Recent Developments

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

Federal Administrative Developments

Centralized audit regime in effect for partnerships; final and proposed regulations issued.

For tax years beginning after Dec. 31, 2017, the new centralized audit regime (Sections 6221-6241 of the Code) will apply to all partnerships. Under the new regime, any adjustments made to a partnership’s tax return during an audit will be implemented at the partnership level, rather than resulting in adjustments to each partner’s individual tax return, as was the case under the prior TEFRA regime. Certain partnerships are eligible to elect out of the new regime if such election is made on the partnership’s tax return and the partnership satisfies certain ownership requirements. If the partnership makes a valid election out, any future audit will be conducted pursuant to the prior TEFRA regime. An election out is available to partnerships that are required to issue fewer than 100 statements under Section 6031(b) and of which all partners are individuals, domestic or foreign C corporations, S corporations, or estates of a partner (“eligible partners”). Partnerships that do not elect out of the new regime may request modifications to an imputed underpayment in certain situations, including if a partner files an amended return or the partnership had a tax-exempt partner during the reviewed year. The new regime requires the appointment of a partnership representative, who will be the sole point of contact for the Internal Revenue Service in the event of an audit. In the event of an audit, for the Service’s purposes, the partnership representative has the sole authority to represent and bind the partnership during the course of the audit. For example, the partnership representative alone may accept or reject any adjustments made by the Service, may settle with the Service, and may decide who bears the cost of the tax by either requiring the partnership, as it exists in the year of audit, to pay any deficiency or by requiring the partners of the reviewed year to pay such deficiency by making a push-out election (Section 6226). Once a partnership representative has been designated for a particular tax year on that year’s tax return, the partnership representative for the year may not be changed unless an amended tax return is filed, which may not be filed for the sole purpose of changing the partnership representative, or until an audit has commenced. Although not binding on the Service, advisors will want to ensure that the governing documents of clients’ partnerships or limited liability companies are updated to take into account new considerations raised by the new regime, including the liability of the partnership representative in binding the partnership and its partners in audits, the duties owed by the partnership representative in an audit and the extent to which the partnership representative must consult with audit-year partners and reviewed-year partners before entering into an agreement with the Service or making an election regarding the payment of any deficiency, the ability to change the partnership representative in the event a reviewed-year partnership representative is no longer affiliated with the partnership at the time of audit, the duties owed by such a lame duck partnership representative until the appointment of a new partnership representative is recognized by the Service, and the duties owed by partners to the partnership representative regarding the request of information necessary to make certain elections and modifications allowed under the new regime.

In Treasury Decision 9829, 83 Fed. Reg. 24 (Jan. 2, 2018), the Service issued final regulations regarding a partnership’s election out of the new regime under Section 6221(b) of the Code incorporating comments received after the proposed regulations were released on June 14, 2017. Most notably, the Service rejected comments that would have expanded the definition of eligible partners to trusts and disregarded entities. In addition, the Service rejected comments that would have calculated the number of eligible partners based on the number of individual tax returns filed by such partners, rather than the number of statements required to be issued by the partnership to its partners. Rejection of this comment results in spouses who each own interests in a partnership being treated as separate partners even though they may file a single tax return.

In REG-118067-17, 83 Fed. Reg. 4868 (Feb. 2, 2018), the Service issued proposed regulations regarding all aspects of the new regime. The period for comments ended on May 3, 2018. Comments were requested for issues relating to the adjustment of partners’ inside and outside bases to reflect the partnership’s payment of a tax deficiency in order to avoid double taxation, the treatment of special allocations, and the effect on the owners of a pass-through partner of such pass-through partner’s payment of an imputed underpayment in the event the partnership makes a push-out election.

Service confirms annual gift tax exclusion and basic exclusion amount.

Applying its Chained Consumer Price Index for All Urban Consumers (“C-CPI-U”) adjustments, the Service confirmed on its website that the annual gift tax exclusion for 2018 remains $15,000, as initially provided in Rev. Proc. 2017-58 (Oct. 19, 2017), and in Rev. Proc. 2018-18 (March 2, 2018) confirmed that the basic exclusion amount for 2018 is $11,180,000.

Service issues guidance indicating intent to issue regulations regarding three-year holding period limitation for certain profits interests.

