2018 Estate Tax and Charitable Giving Update

Robert S. Keebler, CPA/PFS, MST, AEP

Robert.Keebler@keeblerandassociates.com

Critical Changes

- **Estate & GST tax**
  - Exemption to $11,180,000 in 2018
  - Sunsets December 31, 2025
  - Step-up in basis retained at death

Portability

- Portability Election

- Allows a decedent's unused exclusion amount (DSUE amount) to become available for application to the surviving spouse's subsequent transfers during life or at death.

- Applies to estates of decedents dying after December 31, 2010, if such decedent is survived by a spouse.

Portability

- To elect portability, an estate had to timely file an estate tax return.
- Previously, relief for filing late had to be obtained via private letter ruling (PLR) process.
- Simplified method provided in Revenue Procedure 2017-34 is to be used in lieu of the PLR process.

Portability

- Revenue Procedure 2017-34
- Simplified method for certain taxpayers to obtain an extension of time to make a portability election
- No user fee is required for submissions filed under this revenue procedure.

Portability

- Revenue Procedure 2017-34

- Available to the estates of decedents having no filing requirement for a period the last day of which is the later of January 2, 2018, or the second anniversary of the decedent's date of death.

- Taxpayer seeking relief to elect portability after the second anniversary of a decedent's death may do so by requesting a private letter ruling.

Portability

- Revenue Procedure 2017-34

- The decedent must:
  - be survived by a spouse;
  - have died after December 31, 2010; and
  - have been a citizen or resident of the United States on the date of death.

Portability

- Revenue Procedure 2017-34

- Not available to the estate of a decedent whose executor timely filed an estate tax return.

- Such an executor either will have elected portability of the DSUE amount by timely filing that estate tax return or will have affirmatively opted out of portability.

Portability

- Revenue Procedure 2017-34

- Form 706 must state at the top of the Form 706 that the return is “FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A).”

Portability

- Revenue Procedure 2017-34

- If, subsequent to the grant of relief pursuant to this revenue procedure, it is determined that, based on the value of the gross estate and taking into account any taxable gifts, the executor was required to file an estate tax return, the grant of an extension is deemed null and void *ab initio*.

Portability

- *Estate of Sower v. Commissioner*, 149 TC No. 11
- Tax Court determined that the IRS wasn't precluded from auditing the return of the first spouse to die to determine the correct DSUE for the surviving spouse's estate.
- Husband died in 2012 and his estate elected portability.
- The IRS issued an Estate Tax Closing Document to his estate stating that the return was accepted as filed.

Portability

- *Estate of Sower v. Commissioner*
- Wife died in 2013 and the IRS audited her estate tax return.
- Strictly for purposes of determining Wife's estate tax, IRS reviewed Husband's estate tax return, and determined that the DSUE amount on that return was overstated because he did not report certain lifetime gifts.
- Wife's estate argued that (1) the review was a prohibited second examination under IRC § 7605(b) and (2) that the IRS was estopped from examining H's return because of the Letter 627.

Portability

- *Estate of Sower v. Commissioner*
- The court rejected both arguments:
  - The review wasn't a second examination because the IRS isn't deemed to conduct a second examination when it obtains no new information and only the examined party is protected from a second examination, in this case the Wife's estate.
  - Estate failed to establish the elements necessary for equitable estoppel. There were no false representations or wrongful misleading silence on the part of the IRS.

IRS Closing Letter

- Prior to June 1, 2015, the IRS issued an estate tax closing letter for every estate tax return filed.

- For estate tax returns filed on or after June 1, 2015, IRS now will issue closing letter only at the request of an estate.

IRS Closing Letter

- Notice 2017-12
  - Provides guidance on the methods available to confirm the closing of an examination of the estate tax return.
  - For confirmation that the IRS examination of an estate tax return has been completed and is closed, estates can request an account transcript in lieu of an estate tax closing letter.
  - Receipt of an account transcript with a transaction code of “421” like receipt of an estate tax closing letter, confirms the closing of the IRS examination of the estate tax return.

IRS Closing Letter

- IRS may reopen the examination of the estate tax return after the issuance of a closing letter or the entry of transaction code “421” on the account transcript for the purpose of determining the estate tax liability of a decedent in certain circumstances.

- IRS may examine the estate tax return of a decedent after the issuance of a closing letter or the account transcript for the purpose of determining the transfer tax liability of the surviving spouse of that decedent when portability has been elected.

IRS Closing Letter

- Estates may request an account transcript by filing Form 4506-T.

- Estates and their authorized representatives may call the IRS at (866) 699-4083 to request a closing letter no earlier than four months after the filing of the estate tax return.

Estate Tax Liens

- April 5, 2017
  - Treasury provided interim guidance to its employees regarding the responsibility to process all requests for a discharge of an estate tax lien.
  - Upon the death of an individual, the estate tax lien immediately arises and attaches to all property included in the gross estate, whether or not such property is part of the probate estate.
  - The lien is in effect for ten years from the date of death and cannot be extended

Estate Tax Liens

- Unlike other tax liens, no assessment, no notice and no demand payment are necessary to create the estate tax lien.
- It attaches at the time of the decedent’s death, before the tax is determined, and is security for any estate taxes that may be determined to be due.
- Often referred to as a silent lien.

Estate Tax Liens

- If an estate wants to sell property subject to the lien, a request for discharge can be filed on a Form 4422.
- The Service's authority to issue a certificate of discharge related to the estate tax lien is governed by IRC § 6325(c).
- Form 792 is used to discharge particular property from the lien under IRC § 6325(c).
- Treasury Regulation § 301.6325-1(c)(1) specifically provides that, if the appropriate official determines that the tax liability for the estate has been fully satisfied or adequately provided for, he may issue a certificate discharging all or specific property from the lien.

Estate Tax Liens

- Pursuant to Treasury Regulation § 301.6325-1(c)(1), the issuance of the certificate of discharge is a matter resting within the discretion of the appropriate IRS official.
- 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.
- The estate tax will be considered fully satisfied only when an investigation has been completed and payment of the tax, including any deficiency that has been determined, has been made.

Estate Tax Liens

- In many instances, in determining whether to grant an estate tax lien discharge, the issue the IRS employee will need to consider is whether the estate tax liability is adequately provided for, meaning that the government's interest in collecting the estate tax is secured.

GRAT Reformation

- PLR 201652002
- Service allowed grantor to reform trusts to ensure qualification as a grantor retained annuity trusts under IRC Section 2702.
- Drafting attorney failed to include language prohibiting the trustee from using a note or other debt instrument to satisfy the annuity obligation.
- Because the trust instruments and applicable state law allowed the court to correct a scrivener's error, the IRS ruled that the trusts qualified as GRATs effective as of the date each trust was created.

Beneficiary Designation

- *Ruiz v. Publix Super Markets, Inc.*, 2017 WL 1180095, Case No. 8:17-cv-735-T-24TGW (M D Fl 2017)
- Beneficiary designations made by the now-deceased participant in Publix's ESOP and 401(k) plans.
- Plans' documents provided specific instructions on how a participant changes their beneficiary which included completing a signed beneficiary designation card.

