family money to be available for an elective share claim.”

Regardless of the examples above, any couple may answer these questions differently if they are separated versus deceased. Yet the Court of Appeals has said, “[T]he plain and unambiguous language does not permit us to read the agreement to mean the parties intended to waive rights to each other’s separate property while they were alive, but not after one of them had pre-deceased the other” Sharpe at *14. In the months since In re Sharpe was published (and brought to my attention by a colleague in the family law section), when reviewing or drafting premarital agreements, that friend and I have started using express carve-out language for those clients who answer the family law question and estate planner question differently, in the provisions expressly regarding the respective estates of the parties and the rights of the surviving spouse, we might say, “The other provisions of this Agreement notwithstanding, the parties expressly reserve the statutory rights of the surviving spouse and opt out of the rule set forth in In re Sharpe.” How will you change your review and/or drafting of premarital agreements for your clients?

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Recent Developments

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

Lead Development

Minnesota statute subjecting irrevocable trusts to income taxation based on grantor’s residency found unconstitutional.

In Fielding v. Comm’r, 916 N.W.2d 323 (Minn. Sup. Ct. July 18, 2018), the Minnesota Supreme Court ruled in a 4-2 decision that Minnesota’s definition of a “resident trust” for income tax purposes made the trusts income-tax residents for the tax year in which the trusts became irrevocable, rather than income-tax residents only after the year the trusts became irrevocable for Minnesota income tax purposes. The trusts selected Minnesota law as their governing law and were initially funded with stock in an S corporation incorporated in Minnesota. A Minnesota law firm prepared and kept custody of the trust instruments. The primary beneficiary of one of the four trusts was a Minnesota resident, but the primary beneficiaries of the remaining trusts resided elsewhere. The initial trustee of the trusts was domiciled in California, with successor trustees residing in Colorado and Texas; at no time was a Minnesota resident trustee of any of the trusts. The court determined as a threshold matter that Minnesota taxation of the trusts would be permissible under the Due Process Clause if the trusts had a minimum connection with the state of Minnesota, regardless of whether the grantor’s residency by itself met the threshold for such minimum connection, and if the taxation were rationally related to benefits conferred upon the trusts by Minnesota. The court then determined that no such minimum connection existed, finding that (i) the grantor’s residency was not applicable, because the trusts were legal entities separate and apart from the grantor, and the trusts had no dealings with the grantor during the tax year at issue (which was after the year the trusts become irrevocable for Minnesota income tax purposes); (ii) the activities of the Minnesota law firm were not relevant because the firm was an agent of the grantor, not the trusts, and the trust instrument storage was an incidental benefit to the trusts that was in essence a service to the grantor; (iii) the trusts owned no physical property in Minnesota (the stock in the Minnesota corporation being intangible and therefore held by the trustees in the trustees’ places of residency); (iv) contacts by the trusts with Minnesota prior to the tax year at issue were not relevant; and (v) any contacts between the trusts and Minnesota based on owning stock in the Minnesota corporation were too tenuous and were not rationally related to the concept of taxing all of the income of the trusts regardless of such income’s source. Without a minimum connection, the majority found that the Minnesota statute violated the Due Process Clause as applied to the trusts. In contrast, the dissenting justices argued that because the grantor had notice of the state’s criteria for taxing the trusts as Minnesota resident trusts at the time the grantor created the trusts, there was no failure of due process in Minnesota’s taxing the trusts. The dissent also considered the trusts’ selection of Minnesota law and their funding with Minnesota corporate stock (which was liquidated in the tax year at issue) as contributing to the trusts’ minimum connection with Minnesota. The dissent disagreed that only connections in the tax year at issue were relevant but still found that sufficient connections were in place in the tax year at issue. In general, the dissent believed that the trusts did not meet their “heavy burden” of demonstrating that no minimum connection existed, the benefit of the doubt being afforded to the state. Further, since the trusts’ complaint asserted that the Minnesota statute violated the Commerce Clause of the United Constitution in addition to the Due Process Clause, the dissent provided that it did not believe the Minnesota statute placed an undue burden on interstate commerce and thus did not violate the Commerce Clause.

Federal Administrative Developments

Service issues proposed regulations for pass-through deduction for qualified business income.