In Notice 2018-18 (March 1, 2018), the Service announced that regulations will be issued to clarify that a “corporation,” for purposes of applying the new three-year long-term capital gain holding period limitation for “applicable partnership interests” under Section 1061, includes only C corporations. While commentators have expressed the view that Section 1061(c)(4)(A), under which an applicable partnership interest does not include “any interest in a partnership directly or indirectly held by a corporation,” would apply to partnership interests owned by both C corporations and S corporations, the forthcoming regulations, notwithstanding the plain meaning of the statute, will attempt to limit the application of that exclusion only to
C corporations, subject to two levels of tax, and not S corporations, taxed on a flow-through basis. Absent a legislative revision to the statute, it is likely that the enforcement of the new regulations will be subject to challenge.

**Service to end voluntary disclosure program for offshore assets.**

In **IR-2018-52** (March 13, 2018), the Service announced that the 2014 Offshore Voluntary Disclosure Program, allowing taxpayers to resolve non-compliance with reporting foreign financial assets and filing informational returns, is beginning to be phased out and will conclude on Sept. 28, 2018.

**Tax practitioners required to provide personal information when calling Service hotline and to disclose use of Intermediate Service Providers in Form 2848 and Form 8821.**

The Service has instituted a policy to require certain personal information, such as a Social Security number and date of birth, to be provided by tax practitioners in addition to the practitioner's Centralized Authorization File (CAF) number when calling the Service's Practitioner Priority Service support line or any toll-free Service telephone number in order to verify the identity of the caller. In addition, revisions have been made to Form 2848 and Form 8821 to require a client's consent to a third-party Intermediate Service Provider accessing records via a Transcript Delivery System.

**Treasury and Service's Priority Guidance Plan updated.**

The second quarter update to the 2017-2018 Priority Guidance Plan issued by Treasury and the Service on Feb. 7, 2018 detailed certain projects intended to be undertaken through June 30, 2018, including the following:

- Guidance on certain items related to tax reform, including the new business interest expense limitation under Section 163(j), pass-through business deduction under Section 199A, changes affecting electing small business trusts (ESBTS), and the computation of estate and gift taxes based on changes to the basic exclusion amount;
- Regulations for basis consistency requirements under Sections 1014(f) and 6035;
- Regulations for extensions of time to allocate GST exemption under Section 2642(g);
- Guidance on the basis of assets owned by a grantor trust at death under Section 1014;
- Restrictions on estate assets during the six-month alternate valuation period under Section 2032(a);
- Personal guarantees and present value determinations as expenses and claims against an estate under Section 2053.

**Allocations of gift tax exemption by taxpayer and spouse were finally determined as reflected on gift tax returns, but taxpayer's allocation of GST exemption was subject to split gift limitations.**

In **PLRs 201811002 and 201811003** (March 16, 2018), the Service ruled on allocations of gift and GST tax exemptions for gifts to trusts for the taxpayer's children where the taxpayer and his spouse consented to split gifts but actually allocated the taxpayer's gift tax exemption to three-quarters of the transfers and his spouse's gift tax exemption to the remaining one-quarter on their initial gift tax returns. In a later year, the taxpayer decided to allocate his GST tax exemption to the transfer and filed a gift tax return allocating a portion of his GST exemption (and none of his spouse's GST exemption) to the transferred property in an amount intended to provide that the trust property would have an inclusion ratio of zero valued as of the date of allocation. The statute of limitations subsequently expired for both sets of allocations. The Service ruled that the disproportionate allocations of gift tax exemption were effective as being finally determined for federal gift tax purposes under Section 2504(c) but that, pursuant to Regulations § 26.2652-1(a)(4), the taxpayer could only be deemed the transferor of one-half of the property initially transferred to the trusts for GST tax purposes and, therefore, could only allocate his GST tax exemption to one-half of the transferred property. The estate of taxpayer's spouse, who died in the interim, was given 120 days to make a late allocation of her GST exemption to the remaining amount of the trust property.