Beneficiary Designation

- *Ruiz v. Publix Super Markets*
- During her life, the participant called the company about changing her beneficiary designation and the company representative instructed her that she could write a letter to update her beneficiary designation.
- Participant submitted such a letter but also submitted an unsigned beneficiary designation card.
- Because of the lack of a signed beneficiary designation card, the plans did not honor the change and paid the death benefits to the original beneficiaries.

Beneficiary Designation

- *Ruiz v. Publix Super Markets, Inc.*
- The intended new beneficiary sued the plan, claiming that the letter was sufficient to name her as beneficiary.
- Court rejected her claim and ruled that the original beneficiaries were entitled to receive the benefits.
- Court - it is doubtful that the doctrine of substantial compliance remains viable, given the Supreme Court's emphasis on the duty of a plan administrator to act in accordance with the plan documents.

Beneficiary Designation

- *Ruiz v. Publix Super Markets, Inc.*
- Supreme Court has specifically stated that ERISA forecloses any justification for inquiries into expressions of intent that do not comply with the plan documents.
- It didn’t matter if there was substantial compliance by the participant because the plan's requirements needed to be followed.

Estate Inclusion of Partnership Interest

- *Estate of Nancy H. Powell v. Commissioner,* 148 TC No. 18

- Tax Court held that a limited partner interest was includible in a decedent's gross estate.

Estate Inclusion of Partnership Interest

- *Estate of Nancy H. Powell v. Commissioner*
- Early August 2008, decedent's son, acting on her behalf, transferred cash and securities to a limited partnership in exchange for a 99% limited partner interest.
- Partnership agreement allowed for the entity's dissolution with the written consent of all partners.
- On same day, the son, acting under a POA, transferred the decedent's LP interest to a CLAT, the terms of which provided an annuity to a charitable organization for the rest of the decedent's life.

Keebler & Associates, LLP
Expertise. Insight. Clarity.

Estate Inclusion of Partnership Interest

- *Estate of Nancy H. Powell v. Commissioner*
- Upon decedent's death, CLAT went to the decedent's sons.
- Decedent died on August 15, 2008.
- Tax Court - decedent's ability, acting with the other partners, to dissolve the partnership was a right "to designate the persons who shall possess or enjoy" the assets transferred to LP "or the income therefrom", within the meaning of IRC Sec. 2036(a)(2).

Estate Inclusion of Partnership Interest

- *Estate of Nancy H. Powell v. Commissioner*
- Because decedent’s LP interest was transferred less than three years before her death, the value of the assets transferred to the partnership was includible in the value of her gross estate to the extent required by either IRC Sec. 2036(a)(2) or IRC Sec. 2035(a).

Estate Inclusion of Partnership Interest

- *Estate of Nancy H. Powell v. Commissioner*
- Further held that neither IRC Sec. 2036(a)(2) nor IRC Sec. 2035(a) required inclusion in the value of the decedent's gross estate of the full date-of-death value of the assets transferred to the partnership but only the excess of that value over the value of the limited partner interest the decedent received in return is includible in the value of her gross estate.

Estate Inclusion of Partnership Interest

- *Estate of Nancy H. Powell v. Commissioner*
- Court also held that the son's transfer of decedent's partnership interest to the CLAT was either void or revocable under applicable State law because the decedent's power of attorney did not authorize the son to make gifts in excess of the annual Federal gift tax exclusion.
- Value of the 99% LP interest, as of the date of the decedent's death, was includible in the value of her gross estate under IRC Sec. 2033 or IRC Sec. 2038(a).

IRS Claim Against Estate

- CCA 201723018
- Chief Counsel's office responded to a request for advice on a case involving the failure of a probate court to pay a claim filed by the IRS.
- IRS employee asked whether the IRS is bound by the probate court's decision to not pay the claim, which should have been paid ahead of the claim of a competing secured creditor based on priority principles established under the Internal Revenue Code, and whether the IRS might be able to recoup the amount erroneously paid out.

IRS Claim Against Estate

- CCA 201723018
- Chief Counsel noted that the Service's claim was superior to that of the competing creditor and that the federal insolvency statute arguably applied.
- Per section 3713(a)(1)(B), claims of the United States shall be paid first when the deceased debtor's estate is not large enough to pay all of the debtor's debts.

IRS Claim Against Estate

- CCA 201723018
- Thus, in a case like this one, where the estate was unable to pay all the debtor's debts, the executor should have paid the tax claim ahead of the other creditor's claim.
- If an estate's representative violates this ordering rule, he or she is personally liable to the extent of the incorrectly made payment.

IRS Claim Against Estate

- CCA 201723018
- Chief Counsel stated that, despite the potential applicability of these authorities in this case, the Service appears to have waived its right to challenge the executor's incorrect action since the government did not object to or appeal the determination that the other creditor should be paid ahead of the Service.
- If the government were to file suit for breach of fiduciary duty, the executor would most likely have a viable defense that a fiduciary has no personal liability when the government becomes a party to the proceeding by filing a claim, receives notice of the distribution, and does not object, all of which occurred in this case.

IRS Claim Against Estate

- CCA 201723018
- Because the government participated in the probate case, the government probably waived its right to challenge the probate court's final determination regarding the Service's claim.
- Chief Counsel indicated that an action against the executor would probably not be successful.
- Moreover, alternative bases of recovery such as quiet title or levy are not applicable since the competing creditor was not in possession of tangible property of the taxpayer.

IRS Claim Against Estate

- CCA 201723018
- Chief Counsel recommended as a "best practice" that the Service either refrain from any participation in probate proceedings involving a taxpayer, thus preserving its right to sue the executor, or participate fully in the proceedings, objecting to proposed distributions and appealing adverse determinations as appropriate.

Tax Lien

- *In re: Estate of Simmons*, 120 AFTR 2d 2017-5368
- U.S. District Court: IRS liens over property held by a decedent had priority over claims of the personal representative for funds she advanced for maintenance and preservation of estate property.
- Under the federal Tax Lien Act of 1966, a properly filed IRS lien has priority over the interests of all other creditors except for purchasers, holders of security interest, mechanics lienors, and perfected judgment lien creditors.
- Because the personal representative didn’t fall into any of these categories, the IRS lien prevailed.

Transferee Liability

- *Hawk v. Commissioner*, T.C. Memo. 2017-217
- Court imposed transferee liability on decedent's estate, trusts, and widow.
- Following the death of the patriarch, the Hawk family sold two bowling alleys to third-parties.
- Bowling alleys were owned by a C-corp which in turn was owned by the estate and family members.
- This transaction caused the corporation to recognize a significant amount of gain.
- Following the transaction the entity did not own any business assets or engage in any business activity.

Transferee Liability

- *Hawk v. Commissioner*
- Following the asset sale, the family was approached by MidCoast with offer that MidCoast would pay above book value for the bowling alley because it could use losses from different transactions to offset the gain.
- The family redeemed some stock for the remaining assets the family desired to retain and sold the balance of the stock to MidCoast.

Transferee Liability

- *Hawk v. Commissioner*
- A portion of the proceeds were distributed from the estate to the family trusts.
- The Service subsequently audited the MidCoast transaction and determined additional tax was owed by the Hawk family and imposed transferee liability on the Mr. Hawk's estate, the family trusts, and Mrs. Hawk.

