otherwise risked becoming subject to the corporate AMT upon the receipt of policy proceeds. This approach could simplify a redemption of corporate stock at a shareholder’s death in lieu of each of the remaining shareholders maintaining separate policies and allow for better pricing on a single policy versus multiple policies that are separately owned.

Final Thought

The Act has presented numerous challenges to future tax planning for businesses, and accordingly, an understanding of the reform is important, together with consideration of the uncertainty that remains. Significant opportunities exist for effective tax planning, and with a thorough analysis of the provisions of the Act and the manners in which they interact, business owners, operators, and advisors can adapt effectively.

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Recent Developments

By the Trusts and Estates Team of Moore & Van Allen PLLC

Federal Statutes


Federal Cases

Estate and trusts funded from estate liable as transferees for corporate income tax unpaid after sham transaction.

In Billy F. Hawk, Jr., et al. v. Commissioner, T.C. Memo 2017-217 (Nov. 6, 2017), a decedent’s estate and surviving spouse were the successors-in-interest to the decedent’s bowling alley business, which was organized as a C corporation. After the decedent’s death, the estate and surviving spouse caused the corporation to sell its bowling alley-related assets, causing a $2.7 million gain. Then, in the same calendar year, the estate and surviving spouse participated in a sham transaction that purported to be a sale of the corporation’s stock to a third party buyer for cash, but the buyer essentially paid the purchase price to the shareholders with the corporation’s own money. The buyer paid a premium for the stock above the amount of the corporation’s net assets as reduced by the built-in capital gain, representing that it could offset the built-in capital gain with operating losses from other businesses the corporation would undertake after the stock sale and therefore cause the corporation to pay no capital gains tax. In reality, the corporation was essentially liquidated in favor of the shareholders and the buyer, and it subsequently existed as a shell for several years without ever paying any income tax. The Service issued a notice of deficiency, and finding the corporation insolvent, it proceeded against the estate, the two marital trusts funded from the estate, and the surviving spouse for the unpaid corporate income tax, including penalties and interest, under the transferee liability provisions of Code § 6901. The Tax Court upheld the Service’s assessment, except that it did not hold the transferees liable for interest on the unpaid tax that accrued before the Service’s notice of transferee liability. Critical to the Service’s ability to recover from the transferees was the determination that the “sale of stock” by the shareholders to the buyer could be recharacterized under applicable state fraudulent transfer law as a distribution from the corporation to the shareholders.

Loss-related income tax deduction denied, penalty imposed, in transaction lacking economic substance.

In Robert E. Smith, III, et ux. v. Commissioner, T.C. Memo 2017-218 (Nov. 6, 2017), two taxpayers contributed personal assets to an S corporation in exchange for stock. The S corporation then contributed the assets to a limited partnership, which was controlled by the taxpayers, in exchange for a limited partnership interest. Later that same year, the S corporation dissolved and distributed the limited partnership interest to the taxpayers. The taxpayers then claimed a loss-related income tax deduction based on the value of the distributed limited partnership interest, which the taxpayers claimed was discounted for lack of control and marketability, being less than the value of the assets the taxpayers contributed to the S corporation. The Service applied the economic substance doctrine to deny the loss deduction and assessed an accuracy-related penalty for the underpayment of tax. The Tax Court upheld the Service’s position, finding that the S corporation had no genuine business purpose and was organized solely for tax avoidance and that the taxpayers did not act in good faith or in reasonable reliance on the advice of a tax professional.

Conservation easement deduction denied when mortgage lender’s rights were not subordinated to rights of charitable grantee.