**Reformation of trust to reflect grantor trust status was valid.**

In **PLR 201807001** (Feb. 16, 2018), shortly after a 1996 modification of Section 672(f) that made grantor trust status applicable to a trust with a foreign grantor only if no one but the grantor and the grantor's spouse could receive distributions from the trust during the grantor's lifetime, an attorney drafted a trust for a foreign grantor that both the attorney and grantor intended to be a grantor trust but that permitted distributions to the grantor's descendants during the grantor's lifetime. The grantor reported the trust's income on his individual income tax return in each year after the formation of the trust. When the grantor was later informed that the trust did not qualify as a grantor trust under Section 672(f) because the grantor's descendants were beneficiaries during the grantor's lifetime, the grantor sought reformation of the terms of the trust to remove the grantor's descendants as beneficiaries during the grantor's lifetime. At no time during the administration of the trust were distributions made to the grantor's descendants. A state court found by clear and convincing evidence that the inclusion of the grantor's descendants as beneficiaries was a mistake of law and of fact and thus reformed the trust to provide that the trust had been a grantor trust since formation. The Service concluded that the state court applied the law in the same manner as the highest court of the applicable state would have and respected the reformed terms of the trust, treating the trust as a grantor trust since its formation.

**Proposed disclaimers and trust modification would not result in taxable gifts or subject trust to GST tax.**

In **PLR 201803003** (Jan. 22, 2018), a married couple had created a trust for their daughter prior to 1942. The daughter had an income interest during the trust during her lifetime, and the trust provided that when the daughter died, her heirs would succeed to her interest in the trust. The trust was designated to terminate 21 years after the daughter's death. Prior to the PLR request, a state court confirmed that (i) upon the daughter's death, each heir of the daughter would become the beneficiary of a separate trust created from the trust assets, (ii) because the daughter could control who her heirs were, she had a testamentary general power of appointment with respect to the trust assets, and (iii) any beneficiary who might succeed to
the daughter’s interests in the trust could disclaim those interests, which would include, with respect to a given successor beneficiary and such beneficiary share of the trust assets, an income interest, a future interest in the trust principal that would vest upon the trust’s termination if the successor beneficiary were then living, and a testamentary general power of appointment with respect to the trust assets by virtue of the successor beneficiary’s interests passing to the successor beneficiary’s heirs upon the successor beneficiary’s death. The disclaimers would need to be made within nine months of the daughter’s death, which is when the interests would be deemed to be created. Some of the daughter’s descendants executed prospective disclaimers of their interests in the trust, and others represented that they intended to disclaim their interests after the daughter’s death. Instant to the PLR, the tax beneficiaries petitioned a state court to modify the trust to provide that (i) if any trust property would become distributable outright to a beneficiary under a certain age upon the termination of the trust, that trust property would vest in such beneficiary for transfer tax purposes but would be retained in trust for such beneficiary’s benefit, (ii) if at any point more than one trust would otherwise exist under the trust instrument for the same beneficiary, such trusts would be consolidated, and (iii) if any descendant of the daughter disclaims his or her interests in the trust and has another child after the daughter’s death and before the termination of the trust, a separate trust for such child’s benefit would be created from the assets of the separate trusts created for other beneficiaries pursuant to the daughter’s death. The beneficiaries requested, and the Service granted, rulings that (i) any testamentary general powers of appointment over separate trusts established for the daughter’s descendants pursuant to the daughter’s death would be considered pre-1942 general powers of appointment, the lapse of which would not result in the inclusion of the assets subject to the power in the power holder’s estate pursuant to Section 2041(a) (1), (ii) the contemplated disclaimers of interests in the trust by the daughter’s descendants would be qualified disclaimers under Section 2518, and (iii) the modifications proposed by the instant state court petition would not represent a taxable gift by any person and would not cause the trust to be subject to generation-skipping transfer tax.

Tax consultant liable for penalties when knowingly providing advice causing understatement of tax.

In Chief Counsel Advice 201805001 (Feb. 2, 2018), when a tax consultant advised a client that property properly depreciable over 39 years was instead depreciable over 5 years, and the tax consultant knew that such position would result in an understatement of tax, the tax consultant was liable for a separate $1,000 penalty under Section 6701 for each of the 5 income tax returns filed by the client during the purported 5-year depreciation period that understated tax due to excessive depreciation deductions.

American Institute for Certified Public Accountants (AICPA) requests clarification on new pass-through deduction.

On Feb. 21, 2018, the AICPA issued a letter to the Treasury and the Service requesting clarification and guidance on a number of issues related to the new 20% deduction for qualified business income (QBI) generated by pass-through businesses, including the following:

- Clarification that a “qualified trade or business” does not need to be housed in a separate legal entity from a nonqualified business to be eligible for its QBI to be deductible and that business activities may be aggregated or separated within or among legal entities (including through employee leasing companies) as necessary to determine the appropriate deduction.
- Guidance on defining a specified service business “where the principal asset . . . is the reputation or skill or one or more of its employees or owners.”
- Request for a “gross receipts safe harbor” to deem all income of a business to be QBI if only 5% or less of its gross receipts do not qualify as QBI.
- Clarification that active participation in a business is not necessary for a business owner to be eligible for a deduction.
- Guidance on whether rental real estate activities qualify as a “trade or business” eligible to generate QBI.
- Clarification on the scope of activities that make up a “specified service trade or business.”
- Calculating a deduction for a business with a fiscal year ending in 2018.
- The availability of a deduction for an Electing Small Business Trust.