Special Use Valuation

- PLR 201743013
- IRS ruled that a transfer of farm property from the decedent’s grandson, a qualified heir for purposes of the special use valuation rules, to the decedent’s daughter didn’t result in imposition of additional estate tax.
- IRC Sec. 2032A(c)(1)(A) - if, within ten years after the decedent’s death, and before the death of the qualified heir, the qualified heir disposes of any interest in qualified real property (other than by a deposition to a member of the qualified heir’s family), an additional tax is imposed.

Special Use Valuation

- PLR 201743013
- Daughter qualified as a member of grandson's family under IRC Sec. 2032A(e)(2) because she was an ancestor of grandson so the additional tax didn't apply.
- However, daughter was required to sign and execute an amended written agreement consenting to personal liability for additional estate tax under IRC Sec. 2032A(c) to reflect the changed ownership of the property.

Estate Tax Deduction

- *Estate of Sommers*, (2017) 149 TC No. 8
- Tax Court denied an estate tax deduction for gift tax owed at decedent's death.
- Decedent made net gifts to his nieces on which the nieces agreed to pay any gift tax due.
- Decedent died less than three years later, causing the gift tax to be grossed up under IRC Sec. 2035(b).
- Estate claimed a deduction for the gift tax payable under section 2053.
- Although the estate was technically liable for the gift tax, it had a right of reimbursement from the nieces.

Estate Tax Deduction

- *Estate of Sommers*
- Citing longstanding precedent holding that a claim against an estate is deductible only to the extent it exceeds any right to reimbursement, the Tax Court denied the deduction.
- Because the estate's payment of the gift tax liability would have given rise to a claim for reimbursement from the nieces under the agreements governing the gifts, the gift tax owed on those gifts at the decedent’s death is not deductible under IRC Sec. 2053(a).

IRA in Bankruptcy

- *Smith, Elvin and Linda, In re* (2017, Bktcy ID) 2017 WL 2062853
- US Bankruptcy Court held that a rollover IRA did not qualify for a bankruptcy exemption.
- The debtor invested IRA funds in life insurance policies.
- In late 2013, to avoid paying annual fees, the debtor decided to close the IRA and open a new account to receive the proceeds to the policies.
- Custodian of the closed IRA registered the assets in the debtor's name individually.

IRA in Bankruptcy

- *Smith*
- 2014 - company which issued the insurance policies filed for bankruptcy and named the debtor as an unsecured creditor with a fractional ownership position in his insurance policies.
- 2016 - debtors sold their interest in the bankruptcy estate of the insurance company and deposited the sales proceeds into an IRA. This deposit occurred beyond the 60-day rollover period.

IRA in Bankruptcy

- *Smith*
- Late 2016 - the debtors filed for bankruptcy.
- Debtors claimed that the IRA funds were exempt from bankruptcy under applicable state law.
- Trustee objected.
- Court - the IRA was not exempt because the debtors were not eligible to make an IRA contribution in 2016 because they had no earned income and because the IRA deposit was not a qualified rollover contribution.

QTIP Renunciation

- PLR 201721006
- IRS addressed tax consequences of a proposed division of a QTIP trust into two trusts followed by a renunciation by the surviving spouse of any interest in the original trust.
- Upon the decedent's death, the trust estate was divided into three separate trusts, one of which was the Marital Trust.

QTIP Renunciation

- PLR 201721006
- Under the Marital Trust, all net income and discretionary principal is paid to the spouse.
- On death of spouse, Marital Trust is divided into nineteen equal trust shares for the benefit of descendants.
- Decedent's personal representative elected on the Form 706 to treat the Marital Trust as QTIP under IRC Sec. 2056(b)(7).

QTIP Renunciation

- PLR 201721006
- Trustee of Marital Trust proposes to divide the Marital Trust into two separate trust shares (Marital Trust One and Marital Trust Two).
- Each share will be administered as a separate trust for the benefit of the spouse upon the same terms as the Marital Trust.
- Spouse would further renounce any right, title or interests he has in Marital Trust One with the result that his interests in income and principal of Marital Trust One will terminate.

QTIP Renunciation

- PLR 201721006
- IRS: the renunciation of Marital Trust One would not result in a deemed gift to Marital Trust Two under IRC Sec. 2519.
- IRS: as a result of the trust division, spouse's interests in Marital Trust One will be separate and distinct from his interests in Marital Trust Two.
- Therefore, when spouse renounces his right, title and interests in Marital Trust One, spouse's interests in Marital Trust Two are not treated as a retained interest for purposes of IRC Sec. 2702(a)(1).

QTIP Renunciation

- PLR 201721006
- IRS: spouse's renunciation of his entire interest in Marital Trust One would not result in the spouse's interest in Marital Trust Two being valued at zero under IRC Sec. 2702.

QTIP Renunciation

- PLR 201721006
- When the spouse renounces his right, title and interests in Marital Trust One, spouse will be deemed to have made a transfer of all of the property of Marital Trust One, other than his qualifying income interest therein, under IRC Sec. 2519.
- IRC Sec. 2044(a) provides that the value of the spouse's gross estate shall include the value of any property in which the spouse had a qualifying income interest for life.

QTIP Renunciation

- PLR 201721006
- IRC Sec. 2044(b)(2) provides that IRC Sec. 2044(a) does not apply to any property if IRC Sec. 2519 applies to the disposition of part or all of that property prior to the spouse's death.
- IRS: the property owned by Marital Trust One that is deemed transferred pursuant to IRC Sec. 2519 will not be included in the spouse's gross estate under IRC Sec. 2044(a) because of the application of IRC Sec. 2044(b)(2).

Trust Reformation

- PLR 201730018
- IRS ruled on the tax consequences of changing a trust from a non-grantor trust to a grantor trust.
- Taxpayer created a trust that provided for an annuity amount to be paid to charity until a specific anniversary date.
- The non-grantor trust was seeking to amend the trust so it becomes a grantor trust via a substitution power.
- The person given the substitution power is not a trustee but is the grantor’s sibling.

Trust Reformation

- PLR 201730018
- The taxpayer requested, and received, a ruling that the conversion of the trust from a non-grantor trust to a grantor trust was not a taxable transfer of property held by the trust to the grantor for income tax purposes.
- IRS: there was a lack of authority imposing such tax consequences when a trust is converted from a non-grantor trust to a grantor trust.

Trust Reformation

- PLR 201730018
- IRS: the conversion was not an act of self-dealing.
- IRS: ruled adverse to one request in stating that the conversion would not result in an income tax charitable deduction for the grantor in the year of conversion.
  - A charitable deduction was not available because the conversion was not a transfer of property held by the trust for income tax purposes.

Trust Reformation

- PLR 201732029
- Taxpayer requested guidance on the gift, estate, and GST tax consequences of a proposed reformation of a trust.
- The trust became irrevocable prior to September 25, 1985, making it a grandfathered trust for GST purposes and therefore GST exempt.
- IRC Sec. 2601: certain trust modifications or trustee actions can cause a trust to lose its GST exempt status.

Trust Reformation

- PLR 201732029
- Regulations provide that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the GST tax if
  - the action involves a bona fide issue; and
  - the construction is consistent with state law that would be applied by the state's highest court.

Trust Reformation

- PLR 201732029
- Trust provided that at the son’s death, the Trust is to be divided into shares for grandchildren but the trust, as drafted, did not provide for a share for a previously deceased grandchild’s issue.
- It was represented that this was a scrivener's error and that the grantor’s intention was that any share of a deceased grandchild be distributed to such grandchild's children.

