting control; or (f) a subordinate employee of a corporation in which such trustee is an executive.

4. ADisinterested Trustee" Defined. A Adisinterested trustee" means a trustee who is not an interested trustee.

Article 9. Tax Purposes

This article states some of my purposes in creating this trust, and all provisions of this trust shall be construed so as best to effect these purposes. No trustee shall exercise any discretion in a manner that could reasonably be expected to frustrate the effectuation of these purposes.

A. Income Tax. The trust, to the extent attributable to transfers by me, shall be a grantor trust deemed owned by me for federal income tax purposes, unless and until the powers under the article entitled AReserved Right to Substitute Assets" is removed and not re-granted and my *husband/wife* ceases to be a beneficiary of this trust.

B. Gift Tax. All transfers to the trust shall be completed gifts for federal gift tax purposes and shall be gifts of a present interest that will qualify for the gift tax annual exclusion.

C. Estate Tax. The assets of the trust shall be excluded from my gross estate for Federal estate tax purposes.

D. Generation-Skipping Transfer Tax. I intend that no distributions from or terminations of interests in this trust or any trust under this instrument shall be subject to the federal tax on generation-skipping transfers.

E. Right to Amend. A disinterested trustee may, without the consent of any other person, amend the trust to the extent required for the sole purpose of ensuring that the trust meets these tax objectives.

Article 10. Trust Administration

A. Accountings. The trustee shall not be required to file annual accounts with any court or court official in any jurisdiction.

B. Disabled Beneficiaries. The trustee may distribute income, principal, or both to a minor or disabled beneficiary to his or her parent, guardian, personal representative, or the person with whom the beneficiary resides, without looking to the proper application of those payments.

C. Change of Situs. The trustee may change the situs of any trust (and to the extent necessary or appropriate, the trust assets) to a state or country other than the one in which the trust is then administered, if the trustee believes it to be in the best interests of the trust or the beneficiaries. The trustee may elect that the law of such other jurisdiction shall govern the trust to the extent necessary or appropriate under the circumstances.

D. Spendthrift Clause. No interest in the trust shall be subject to the beneficiary's liabilities or creditor claims, assignment, or anticipation, voluntary or involuntary. If the trustee determines that a beneficiary would not benefit as greatly from any outright distribution of trust income or principal because of the availability of the distribution to the beneficiary's creditors, the trustee shall instead expend those amounts for the benefit of the beneficiary. This direction is intended to enable the trustee to give the beneficiary the maximum possible benefit and enjoyment of all of the trust income and principal to which the beneficiary is entitled.

E. Multiple Trusts and Shares. The trustee may invest the assets of multiple trusts in a single fund if the interests of the trusts are accounted for separately. The trustee may merge or consolidate any trust into any other trust that has the same trustee and substantially the same dispositive provisions. The trustee may divide any trust into multiple separate trusts.

F. I Shall Pay Certain Income Taxes. The trustee shall not pay or reimburse me for the payment of any incremental income taxes imposed upon me with respect to income or gains received by the trustee and not distributed to me, notwithstanding any requirement of state law that I be paid or reimbursed for such tax payments.

Article 11. Annual Withdrawal Power: Guidelines

This article applies to the annual withdrawal power created in Article 4 of this instrument.

A. Immediate Power. This withdrawal power shall arise immediately after each contribution to the trust (defined below).

B. Shares. Each child's and descendant's proportionate share of a contribution is the amount of such contribution, divided by the number of my then-living children (excluding *Beneficiary*) and more remote descendants.

C. Annual Limit. The maximum amount that any child or descendant may withdraw with respect to all contributions made by the same donor in a single calendar year shall be the lesser of (1) the total amount of the donor's contributions to this trust during that year and (2) the amount of the federal gift tax annual exclusion in effect on the date of the earliest of such contributions or twice the gift tax annual exclusion if the donor is married on the date of the last of all contributions made during that year.

D. Priority. This withdrawal power takes precedence over any other power or discretion granted the trustee or any other person.

E. Exercise. Each child or descendant can exercise this withdrawal power by a written request delivered to a trustee. The legally authorized personal representative of any person unable to exercise a withdrawal power because of a legal disability, including minority, may make the demand on the child's or descendant's behalf. If there is no legally authorized personal representative, the trustee shall designate an appropriate adult individual (who may be a trustee but may not be me) who may make the demand on such child's or descendant's behalf.

F. Notice. The trustee must reasonably notify the person who would exercise a child's or descendant's withdrawal power of its existence and that of any contributions made to the trust that are subject to the power.