AICPA requests miscellaneous technical corrections.

On Feb. 22, 2018, the AICPA issued a letter request to the Senate Committee on Finance and the House Ways and Means Committee for the following technical corrections related to tax reform:

- Clarification that the terms now applicable to net operating loss (NOL) carryforwards and carrybacks be applicable for taxable years beginning after December 31, 2017, for consistency with the new treatment of NOL deductions.
- Revising the terms of the increased charitable deduction limitation for cash contributions of up to 60% of adjusted gross income to accommodate transfers that also include a portion of non-cash assets in addition to cash.

Federal Cases

Regulations expanding definition of “fiduciary” as applied to retirement account service providers overturned.

In Chamber of Commerce of the United States v. U.S. Department of Labor, 2017 WL 1284187 (5th Cir. April 5, 2017), a split panel of Fifth Circuit judges reversed the District Court and overturned regulations promulgated by the Department of Labor under the Obama administration in 2016 that expanded the definition of “investment advice fiduciary” for purposes of Employee Retirement Income Security Act (ERISA) employee benefit plans and individual retirement plans. The new regulations removed requirements from the old regulations that to be a fiduciary to a particular client, a financial professional must offer advice to the client “on a regular basis” and that such advice must serve as the “primary basis for investment decisions” by the client. Under the new regulations, a single instance of advice from a financial professional would be considered advice made as a fiduciary if it constitutes a recommendation un-
derstood to be made based on the needs of the client. If a financial professional is considered a fiduciary under the regulations, the financial professional is subject to certain conflict-of-interest rules under the Code and regulations that limit the financial professional's ability to receive compensation from third parties for transactions the financial professional recommends to an investor. The majority, consisting of two Republican appointees, determined that the regulations exceeded the Department of Labor's statutory authority and further were arbitrary and capricious. In addition to finding that the new regulations impermissibly expanded the definition of "fiduciary" beyond the common law understanding that required a special relationship of trust and confidence, that the Department of Labor should not be addressing the issue of oversight of retirement plan service providers because the Dodd-Frank Act authorizes the Securities Exchange Commission to do the same, and that the regulations were unreasonable on several other grounds, the majority complained that the regulations were onerous to financial service providers, upset existing industry standards, and created costs of compliance. The dissent, written by a Democratic appointee, held that the regulations were within the Department of Labor's statutory authority based on the plain meaning of the statute and, not finding the regulations to be arbitrary or capricious, deferred under United States Supreme Court precedent to the Department of Labor's judgment. The dissent noted that the Department of Labor's stated intent in promulgating the new regulations was to respond to the significant increase in the number of individual investor-directed retirement accounts since the original regulations were promulgated in 1975 and to protect such unsophisticated individual investors from investment recommendations that may appear to be made in the best interests of the investor but might rather be made in the best interests of the financial professional due to commissions received by the financial professional from a third party as a result of the recommended transaction. The Department of Justice, acting on behalf of the Department of Labor (now under the Trump administration), did not appeal the Fifth Circuit panel's ruling by the April 30, 2018 deadline. Before the deadline, the AARP and the attorney generals of California, New York, and Oregon petitioned to intervene as defendants and to request an en banc hearing before the entire Fifth Circuit (the majority of which also consists of Republican appointees), but the Fifth Circuit denied those petitions. The Department of Labor, under the Trump administration, had already delayed the applicability of the rules until July 1, 2019.

Slayer statute denies wife who murdered husband benefit from husband's pension despite no ERISA provision that would revoke wife's benefit.