Trust Reformation

- PLR 201732029
- To correct the error, Trustee petitioned the County Court to reform the Trust.
- IRS: the reformation would not cause the trust to lose its GST exempt status.

Self-Settled Trust

- *PLR 201744006*
- IRS once again ruled that the contribution of property to a trust by the grantors wouldn't be a completed gift subject to gift tax where each of the grantors retained a testamentary limited power of appointment.
- IRS also ruled on the basis of property at the death of the grantors.
- Grantors resided in a community property state and the trust provides that all transferred property to the Trust is community property and that all property transferred to the Trust prior to the death of the first to die grantor is and shall retain its character as community property.

Self-Settled Trust

- *PLR 201744006*

- The trust would be includible in the grantors' gross estates for federal estate tax purposes and the IRS therefore concluded that the basis of all community property in the trust on the date of death of the first to die Grantor will receive an adjustment in basis to the fair market value of such property at the date of death of such Grantor.

- In other words, the trust assets would receive a double step-up in basis at the first to die grantor's death.

Gift Tax Statute of Limitation

- Field Attorney Advice 20172801F
- Service addressed whether the gift tax could be assessed for prior years.
- Donor made gifts in Years 1-6, but did not file Forms 709 for those years.
- Donor made gifts in Year 7, and filed a Form 709 for that year.
- On the Year 7 Form 709, Donor did not describe any of the property transferred in Year 7, nor did Donor provide a description of the method used to determine the value of that property.

Gift Tax Statute of Limitation

- Field Attorney Advice 20172801F
- The issues addressed were:

1. Whether the period of limitations on assessing gift tax remains open for gifts made in Years 1-6 for which no Forms 709 were filed.

2. Whether the period of limitations on assessing gift tax remains open for gifts made in Year 7 for which a Form 709 was filed, but where the Form 709 did not describe the transferred property, nor did it provide a description of the method used to determine the value of the transferred property.

Gift Tax Statute of Limitation

- Field Attorney Advice 20172801F
- Period of limitations on assessing gift tax for Years 1-6 remains open because no returns were filed.
- Period of limitations on assessing gift tax for Year 7 remains open because the gifts were not adequately disclosed.
- Good reminder that helping our clients start the running of the statute of limitations period is critical.

Gift Splitting and GST Allocation

- PLR 201724007
- Wife created and made gifts to a trust for the benefit of her husband and descendants.
- Trustee of Trust has discretion to distribute income and principal to the husband for his "comfort, welfare and best interests."
- On the husband and wife's gift tax returns, they elected to gift split.
- On the wife's gift tax return, the wife mistakenly did not report any allocation of her GST exemption to the trust despite the fact that it eventually passed to skip persons.

Gift Splitting and GST Allocation

- PLR 201724007
- The couple subsequently amended their gift tax returns to correctly indicate that their respective GST exemption was automatically allocated to the transfer to the trust.
- The amended return was filed pursuant to Rev. Proc. 2000-34.
- All years at issue are subsequent to December 31, 2000.

Gift Splitting and GST Allocation

- PLR 201724007
- The period of limitations has expired with respect to the Year 1 Forms 709.
- IRS: the husband and wife would be treated as transferor of one-half of the property transferred to the trust in the stated year and that the automatic allocation rules applied to allocate the husband's and wife's GSTT exemption to the trust.

Gift Splitting and GST Allocation

- PLR 201724007
- IRS: the husband's interests in the trust are not susceptible of determination and, therefore, the husband's interests are not severable from the interests that the other beneficiaries have in the trust.
- However, under IRC § 2504(c), the time for determining whether gift split treatment is effective with respect to the first year has expired.
- Therefore, the gift split treatment is irrevocable for purposes of the year one transfer to the trust.

Basis of Property Acquired by Gift § 1015(a)

- Donee's basis for computing gain is the same as the donor's basis

- Donee's basis for computing loss is the lesser of—
  - Donor's basis, or
  - FMV of property on date of gift (Reg. § 1.1015-1(a)

Property Acquired by Gift

Example 1

- Facts
  - On July 1, 2016, T purchases XYZ stock for $100
  - On August 1, 2017, T gifts the stock to D
  - At the time of the gift, the stock had a FMV of $75
  - Assume no gift tax was paid on the transfer

Property Acquired by Gift

Example 1 (cont)

- If D subsequently sells the stock, the gain or loss recognized will be as follows for various sale prices:

- Sale price = $120
  - Gain recognized = $20—Sale price ($120) minus basis for gain ($100)

- Sale price = $60
  - Loss recognized = $15—Basis for loss ($75) minus sale price ($60)

- Sale Price = $90
  - Neither gain nor loss recognized (Sale price is less than basis for gain and more than basis for loss)

Adjustment for Gift Tax Paid § 1015(d)

- The basis calculated in the previous slides is increased by all or a portion of the federal gift tax paid with respect to the gift.

- The increase is the amount of gift tax attributable to the net appreciation in the value of the gift

- $Basis\ increase = \dfrac{(gift\ tax\ paid) \times (net\ appreciation)}{amount\ of\ gift}$

Adjustment for Gift Tax Paid

Example 2

- Facts
  - T gifts Blackacre to D
  - T's basis = $1,000,000
  - FMV of Blackacre = $4,000,000
  - Gift tax payable = $1,600,000 ($4,000,000 x 40%)
  - T has already used her annual exclusion

Adjustment for Gift Tax Paid

Example 2 (cont)

- Net appreciation = $3,000,000
- Amount of basis increase =
  - $1,600,000 x $3,000,000/$4,000,000 = $1,200,000
- D's basis = $1,000,000 (carryover from T) + $1,200,000 basis adjustment = $2,200,000

Single Client
Age 92 – Gift versus Death Analysis
Simple Breakeven

Size of Estate	$	22,400,000	$	22,400,000	$	22,400,000
Size of Gift	$	10,000,000	$	10,000,000	$	10,000,000
Basis of Gift	$	1,000,000	$	6,000,000	$	10,000,000
Built-in Gain	$	9,000,000	$	4,000,000		0
Built-in Gain taxed @ 25%	$	2,250,000	$	1,000,000		0
Appreciation needed to overcome value of step-up	$	5,625,000[1]	$	2,500,000[2]		0[3]
% of Appreciation		56.25%		25%		N/A