In Palmolive Building Investors, et al. v. Commissioner, 149 T.C. No. 18 (Oct. 10, 2017), the Tax Court denied an income tax deduction for the grant of a façade conservation easement because the conserved property was also subject to a mortgage; the mortgage lender retained rights to any proceeds of the conserved property (up to the then outstanding amount of its loan) that followed any judicial extinguishment of the conservation easement, which extinguishment could occur if the property containing the façade were destroyed and insurance proceeds claimed with respect thereto; and the mortgage lender’s rights to such proceeds were superior to those of the charitable recipient of the conservation easement. Regulation § 1.170A-14(g) requires the charitable recipient of a conservation easement to be entitled to a ratable portion of any proceeds from the conserved property following the judicial extinguishment of the conservation easement and forbids any mortgage lender from having superior rights to the charitable recipient in the conserved property. The court denied the taxpayer’s argument that the circumstance of the destruction of the conserved property was so remote...
as to be negligible and therefore disregardable under Regulations § 1.170A-14(g)(3). The deed included a savings clause intended to ensure compliance with the conservation easement regulations, but because any deemed amendment of the deed pursuant to the savings clause required the mortgage lender's consent if the mortgage lender's rights would be adversely affected, the court ruled that the savings clause was ineffective. The court also rejected the taxpayer's argument that the restriction on subordinating a charitable recipient's rights is per se unenforceable if interpreted strictly because a hypothetical tax lien on the property would always be superior to the interests of a charitable recipient, distinguishing hypothetical tax liens from security interests existing at the time of the donation of a conservation easement.

Conservation easement deduction denied when property could be transferred to a non-qualified organization.

In Salt Point Timber, LLC, et al. v. Commissioner, TC Memo 2017-245 (Dec. 11, 2017), the Tax Court denied an income tax deduction for the grant of a conservation easement when the property subject to the easement could be transferred to someone other than a “qualified organization” for purposes of Code § 170(h). Although the property subject to the easement could only be transferred if the transferred property would be subject to a “comparable conservation easement,” the Tax Court found that (i) “comparable” was meant to refer to the terms of the easement, not the holder of the easement, and (ii) applicable state law’s definition of the holder of a conservation easement was not limited to qualified organizations for federal income tax purposes. The court also found that the possibility of a transfer in violation of the regulations was not so remote as to be negligible and therefore could not be disregarded under Regulations § 1.170A-14(g)(3).

Federal Administrative Developments

Service yet to confirm revised inflation adjustments for 2018 as based on new tax law.

The Service originally released inflation adjustments for 2018 on Oct. 19, 2017 in Rev. Proc. 2017-58, which included increasing the estate and gift tax basic exclusion amount and GST exemption amount to $5.6 million and increasing the annual gift tax exclusion amount to $15,000. However, Public Law 115-97, enacted on Dec. 22, 2017, changed the method by which such inflation adjustments are calculated, in addition to changing the base amount to which the basic exclusion amount adjustments are applied from $5 million to $10 million. Calculations based on the methodology prescribed by the new law indicate a 2018 estate and gift tax basic exclusion amount and GST exemption amount of $11.18 million and an annual gift tax exclusion amount of $15,000, but as of Jan. 31, 2018, the Service had yet to officially confirm those amounts.

Service issues preliminary guidance with respect to certain uses of donor advised funds.

In Notice 2017-73 (Dec. 4, 2017), the Service announced that it is considering proposing regulations regarding donor advised funds to the following effects: (i) a distribution from a donor advised fund to a distributee organization that permits the donor or a related person to attend an event organized by the distributee organization results in a prohibited benefit to the donor under Code Section 4967, even if the donor individually contributes the portion of the event admission price that is considered non-deductible for individual income tax purposes; (ii) a distribution from a donor advised fund to a distributee organization to which the donor has made a charitable pledge is not a prohibited benefit to the donor under Code Section 4967, even if the distributee organization considers the donor advised fund distribution as fulfilling the charitable pledge, and regardless of whether the pledge is legally enforceable under state law, so long as the organization administering the donor advised fund makes no reference to the donor’s pledge in making the distribution; and (iii) for purposes of determining whether an organization receiving a distribution from a donor advised fund is publicly supported, the distribution is deemed to have been made by the donor, and not the organization administering the donor advised fund. The Service further requested public comments regarding the tax treatment of donor advised funds, including but not limited to comments regarding (a) the proposed rules discussed above, (b) coordination between private foundations and donor advised funds, (c) whether a distribution from a private foundation to a donor advised fund should be deemed a qualifying distribution for the private foundation’s minimum distribution requirements under Code Section 4942 if the distributed funds are not subsequently distributed from the donor advised fund for charitable purposes within a certain time frame, and (d) how donor advised funds with multiple donors might be treated for purposes of the proposed rule deeming distributions from donor advised funds to be made from the donors thereof for purposes of determining the public support of the distributee organization. The deadline for comments is March 5, 2018.