In Laborers’ Pension Fund v. Miscevic, 880 F.3d 927 (7th Cir. Jan. 29, 2018), a wife killed her husband and then claimed a "surviving spouse benefit" under the husband's pension plan. The estate of the couple's minor child argued that the Illinois slayer statute barred the wife's access to the surviving spouse benefit, meaning that the minor child was instead entitled to a benefit under the pension plan. The wife argued that the failure of ERISA to include any slayer provision overrode the Illinois slayer statute because ERISA provides that it "shall supersede any and all State laws [that] related to any employee benefit plan." The United States Supreme Court had previously ruled that a Washington statute deeming beneficiary designations made in favor of a spouse to be revoked in the event of divorce was in fact preempted by ERISA, which has no similar provision (meaning that the surviving divorced spouse was still entitled to benefit from the deceased divorced spouse's retirement plan because the beneficiary designation had not been changed), but the Supreme Court noted in dicta to that case that it did not believe ERISA should preempt slayer statutes. The Seventh Circuit followed that dicta in this case, finding that the slayer statute was not sufficiently "related to" ERISA so as to be preempted and that such finding did not upset the interests of ERISA plans being administered uniformly nationwide because of the general consistency of slayer statutes across the 50 states. Several other federal courts have also ruled that ERISA does not preempt state slayer statutes, but state courts in Oregon and Ohio have ruled the opposite.

New York State's requirement that nonprofit entities disclose donor lists upheld.

In Citizens United v. Schneiderman, 882 F.3d 374 (2nd Cir. Feb. 15, 2018), the Second Circuit upheld a district court's ruling that a New York state law requiring nonprofits to disclose their lists of donors to the New York Attorney General in the same manner that such information is required to be disclosed to the Service did not violate the First Amendment's freedom of speech, the Fourteenth Amendment's Due Process Clause, or the New York State constitution. Because such information must separately be provided to the Service on Schedule B of Form 990, such form could be submitted to satisfy New York's requirements, and such information must remain confidential in the hands of the Attorney General, the court found that a donor list disclosure requirement did not create a climate of fear chilling donors' speech, nor did it operate as a prior restraint on nonprofits' solicitation. In addition, the court found that, although the Attorney General had not widely enforced the statute against nonprofits, the Attorney General's decision to enforce the law as provided in the statute was not a violation of due process. Further, the court found that the law was not preempted by federal statute as the state law did not require the Service to violate federal law regarding the confidentiality of donor lists because the state law requested in information directly from donors. Finally, the court found that requiring 501(c)(4) organizations to file donor lists was permissible within the terms of the statute.

Amount of charitable deduction limited to trust's adjusted basis in donated property.

In Green v. U.S., 880 F.3d 519 (10th Cir. Jan. 12, 2018), the Tenth Circuit held that a trust's charitable contribution of real property originally purchased by the trust from the trust's gross income was eligible for a charitable deduction under Section 642(c) of the Code in the amount of the trust's adjusted basis in the property, rather than the current fair market value of the property. The Court found that, unlike charitable deductions available to individuals and corporations under Section 170 of the Code, trusts receive a charitable deduction only for amounts of a trust's gross income contributed. Both the trust and the Service agreed that Section 642(c) should not be read to limit deductions to contributions of gross income from the current year or property actually received as gross income at some time, but, instead, should be read more broadly to allow contributions from property traceable to current or accumulated income of the trust. Because the real property at issue was purchased with
the trust’s gross income, both the trust and the Service agreed that a charitable deduction is appropriate. The Service argued, and the Court agreed, that, because the trust was never subject to income tax on the appreciation of the property, the appreciation did not come from the trust’s gross income. Therefore, a charitable deduction in the amount of the adjusted basis of the property, which was traceable to the trust’s income, and not the full fair market value, including untaxed appreciation, was allowed.

**Series of real estate tracts held for investment did not constitute a “trade or business” for expense deduction purposes.**

In *Conner v. Comm’r*, TC Memo 2018-6 (Jan. 22, 2018), the taxpayer purchased a series of vacant real estate tracts in the mid-2000s, intending to develop each. Due to the downturn in the real estate market in the late 2000s, the tracts were not developed as planned. The taxpayer deducted the carrying costs for the tracts under Section 162 as ordinary and necessary expenses incurred in the carrying on of a trade or business. The Service contended that the costs were only deductible as investment expenses under Section 212 and that the deductions were limited under Section 163 to the amount of the taxpayer’s net investment income. The Tax Court agreed with the Service, refusing the taxpayer’s argument that the taxpayer’s development efforts in the aggregate could be considered a “trade or business.” The court also ruled that the deductions were subject to passive activity loss limitations under Section 469 because the taxpayer did not materially participate in activities of the tracts (which activities were minimal). The court did rule that since the tracts were held for investment, the taxpayer’s charitable deduction for the bargain sale of one tract to a church was the difference between the tract’s fair market value and the sale price and was not limited under Section 170(e) to the difference between the tract’s income tax basis and the sale price. The court also ruled that the taxpayer owed no penalties with respect to the deficiencies assessed by the Service because the taxpayer relied in good faith on an accounting professional for the taxpayer’s positions.