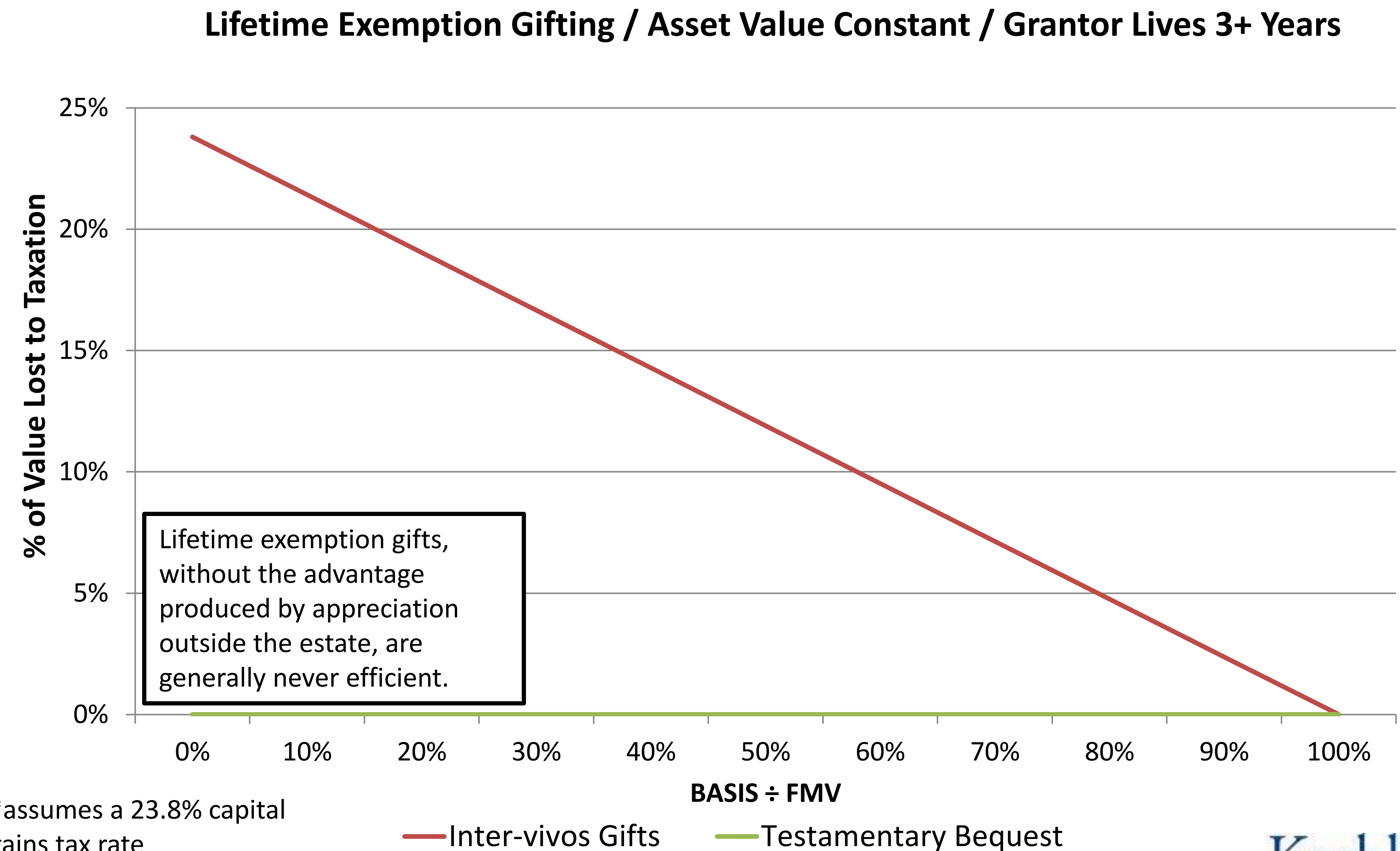
1. $2,250,000/40% = $5,625,000
2. $1,000,000/40% = $2,500,000
3. 40% Estate tax exceeds 25% Income tax

Single Client
Age 92 – Gift versus Death Analysis
Interrelated Breakeven

Size of Estate	$	22,400,000	$	22,400,000	$	22,400,000
Size of Gift	$	10,000,000	$	10,000,000	$	10,000,000
Basis of Gift	$	1,000,000	$	6,000,000	$	10,000,000
Built-in Gain	$	9,000,000	$	4,000,000		0
Built-in Gain taxed @ 25%	$	2,250,000	$	1,000,000		0
Appreciation needed to overcome value of step-up	$	15,000,000[1]	$	6,666,667[2]		0[3]
% of Appreciation		150.00%		66.67%		N/A

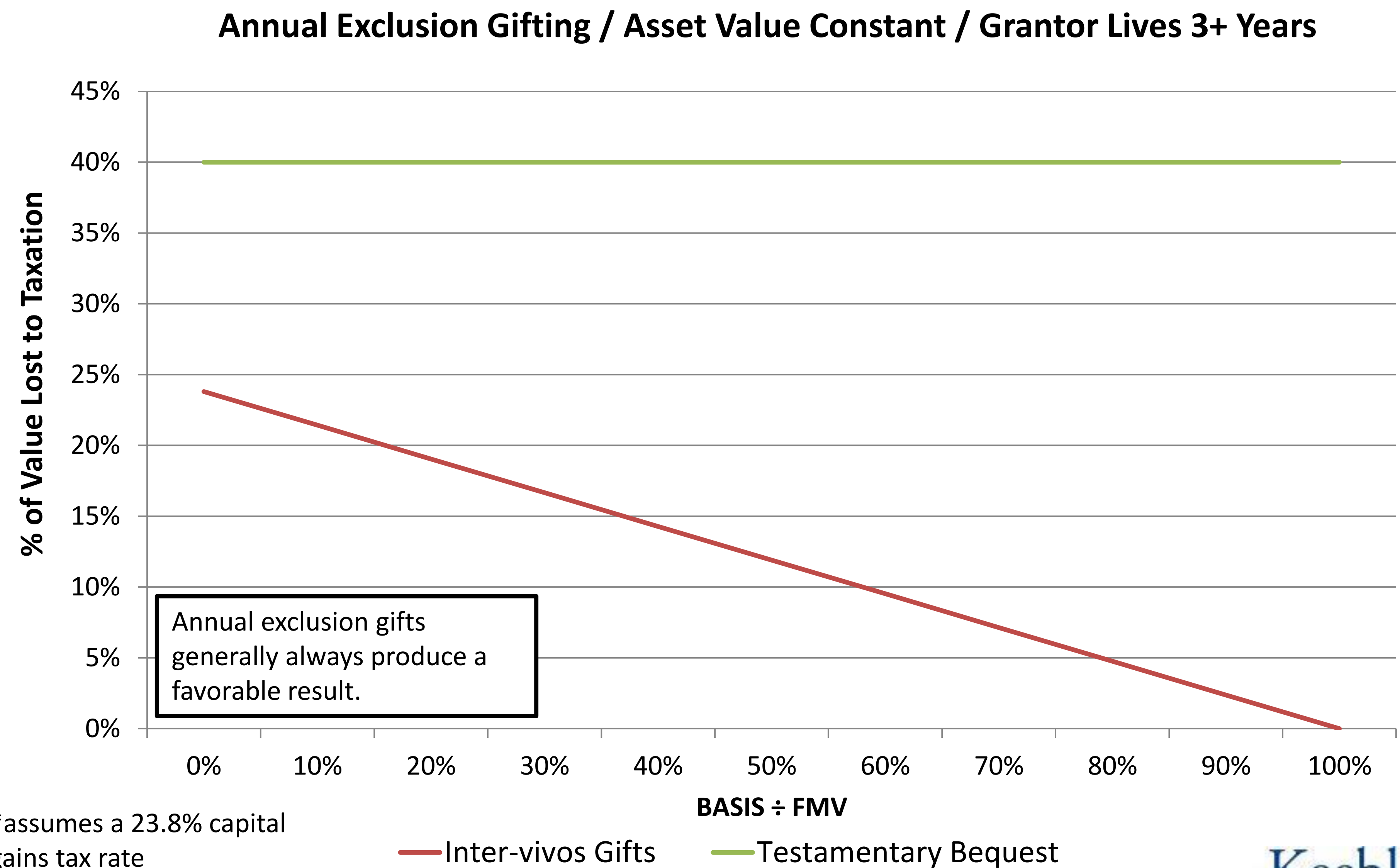
1. $2,250,000/(40%-25%) = $15,000,000 2. $1,000,000/(40%-25%) = $6,666,667 3. 40% Estate tax exceeds 25% Income tax