Service denies income tax charitable deduction for trust income appointed to charities under power of appointment added by state court trust modification.

In CCM 201747005 (Nov. 24, 2017), a state court, but not the highest court in the state, approved a petition to modify an irrevocable trust to give a trust beneficiary the inter vivos power to appoint trust income to two charities. The modification was apparently pursued under a state statute equivalent or similar to Uniform Trust Code Section 416, Modification to Achieve Settlor’s Tax Objectives (which is enacted in North Carolina as N.C.G.S. § 36C-4-416). The beneficiary in fact exercised the power of appointment to appoint trust income to the charities, and the trust deducted the appointed amounts from the trust’s gross income pursuant to Code Section 642(c)(1). Though trust income transferred to charities via the exercise of powers of appointment is typically deductible under Code Section 642(c)(1), the Service ruled in this case that the deduction was disallowed because the Service did not respect the court modification of the trust, and therefore, in the Service’s eyes, the distributions to the charities were not made pursuant to the governing instrument of the trust, as Code Section 642(c)(1) requires. The Service explicitly stated that it believed the purpose of the modification was to avoid taxes and disregarded that the state court found that the modification was made “in order to achieve the settlor’s tax objectives” and was neither “inconsistent with a material purpose of the trust” nor “contrary to the settlor’s probable intention.” The Service relied on Comm’r v. Bosch, 387 U.S. 456 (1967) for the premise that it was not bound by the court modification because the approving court was not the highest court in the state. The Service further denied an income deduction for the trust under Code Section 661 (which describes distributable net income), ruling that distributions to charities are not eligible for
the Code Section 661 deduction and are only eligible for the Code Section 642(c) deduction, despite the Code and Regulations being ambiguous with respect to the matter of whether a distribution to a charity that is deemed ineligible for the Code Section 642(c) deduction may then be deducted under Code Section 661.

Deathbed purchases of GRAT remainder interests by grantor for promissory notes were ineffective to reduce grantor’s taxable estate by note amounts.

In CCM 201745012 (Nov. 9, 2017), the grantor of two grantor retained annuity trusts (the “GRATs”) purchased the remainder interests in the GRATs from a trust for the benefit of his descendants in exchange for promissory notes, and then the grantor died the next day. For estate tax purposes, the grantor’s executor included the entire amount of the GRAT assets in the grantor’s gross estate and deducted the amount of the promissory notes as claims against the estate. However, the Service determined that the GRAT remainder interests received by the grantor pursuant to the sales did not constitute “adequate and full consideration in money or money’s worth” for the promissory notes because the entire GRAT assets would have been included in the grantor’s gross estate upon his death anyway, and consideration that is “adequate and full” for estate tax purposes must augment the grantor’s gross estate. The deathbed timing of the sales was critical to the Service’s finding.

Service approves non-grantor incomplete gift trusts.

In PLR 201742006 (Oct. 20, 2017), PLR 201744006 (Nov. 3, 2017), PLR 201744007 (Nov. 3, 2017), PLR 201751001 (Dec. 22, 2017), PLR 201751002 (Dec. 22, 2017), and PLR 201751003 (Dec. 22, 2017), the Service approved a series of requests that trusts not be deemed grantor trusts for income tax purposes and that transfers to the trusts not be deemed to be completed gifts for gift tax purposes. Under each trust, (i) the grantor remained a beneficiary, but distributions to the grantor were subject to the approval of other trust beneficiaries, so the trust was not a grantor trust under Code Section 676; (ii) the grantor retained an inter vivos power to appoint the trust property among trust beneficiaries other than the grantor, but because the power was only exercisable for purposes of health, maintenance, support, and education, the trust was not a grantor trust under Code Section 674; (iii) the grantor retained a broad testamentary limited power of appointment over the trust assets, which along with the grantor’s inter vivos power of appointment caused the grantor’s transfers to the trust to be incomplete gifts because the grantor’s powers to reallocate the trust assets were held in a non-fiduciary capacity; and (iv) the power to direct distributions held by the beneficiaries other than the grantor was not a general power of appointment, the exercise of which would have been a gift by such beneficiaries, because no beneficiary could make a distribution to himself or herself without the approval of another beneficiary with an adverse interest. Each trust was most likely intended to redomesticate the grantor’s assets in a state with income tax laws that were more favorable than those of the grantor’s domicile while still allowing the grantor to benefit from the assets during the grantor’s lifetime, the grantor to direct the passage of the assets at the grantor’s death, and the basis of the assets to be stepped up at the grantor’s death.