**Deduction for contribution of conservation easement denied when easement enhanced value of surrounding property.**

In *Wendell Falls Development, LLC v. Comm’r*, TC Memo 2018-45 (April 4, 2018), the Tax Court denied an income tax deduction for the charitable contribution of a conservation easement over 125 acres of a 1,280 acre planned-unit development (PUD). The 125 acres was intended to serve as a park, and the court found that the donors expected the conservation easement to result in a substantial benefit to them, in the form of value enhancement to the remainder of the PUD property, thus disqualifying the deduction under United States Supreme Court precedent. The court further found that the value of the easement for purposes of the deduction was zero, because any detriment in value to the 125 acres as a result of the easement was offset by increases in value to the remainder of the PUD property. Also, the donors had sold the 125 acres as conserved to the county government at a price that reflected the unconserved value of the 125 acres according to at least one appraisal, though the court did not rely on that fact for its ruling.

**Transfers to companies characterized as loans and deducted as bad debt were capital contributions.**

In *Sensenig v. Comm’r*, 2018 U.S. App. Lexis 1592 (3rd Cir. Jan. 23, 2018), the Third Circuit affirmed the Tax Court’s determination that a taxpayer’s transfers to companies in which he had an equity interest were capital contributions. The taxpayer had characterized the transfers as loans and then deducted the loan amounts for income tax purposes as uncollectible debt. The Tax Court had found that the totality of the circumstances indicated that the transfers were not loans, citing that there was no written agreement for the payment of interest or repayment of principal, the taxpayer never made any demand for repayment, and the transfers benefited the taxpayer’s equity interests in the “borrower” companies. The Tax Court had further indicated that even if the transfers were loans, there was no evidence that the debt was uncollectible because the companies continued to exist, the taxpayer provided no evidence of any financial distress with respect to the companies, and the taxpayer continued to transfer money to the companies after deducting the previous transfers as uncollectible debt. The taxpayer argued on appeal to the Third Circuit that no written agreement was required for the transfers to be treated as debt, but the Third Circuit confirmed that the Tax Court’s opinion was based on the totality of the circumstances, without solely relying on the matter of a written agreement. The Third Circuit noted that the taxpayer’s argument was undercut by his use of written repayment agreements for other loan transactions in which he participated.

Similarly, in *Burke v. Comm’r*, TC Memo 2018-18 (Feb. 21, 2018), the taxpayer made more than $11 million in advances to his friend’s scuba-diving company in Belize over the course of 15 years. The taxpayer received an equity stake in the company in conjunction with his initial contribution and an additional equity stake in the company in connection with some of the later contributions. The advances were identified as loans on the company’s financial statements, but no debt instruments were prepared, no maturity dates were set, no interest obligations were identified, and no interest or principal was ever paid. The taxpayer indicated that he did expect to be repaid, but only out of company profits, and the company was never sufficiently profitable. At a time after the conclusion of the 15-year contribution period, the taxpayer and the company formally executed promissory notes with respect to the transfers, and the taxpayer then cancelled the “debt” obligations and deducted the cancelled amount for income tax purposes. The Service assessed deficiencies, claiming that the transfers were never loans but were instead capital contributions. Based on the totality of the circumstances, the Tax Court agreed with the Service. The Service had also assessed accuracy-related penalties. In considering the penalties, the Tax Court noted that even though the taxpayer was advised to execute the retroactive promissory notes, cancel the “debt,” and deduct the cancelled amount by sophisticated tax counsel, the Service did not believe that the taxpayer, as a sophisticated businessman, could have relied in good faith on his counsel’s recommendations. Nevertheless, the penalties were overturned because the Service could not demonstrate that the supervisor of the Service representative that initially assessed the penalties approved the assessment, as is required by Section 6751.
60-day qualified rollover of IRA assets did not disqualify IRA from being exempt asset for Chapter 13 Bankruptcy purposes.