Basis Basics



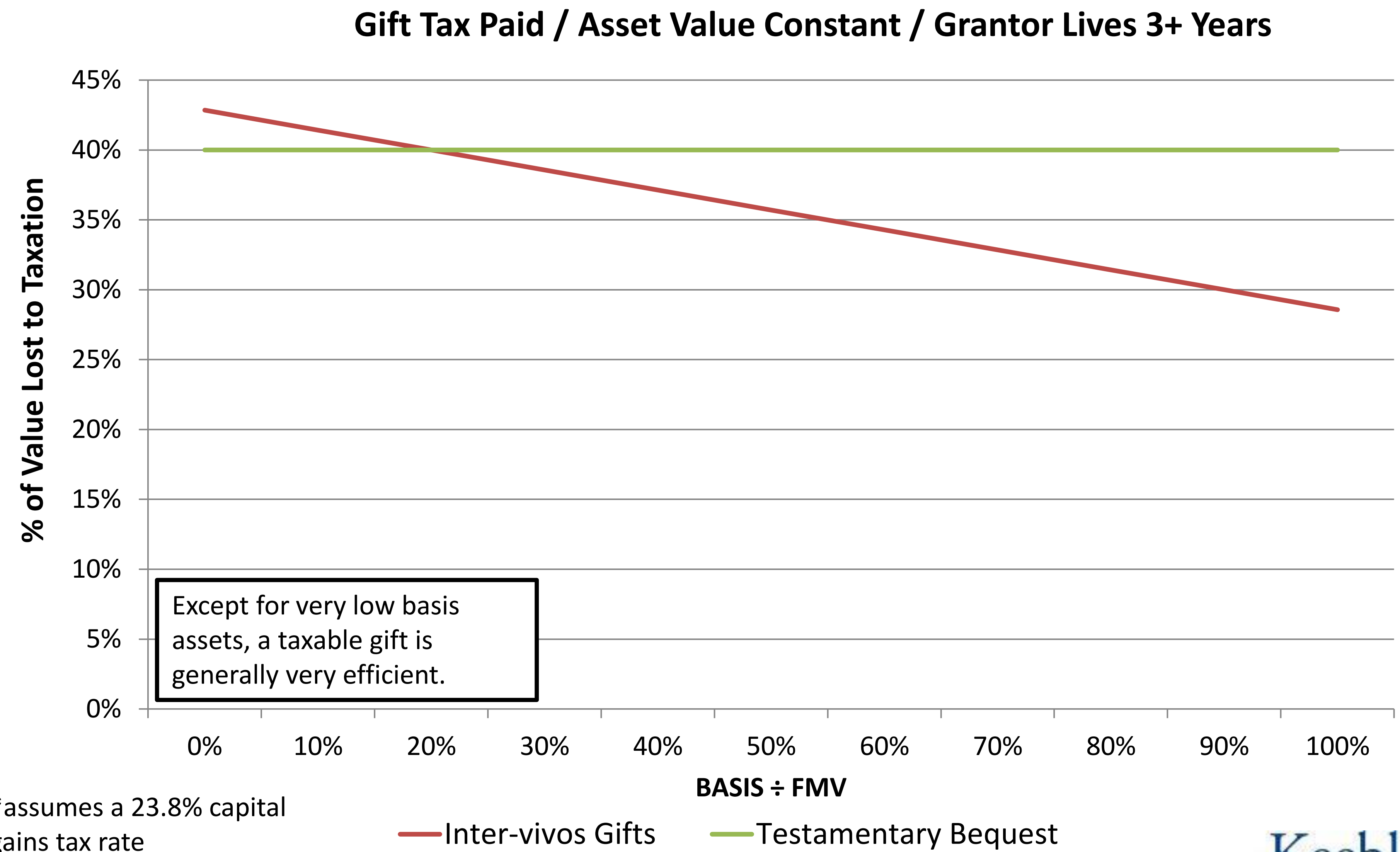
*assumes a 23.8% capital gains tax rate

Basis Basics



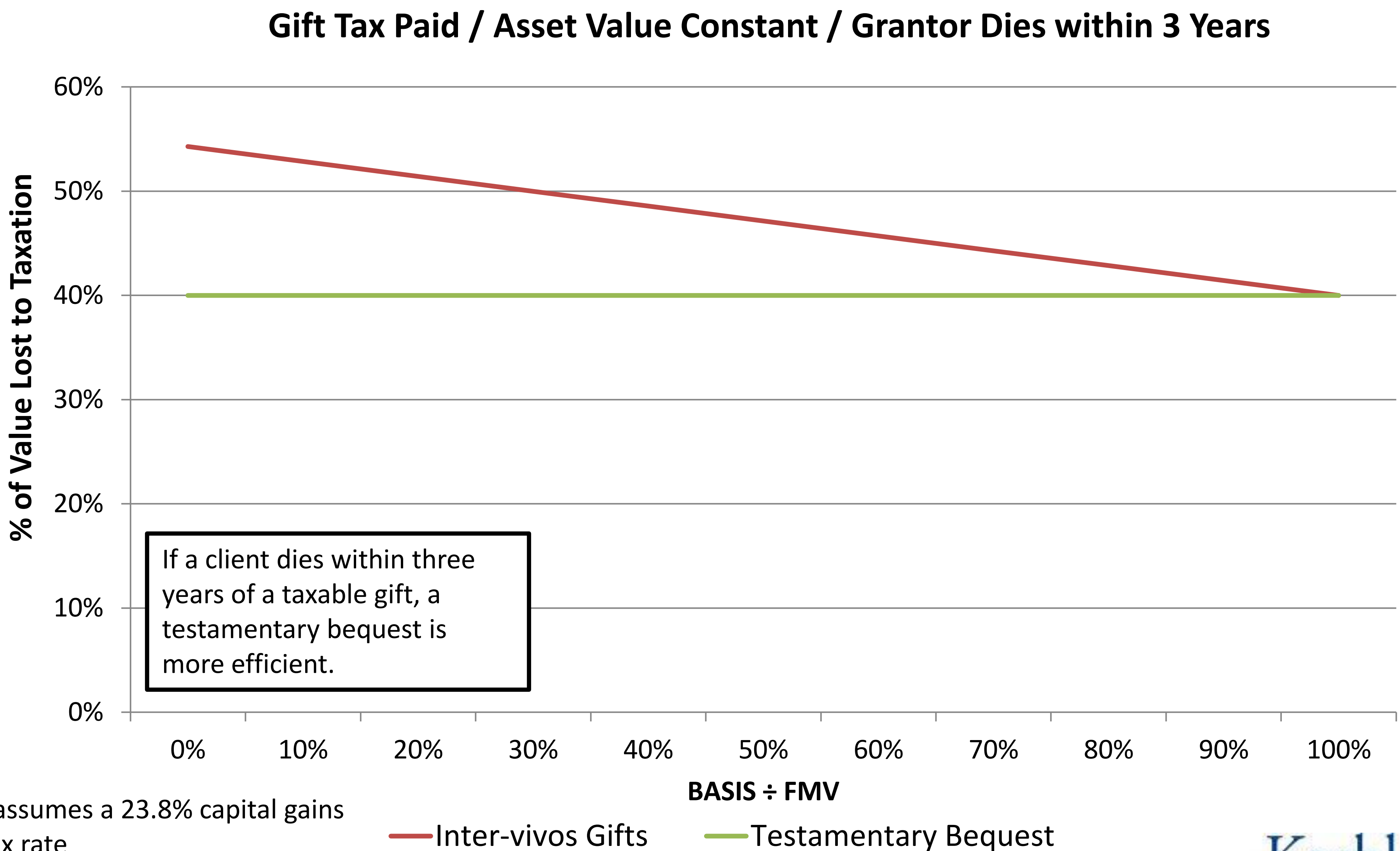
*assumes a 23.8% capital gains tax rate

Basis Basics



*assumes a 23.8% capital gains tax rate

Basis Basics



*assumes a 23.8% capital gains tax rate

Basis of Property Acquired from a Decedent § 1014

- Basis is generally FMV on date of decedent's death or, if elected, the alternate valuation date (IRC § 1014(a))
- Appreciated assets receive a "step-up" in basis at death – saves income tax when the property is sold by "heirs"
- Depreciated assets receive a "step-down" in basis – deprives "heirs" of the income tax benefit of claiming a loss when the property is sold
  - Less common than stepped-up basis because taxpayers have an incentive to realize losses during life

Keebler & Associates, LLP
Expertise. Insight. Clarity.

Charitable Contribution

- *Reri Holdings I, LLC, et al. v. Commissioner*, 149 TC No. 1
- Partnership was denied a charitable deduction for a contribution of a remainder interest in property because it failed to comply with the substantiation requirements for gifts over $5,000.

Charitable Contribution

- *Reri Holdings I, LLC, et al. v. Commissioner*
- A partnership, paid $2.95 million in March 2002 to acquire a remainder interest in property.
- The agreement that created the remainder interest provided covenants intended to preserve the value of the subject property but also limited the remedy available to the holder of the remainder interest for a breach of those covenants to immediate possession of the property.

Charitable Contribution

- *Reri Holdings I, LLC, et al. v. Commissioner*
- On Aug. 27, 2003, the partnership assigned the remainder interest to a university.
- On its 2003 Form 1065, the partnership claimed a deduction under IRC Sec. 170(a)(1) of $33,019,000.
- The Form 8283, Noncash Charitable Contributions, that the partnership attached to its return provided the date and manner of its acquisition of the contributed remainder interest but left blank the space for the "Donor's cost or other adjusted basis".

Charitable Contribution

- *Reri Holdings I, LLC, et al. v. Commissioner*
- Among the charitable deduction substantiation requirements of Treas. Reg. Sec. 1.170A-13(c)(4)(ii)(E), was a summary that included the basis of the contributed property.
- Disclosing this basis would have alerted the IRS to a significant disparity between the remainder interest's claimed value of $33 million and the $3.4 million the taxpayer had paid to acquire the property a year and a half earlier.
- The Tax Court also imposed a gross valuation understatement penalty.

Charitable Deduction

- *Mark A. Rutkoske, Sr., et al. v. Commissioner*, 149 TC No. 6
- Tax Court denied LLC members a 100% charitable deduction for an easement under the special rule of IRC Sec. 170(b)(1)(e)(4) because they weren't qualified farmers.
- For purposes of this rule, a "qualified farmer or rancher" is an individual who gross income from the trade or business of farming is greater than 50% of the individual's gross income for the tax year.

Charitable Deduction

- *Mark A. Rutkoske, Sr., et al. v. Commissioner*
- The donors in this case could only meet this 50% requirement when income from the sale of the subject property and its associated development rights was taken into account.
- Neither the sale of the property nor the sale of its development rights were included in the definition of a farm, trade or business under IRC Sec. 2032A(e)(5).