Distribution and repayment agreement between trustees and remainder beneficiary of charitable remainder trust caused neither self-dealing nor a taxable expenditure.

In PLR 201745001 (Nov. 9, 2017), the Service found that an agreement between the trustees and the sole remainder beneficiary of a charitable remainder trust under which the trustees would accelerate distributions to the remainder beneficiary after the termination of the trust’s non-charitable annuity term but before the administration of the trust was complete so long as the remainder beneficiary returned any funds needed by the trustees to pay future liabilities of the trust and indemnified the trustees did not result in self-dealing or an impermissible taxable expenditure by the remainder beneficiary, which was classified as a private foundation. Although the grantor of the trust was a disqualified person with respect to the remainder beneficiary, because the trustees were not disqualified persons with respect to the remainder beneficiary, the agreement was not self-dealing. In addition, because the remainder beneficiary would not have received any funds used to pay future liabilities if the trustees had retained the trust’s assets until final administration was complete, the repayment of funds to the trustees to pay such liabilities would not be a taxable expenditure by the remainder beneficiary.

Dividends were constructively received by controlling shareholder of C corporations when declared and recorded on corporations’ books.

In PLR 201741012 (Oct. 13, 2017), a shareholder wholly owned one C corporation and was the controlling majority shareholder of another. The corporations declared dividends to the shareholder in three successive years, but not all of the declared dividends were actually paid to the shareholder in the year of declaration. The Service ruled that for income tax purposes, the dividends were effective when declared.

Tax-exempt trust’s income from partnerships was subject to unrelated business income tax.

In Technical Advice Memorandum 201741019 (Oct. 13, 2017), the Service found that because a tax-exempt trust’s ownership of partnership interests and debt-financed property were not substantially related to the trust’s tax-exempt purpose, the trust was subject to unrelated business income tax with respect to those assets. The nature of the assets and the trust’s argument regarding their relationship to the trust’s tax-exempt purpose were redacted from the memorandum.

“No rule list” updated.

In Revenue Procedure 2018-3 (Dec. 29, 2017), the Service declared that it would not issue private letter rulings regarding whether a joint venture between a tax-exempt organization and a for-profit organization furthers an exempt purpose of the tax-exempt organization. In addition, the Service announced it will no longer issue private letter rulings regarding the grant of an extension to file a portability election under Section 2010(c)(5)(A) of the Code and instead refers taxpayers to the procedure set forth in Revenue Procedure 2017-34.

Procedures for domestic rulings and determination letters updated.

In Revenue Procedure 2018-1 (Dec. 29, 2017), the Service clarified that it retains the ability to revoke rulings relating to issues that have been subsequently added to the “no rule list.” The Service also announced that all user fees for rulings and determination letters must now be submitted via www.pay.gov, and it provided several clarifications regarding the calculation and refunding of such user fees under certain circumstances.
Procedures for rulings and determination letters regarding charities updated.

In Revenue Procedure 2018-5 (Dec. 29, 2017), the Service announced that organizations seeking reinstatement of tax-exempt status after a revocation thereof must file Form 1023, and not Form 1023-EZ, if they are seeking a different foundation classification than they had before. The Service further provided that the Form 1023 application fee will now be $600 regardless of the annual receipts of the applying organization. Previously, organizations averaging not more than $10,000 in annual receipts paid an application fee of $400, while other organizations paid $850. The group exemption application fee was also reduced from $3,000 to $2,000.

Proposed Section 2704 regulations withdrawn.

In Notice of Proposed Rulemaking, Federal Register, Volume 82, Number 202B, Page 48779 (Oct. 20, 2017), the Service formally withdrew the proposed regulations under Code Section 2704 regarding the treatment of lapses of liquidation rights in and the valuation of family-controlled entities for estate, gift and generation-skipping transfer tax purposes.