In In re Chaudury, 581 B.R. 279 (Bankr. M.D. Tenn. Feb. 1, 2018), a Bankruptcy Trustee argued that the debtor’s withdrawal of assets from the debtor’s IRA to purchase a house and subsequent contribution to the IRA of an equivalent value of assets within sixty (60) days of the original withdrawal disqualified the debtor’s IRA as an exempt asset for purposes of the debtor’s bankruptcy proceeding. The Bankruptcy Court found that because the debtor’s withdrawal and contribution was a qualified rollover for purposes of Section 408 and thus did not disqualify the IRA for tax purposes, the rollover did not disqualify the IRA as an exempt asset for purposes of the bankruptcy proceeding.

Service may assert additional penalties in Tax Court answers.

In Roth v. Comm’r, TC Memo 2017-248 (Dec. 28, 2017), the taxpayers, a married couple, claimed a $970,000 income tax deduction for the contribution of a conservation easement. The Service’s examiner determined that no deduction was allowable and recommended a 40% penalty for a gross valuation misstatement under Section 6662(h) because the claimed value of the conservation easement was more than 200% of the actual value as determined by the examiner. The taxpayers sought administrative review, and while the Service’s Appeals Office that reviewed the matter stated in its closing memorandum that the “proposed penalties are fully sustained,” the notice of deficiency issued by the Appeals Office did not recite the 40% gross valuation misstatement penalty, instead only reciting a 20% accuracy-related penalty under Section 6662(a). The taxpayers appealed the overall matter to the Tax Court, and the Service’s answer in the Tax Court proceeding asserted the 40% gross valuation misstatement penalty. The Tax Court upheld the 40% penalty, indicating that the Service is permitted under Section 6214(a) to assert additional penalties in answers to taxpayer-initiated Tax Court proceedings because the Tax Court has the jurisdiction to find additional penalties beyond those that appear in an original notice of deficiency. The taxpayers had also obtained and sold state tax credits pursuant to the conservation easement and had to repay some of the sale proceeds due to the value of the easement being overstated. The taxpayers had included the sale proceeds in their income for the year of the sale and claimed that the repayment should entitle them to a deduction for the year of the sale. The Tax Court denied that claim, noting that Section 1341(a) does entitle the taxpayers to a deduction due to the repayment, but only in the year of the repayment, and not the year of the original sale.

Taxpayer not entitled to rely on accountant when providing accountant incomplete information.

In Larson v. Comm’r, TC Memo 2018-30 (March 19, 2018), the Tax Court upheld accuracy-related penalties assessed against a taxpayer notwithstanding the taxpayer’s claim that he relied in good faith on his accountant with respect to his disputed income tax returns. The court judged that the taxpayer provided the accountant with incomplete information and found no evidence that the positions in the returns were based on the accountant’s advice. Further, when the Service began the audit, the accountant refused to assist the taxpayer, reportedly saying to the taxpayer “you’re on your own.”

Service liable for taxpayers’ attorneys’ fees when Service lost on merits and its positions were not substantially justified.

In U.S. v. Johnson, 2018 WL 327245 (Jan. 8, 2018), the Service had sought fiduciary liability for estate taxes and lost on the merits in an earlier ruling. In this ruling, the taxpayers won attorneys’ fees and expert fees from the government with respect to those issues because the government’s positions were not substantially justified, within the meaning of Section 7430. The Service had essentially failed to follow its own published guidance with respect to the matters at hand and did not effectively support its departures.

North Carolina Statutes

Comments published for new and recently modified statutes.

Comments to the following provisions of the N.C.G.S. have been published:

- Chapter 36C, Article 8B (North Carolina Uniform Trust Decanting Act, enacted by S.L. 2017-121 on July 18 2017): Official comments from Uniform Law Commission and North Carolina comments regarding departures from the uniform act both published.
- Chapter 36C, Article 4, Section 415 (Section 4-415 of the North Carolina Uniform Trust Code, modified by S.L. 2017-152 on July 20, 2017): Supplemental North Carolina comment published regarding modification.

North Carolina Administrative Developments

North Carolina Department of Revenue (NCDOR) imposes filing requirement for purchases of real property from nonresident sellers.

The NCDOR issued a notice on Feb. 19, 2018 requiring that a buyer of real property located in the state purchased from a nonresident seller file Form NC-1099NRS within 15 days of the closing of the sale to report information regarding the seller and the transaction.

North Carolina Cases

Oral agreement between spouses regarding real property not enforceable at law or in equity.