- Taxpayers weren’t “qualified farmers” and their charitable contribution deduction was limited under IRC Sec. 170(a) to 50% of their respective contribution bases with respect to the conveyed conservation easement.

Charitable Deduction

- *15 West 17th Street, LLC v. Commissioner*, 147 T.C. No. 19
- Tax Court held that the IRS properly denied a $64 million charitable deduction for a donation of a façade easement to a historic trust.

Charitable Deduction

- *15 West 17th Street, LLC v. Commissioner*
- On its 2007 partnership return LLC claimed a charitable contribution deduction of $64,490,000.
- Under IRC Sec. 170(f)(8)(A), in order to substantiate a charitable contribution deduction of $250 or more, a taxpayer must secure and maintain in its files a "contemporaneous written acknowledgment" (CWA) from the donee organization.
- The CWA must state whether the donee provided the donor with any goods or services in exchange for the gift.

Charitable Deduction

- *15 West 17th Street, LLC v. Commissioner*
- IRC Section 170(f)(8)(D), however, states that subparagraph (A) shall 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.
- To date, the Secretary has not issued regulations to implement this alternative donee-reporting regime.

Charitable Deduction

- *15 West 17th Street, LLC v. Commissioner*
- IRS audited the LLC's 2007 tax return and disallowed the charitable contribution deduction in its entirety.
- After the case was docketed in Tax Court, the donee organization submitted an amended Form 990, Return of Organization Exempt from Income Tax, that included the information specified in IRC Section 170(f)(8)(B).
- Petitioner argued that this action by the donee eliminated the need for a CWA to substantiate the charitable gift.

Charitable Deduction

- *15 West 17th Street, LLC v. Commissioner*
- Tax Court: IRC Section 170(f)(8)(D) sets forth a discretionary delegation of rulemaking authority, and it is not self-executing in the absence of the regulations to which the statute refers.
- The court further held that the general rule set forth in subparagraph (A), requiring a CWA meeting the requirements of subparagraph (B), is fully applicable to the gift at issue and the charitable deduction was therefore denied.

Charitable Deduction

- *Green v. U.S.*, 10th Cir. App., No. 16-6371 (1/12/18)
- United States Court of Appeals for the Tenth Circuit
- Charitable tax deduction for the donation of real property is limited to the adjusted basis in the donated property, rather than the fair market value.

Charitable Deduction

- *Green v. U.S.*
- Plaintiff Mart Green, as trustee of a Dynasty Trust, filed an action seeking a refund of federal income taxes paid by the Trust for the 2004 taxable year.
- Issue: amount of the charitable deduction that the Trust could take pursuant to IRC Sec. 642(c)(1) in connection with its donation of three parcels of real property.

Charitable Deduction

- *Green v. U.S.*
- District court: granted partial summary judgment in favor of Trust, concluding that the Trust was statutorily authorized to a deduction equivalent to FMV of the properties at the time of donation.
- Parties reached an agreement regarding the fair market value of two of the properties, and the district court held a jury trial to determine the fair market value of the third property.
- District court entered judgment in favor of Trust.
- Government appealed.