North Carolina Cases

Premarital agreement provision made separate property of one spouse retain its character despite improvement of property using marital funds during marriage.

In Hankins v. Hankins (17-186) (Jan. 2, 2018), a husband had owned two parcels of real property prior to his marriage to his wife, but the properties were improved using marital property funds during the marriage. When the husband and wife divorced, the trial court determined in their equitable distribution proceeding that the properties were partially the husband's separate property and partially marital property. However, the North Carolina Court of Appeals reversed, ruling that the properties were entirely the husband's separate property because the couple's premarital agreement provided that each spouse would retain all property belonging to that spouse prior to the marriage, including "all interest, profits and rents which may in time accrue, or result in any manner from increase in value, or be collected for use of the same in any way."

Contract to make wills not found in absence of specific contractual language in wills.

In Moore v. McKenzie, 805 S.E. 2d 536 (N.C. Ct. App. 2017), a husband and wife made concurrent reciprocal wills, each of which left the decedent's property to the surviving spouse as between them, or if none, to the wife's son (who was the husband's stepson). After the wife died, leaving all of her property to the husband, the husband revoked his prior will and made a new will leaving all of his property to his stepdaughter, whom he also named as executor. After the husband's death, the stepson claimed that the husband breached a contract with his deceased wife to make wills in favor of the stepson. After the trial court granted summary judgment against the stepson, the North Carolina Court of Appeals affirmed, finding that because no contractual language appeared in the earlier wills, neither the husband nor the wife were bound to retain the terms of those wills, and the husband was free to execute a subsequent will.

Other State Cases

Summary judgment denied to online service provider regarding prohibition of release of digital assets.

In Ajemian v. Yahoo!, Inc., 478 Mass. 169 (Oct. 16, 2017), after a decedent died intestate, Yahoo! refused to permit the decedent's personal representatives to access the decedent's Yahoo! e-mail account, asserting that (i) the federal Stored Communications Act (SCA) prohibited Yahoo! from providing such access, and (ii) alternatively, Yahoo!'s terms of service provide it with the discretion to refuse to provide such access. The personal representatives sued, and the Supreme Judicial Court of Massachusetts denied Yahoo!'s claim for summary judgment, finding that (i) Yahoo! was not prohibited under the SCA from disclosing stored electronic communications to an intestate decedent's personal representative, and (ii) there existed an issue of material fact as to whether Yahoo!'s terms of service constituted a valid contract between the decedent and Yahoo! The court found that, although the decedent's personal representatives did not constitute the decedent's agents for purposes of the SCA because they were appointed by state probate court rather than by the decedent himself, they, as personal representatives, were able to lawfully consent to the disclosure of the decedent's electronic communications as required by the SCA. Therefore, Yahoo! was not prohibited from disclosing such communications. In addition, the Court found that, assuming Yahoo!'s terms of service agreement allowed Yahoo! to withhold such communications, Yahoo! had failed to provide enough evidence to the court that a meeting of the minds had occurred between Yahoo! and the decedent with respect to the terms of service, and the court remanded the matter of whether a valid contract existed. Unlike North Carolina, Massachusetts has not adopted the Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA). However, similar findings would likely be reached with respect to a North Carolina decedent who died intestate. Under North Carolina's version of RUFADAA, the content of electronic communications is not required to be released by a service provider unless the decedent specifically authorizes such disclosure, which is unlikely in the case of an intestate decedent. Otherwise, a valid terms of service agreement governs.

Decedent's online contacts and calendar information, but not e-mail communications, were required to be disclosed to decedent's personal representative.

In Matter of Serrano, 54 N.Y.S. 3d 564 (June 14, 2017), the Surrogate's Court of New York for New York County, following New York statutes, required Google to release a decedent's contacts and calendar information to the personal representative of the decedent's estate because such information constituted a catalogue of electronic communications (and not electronic communications themselves), whereas the content of the decedent's e-mails, as electronic communications, were not required to be released by a service provider unless the decedent specifically authorizes such disclosure, which is unlikely in the case of an intestate decedent. Otherwise, a valid terms of service agreement governs.

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