G. Lapse. The unexercised withdrawal power of each child or descendant shall lapse on the last day of each calendar year or, if earlier, sixty (60) days after the contribution to which it relates, but it shall then lapse only in an amount equal to the greater of that sum referred to in Code Section 2514(e)(1) (currently, five thousand dollars ($5,000)) or that percentage referred to in Code Section 2514(e)(2) (currently, five percent (5%)) of the trust corpus out of which, or the proceeds of which, the exercise of this withdrawal right could be satisfied. These rights of withdrawal that do not lapse at the end of a calendar year shall continue to be exercisable by the child or descendant subject to this same limited annual lapse. These rights of withdrawal respecting a contribution made fewer than sixty (60) days before the end of a calendar year shall not then lapse but shall remain exercisable until the end of the term otherwise designated in this instrument, without respect to the fact that it occurs during the following calendar year.

H. ?Contribution" Defined. ?Contribution" means any cash or other assets transferred to the trustee to be held as part of the trust funds, and any payment of premiums on life insurance policies owned by the trust. The amount of any contribution is its federal gift tax value, as determined by the trustee at the time of the transfer.

Article 12. Definitions and Miscellaneous

A. Definitions.

1. AChildren" and ADescendants." AChildren" and Adescendants" include those now living and those later born, subject to the following rules:

a. AChildren" and Adescendants" include an adopted person and that adopted person's descendants if, that adopted person is adopted before reaching eighteen (18) years of age.

b. AChildren" and Adescendants" includes those born outside of wedlock, if, during such child's or descendant's lifetime, his or her parent through whom such child or descendant claims hereunder, has acknowledged such person as his or her child in a writing duly signed and notarized during such parent's lifetime; and

c. AChildren" and Adescendants" include a child produced before the parent's death by donor artificial insemination, in vitro fertilization or other form of surrogate parenthood, whether or not such child was legally adopted by such parent before such parent's death.

2. ACode." Any reference to the ACode" or to the AInternal Revenue Code" means the U.S. Internal Revenue Code of 1986, as amended, or any similar successor provision of Federal tax law.

3. AMy *Husband/Wife*". I am currently married to *Spouse*, but any reference to my A*husband/wife", whether or not it includes a reference to *Spouse* by name, shall refer to the person to whom I am married at the time of any distribution or event for which the identity of my *husband/wife* is relevant, or if it relates to an event that would occur on or after the date of my death, it shall refer to the person to whom I am married on the date of my death, whether or not such person later remarries.

4. ATrust." The Atrust," without further qualification or specification, shall refer to all trusts under this instrument.

5. ATrustee." The Atrustee" shall include each trustee, multiple trustee, and any successor trustees.

B. Absence of Trust Beneficiaries. If all of the beneficiaries of the trust should die before the trust assets have vested in them, the trustees shall distribute all of the remaining assets of that trust as follows:

1. My Heirs and Distributees. One half (2) (or all, if there are no persons to take under item 2 of this paragraph) to the heirs and distributees who would have inherited my personal estate, and in such shares as they would have inherited it, had I died unmarried and without a valid will, determined on the later of the date of my death or that of the death of the last of the beneficiaries to die; and

2. My *Husband/Wife*'s Heirs and Distributees. One-half (2) (or all, if there are no persons to take under item 1 of this paragraph) to the heirs and distributees who would have inherited the personal estate of my *husband/wife*, and in such shares as they would have inherited it, had my *husband/wife* died unmarried and without a valid will, determined on the later of the date of my death or that of the last of the beneficiaries to die.

C. Tax-Related Terms. All tax-related terms shall have the same meaning in this instrument that they have in the Internal Revenue Code of 1986, as amended.

D. Number. Whenever the context requires, the singular number includes the plural and the plural, the singular.

E. Applicable Law. The trust shall be governed by and construed according to the laws of the state of [state].

F. Copies. There is only one signed original of this instrument. Anyone may rely on a copy of this instrument certified by a notary public or similar official to be a true copy of the signed original (and of any amendments) as if that copy were the signed original. Anyone may rely upon any statement of fact certified by the person who appears from the original document or a certified copy to be a trustee.

DECLARED AND AGREED on the date indicated above.

[Insert signatures, notary clauses, and schedule omitted from this exemplar]

WAIVER OF CERTAIN RIGHTS

I, *husband/wife*, waive all of my right, title, and interest in any property transferred to the attached trust, dated [date] (the trust), by *Grantor*. This waiver shall apply both to current and inchoate interests that I may have, including, but not limited to, rights to an intestate share of *Grantor*'s estate, to a statutory share of *Grantor*'s augmented estate, to another statutory share of *Grantor*'s estate, to a share as an omitted spouse, and to a share in the nature of dower or curtesy. The waiver shall constitute a third-party beneficiary contract for the benefit of all the beneficiaries of the trust, and these beneficiaries or the trustee of this said trust may enforce this waiver by appropriate legal action.

Dated: [date]

[Signature and notary clauses omitted from this exemplar]