Charitable Deduction

- *Green v. U.S.*
- Parties generally disagreed on the allowable amount of the deduction stemming from donations.
- IRC Sec. 642(c)(1) imposes the following requirements for a donation to qualify as a charitable deduction:
  - taxpayer is an estate or trust;
  - during the taxable year at issue, or, alternatively, within the calendar year following the taxable year at issue, the taxpayer makes a qualifying charitable contribution under IRC Sec. 170(c); and
  - the charitable contribution must be authorized by the terms of the instrument that established the taxpayer, i.e., the estate or trust.

Charitable Deduction

- *Green v. U.S.*
- Central question: was the authorized amount of a deduction under § 642(c)(1)
- Answer rested on the statutory phrase "any amount of the gross income."
- Court found this phrase to be ambiguous.
- Court deferred to the regulations to interpret the ambiguous statute if the regulation is reasonable.
- Court found Treas. Reg. Sec. 1.642(c)-1 to be reasonable.

Charitable Deduction

- *Green v. U.S.*
- That construction effectively construes the statutory phrase "any amount of the gross income" to mean that charitable donations must be made out of a trust's gross income.
- IRS articulated an official position regarding the construction of IRC Sec. 642(c)(1) when it rejected the Trust's request for a refund.
- IRS asserted that the statutory phrase "any amount of the gross income" means that charitable donations must be made out of a trust's gross income, but that real property purchased with gross income can also be treated as the equivalent of gross income for purposes of the deduction outlined in IRC Sec. 642(c)(1).

Charitable Deduction

- *Green v. U.S.*
- Court: such an interpretation was the most reasonable one in light of the Code as a whole.
- Remaining open question: allowable amount of a deduction for donated real property that was purchased with a taxpayer's gross income.
- IRS had consistently asserted that the deduction amount is limited to the taxpayer's adjusted basis in the donated real property (i.e., the amount of gross income the taxpayer originally paid for the real property).
- Court: this was the most reasonable interpretation of the statutory language.

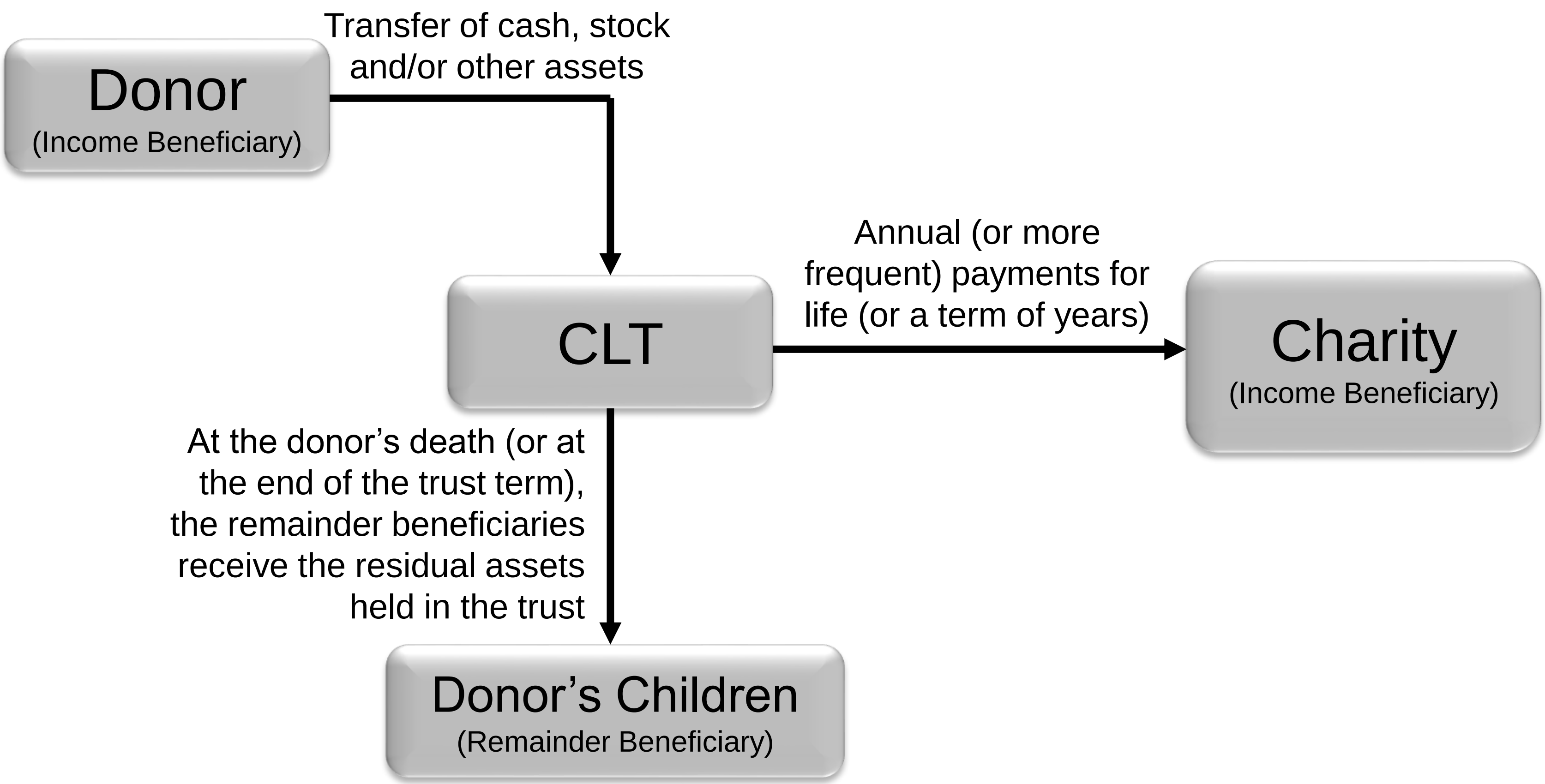
Charitable Deduction

- *Green v. U.S.*
- Court: agreed with the IRS that because the Trust never sold or exchanged the properties at issue, it never realized the gains associated with their increases in market value and was therefore never subject to being taxed on those gains.
- Court: construing IRC Sec. 642(c)(1)'s deduction to extend to unrealized gains would be inconsistent with the Code's general treatment of gross income.
- Court of Appeals rejected district court's interpretation of Sec. 642(c)(1) and concluded that the amount of the deduction is limited to the Trust's adjusted basis in the donated properties.
- Reversed judgment of district court and remanded with directions to enter summary judgment in favor of the government.

Charitable Lead Trust (CLT) Summary

- A Charitable Lead Trust is a split interest trust consisting of a lead income interest and a remainder interest
- During the term of the trust, the income interest is paid out to a named charity
- At the end of the trust term, the remainder (whatever is left in the trust) is paid to non-charitable beneficiaries (e.g., children of the donor) that have been designated in the trust document

Overview


Transfer of cash, stock and/or other assets
Donor
(Income Beneficiary)
Annual (or more frequent) payments for life (or a term of years)
CLT
Charity
(Income Beneficiary)
At the donor's death (or at the end of the trust term), the remainder beneficiaries receive the residual assets held in the trust
Donor's Children
(Remainder Beneficiary)

Other Considerations

- Charitable Remainder Trust (CRT)
  - Potentially useful structures in the current environment
    - 20-year or lifetime CRT
    - Three year CRT

Questions