In Parsons v. Parsons, No. COA 17-278 (N.C. Ct. App. Feb. 6, 2018), two persons with “significant separate assets” married and subsequently entered into a post-marital agreement under which each waived all rights to the other’s property. Later, the spouses each contributed separate assets to the cost of improving a vacant tract owned by the husband. The wife claimed that in return for her contributions to the improvements, the husband orally agreed to grant the wife an enforceable interest in the property equal to the amount of her contributions. When the husband died seven years after the purported oral agreement without ever formally granting the wife such an interest, the wife filed claims against the husband’s estate for breach
of contract and unjust enrichment. The Court of Appeals upheld the trial court’s rulings that the purported oral agreement was unenforceable due to the statute of frauds and that an equitable award for unjust enrichment was not proper because (i) transfers between spouses are assumed to be gifts, (ii) a promise to repay amounts transferred between spouses cannot be implied and must rather be proved by clear and convincing evidence, and (iii) the wife’s pleading for unjust enrichment described the purported oral agreement as “implied.” The Court of Appeals also noted that the wife had ample opportunity in the seven years between the purported oral agreement and the husband’s death to pursue legally securing her rights under the purported oral agreement.

Premarital agreement waived elective share rights even when elective share rights not specifically referenced in agreement.

In In re Estate of Sharpe, 2018 N.C. App. Lexis 326 (April 3, 2018), the Court of Appeals found that a premarital agreement prevented the surviving spouse from claiming an elective share against the deceased spouse’s estate when, even though the agreement did not include an express waiver of elective share rights, the agreement did provide that the spouses’ respective separate property entering the marriage would remain separate property and that each spouse waived any claims such spouse may have to the other’s separate property.

Attorneys’ fees awarded from one co-Trustee to another due to “obstructionist” actions.

In Bullard v. Hoffman, 2018 N.C. App. Lexis 220 (March 6, 2018), two co-trustees, a sister and brother, disagreed regarding the administration of the trust’s sole asset, a single-family residence vacated by their incapacitated father upon his move to assisted living. After each co-trustee sued the other for breach of fiduciary duty, the co-trustees agreed to cooperate under court supervision to sell the residence. The residence went under contract, but the buyer backed out of the contract and requested a price reduction. The sister trustee and the buyer then agreed for the buyer to lease the property while the parties negotiated the sale terms, but the brother trustee would not agree to the lease. On petition from the sister, the clerk of court approved the lease, and the clerk approved the request as applied to the sister’s attorneys’ fees incurred with respect to the lease, deeming the brother’s behavior with respect to that matter as “egregious and obstructionist.” The Court of Appeals upheld the clerk’s finding but clarified that “egregious conduct” is not necessarily a required condition for the assessment of attorneys’ fees even though it is referenced in the comments to N.C.G.S. Section 36C-10-1004, which authorizes the awarding of attorneys’ fees in disputes involving trusts.

Other State Cases

Alaska Supreme Court invalidates Alaska statute purporting to restrict jurisdiction over fraudulent transfer actions involving Alaska self-settled trusts to Alaska courts.

In Toni 1 Trust v. Wacker, 2018 Alas. LEXIS 27 (Alaska Sup. Ct. March 2, 2018), the Trustee of an Alaska self-settled trust filed an action to dismiss judgments by a Montana Court and a Bankruptcy Court invalidating transfers to the trust as being fraudulent. The Trustee argued that the judgments should be dismissed for failure to state a claim, asserting that the Montana Court and Bankruptcy Court lacked jurisdiction over the claim as an Alaska statute granted exclusive jurisdiction to Alaska courts over fraudulent transfer claims involving Alaska trusts. The Alaska Supreme Court dismissed the Trustee’s action, finding that the Alaska statute could not limit other state or federal courts’ jurisdiction in such a manner. The court relied on the United States Supreme Court’s decision in Tennessee Coal v. George stating that the Full Faith and Credit Clause of the United States Constitution does not require states to recognize another state’s restriction of that state’s jurisdiction in transitory causes of actions, such as causes of actions arising from fraudulent transfers, over which that state would otherwise have jurisdiction and the United States Supreme Court decision in Marshall v. Marshall holding the same with respect to the restriction of federal courts’ jurisdiction. The court also relied on the Supremacy Clause of the United States Constitution in upholding the Bankruptcy’s Court’s jurisdiction. The decision does not address the validity of Alaska self-settled trusts against claims of creditors outside of the context of fraudulent transfers.

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