In REG-107892-18 (83 Fed. Reg. 40884, Aug. 16, 2018), the Service issued Proposed Regulations Sections 1.199A-1 through 1.199A-6,
and 1.643(f)-1 regarding the new deduction permitted for qualified business income (QBI) from pass-through entities under Code Section 199A, including:

- Calculations of the deduction, including providing for a "netting" approach to determining QBI among multiple trades or businesses and direction to offset negative QBI from one or more trades or businesses with positive QBI from other trades or businesses before applying limitations to the deduction based on W-2 wages and unadjusted basis immediately after acquisition (UBIA) of property;
- Definitions, including clarification that the definition of a "trade or business" is to be interpreted consistently with the definition for such term developed for Code Section 162, with the definition to be further tailored to accommodate rental or licensing trades or businesses operating under an affiliated group;
- A determination of W-2 wages (supplemented by Notice 2018-64 (Aug. 8, 2018)), consistent with the rules developed for former Code Section 199 and providing for W-2 wages to be calculated separately among different trades or businesses;
- A determination of the UBIA of property, including confirmation that basis adjustments to partnership property under Code Sections 734(b) and 743(b), property acquired for purposes of increasing a deduction, and property subject to a like-kind exchange under Code Section 1031 are non-recognition transactions for calculating the UBIA of property;
- Aggregation rules providing for a single trade or business, other than a specified service trade or business, to be permitted to be conducted through multiple affiliated entities, including as a result of applying attribution rules and requiring that aggregated trades or businesses be consistently reported across tax years;
- The scope of specified service trades or businesses, including additional detail as to what constitutes services provided in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, any trade or business where the principal asset is the reputation or skill of one or more of an employee or owner, investing and investment management, trading, dealing in securities, partnership interests, and commodities, and performing services as an employee;
- Anti-abuse measures designed to prevent the separation of a specified service business from its related administrative business operations for purposes of obtaining a deduction;
- Calculation rules related to the application of QBI to trusts, estates, and beneficiaries; and
- Anti-abuse measures designed to prevent the creation of multiple trusts to obtain additional deductions.

In REG-112176-18 (83 Fed. Reg. 43563, Aug. 27, 2018), the Service proposed amendments to Regulations Section 1.170A-1 to provide that any federal income tax charitable deduction for a contribution by a taxpayer, including an estate or trust, to a governmental entity is reduced by any state or local tax credit the taxpayer receives or "expects to receive" in return for the contribution if the tax credit exceeds 15% of the amount of the contribution. Any state or local tax deduction provided for the contribution, however, is not subject to any such limitations.

**Service clarifies treatment of certain deductions for estates and trusts.**

In Notice 2018-61 (July 13, 2018), the Service clarified that deductions taken by an estate or trust pursuant to Code Section 67(b) (1) for expenses incurred in the administration of an estate or trust, as well as other expenses that would otherwise be allowed under Code Section 67(b) such as a deduction for income in respect of a decedent determined under Code Section 691(c), are not considered miscellaneous itemized deductions for which deductions have been suspended pursuant to last year’s major federal tax act (Public Law 115-97, Dec. 22, 2017) under Code Section 67(g). The Service has requested comments for any clarification needed as to the ability to deduct expenses determined under Code Sections 67(e) and 642(h) upon the termination of an estate or trust.

**Service releases guidelines regarding recent legislative changes applicable to 529 plans.**

In Notice 2018-58 (July 30, 2018), in respect of changes made to Code Section 529 under Public Laws 114-113 (Dec. 18, 2015) and 115-97 (Dec. 22, 2017), the Service provided guidance regarding the treatment of (i) refunded qualified education expenses paid from a qualified tuition program under Code Section 529 ("QTP"), (ii) rollovers from QTPs to ABLE accounts under Code Section 529A, and (iii) elementary and secondary school expenses as qualified higher education expenses. The Service stated that the re-contribution of refunded expenses to a QTP would be treated as principal and not earnings and would not count against the contribution limits for that year, provided that the funds are contributed to a QTP for the same beneficiary for whom the expenses were originally paid, even if such account is a different QTP from which the expenses were originally paid. With respect to rollovers from QTPs to ABLE accounts, such rollovers are not subject to tax if they are made within 60 days of the withdrawal from the QTP and are within the contribution limits for the ABLE account for that year. QTPs are prohibited from transferring funds in excess of the contribution limit for the ABLE accounts, and ABLE accounts are prohibited from accepting such excess funds. Nevertheless, any rejected funds can be returned to the QTP without being subject to the contribution limits for the QTP. In addition, the definition of a “family member” for purposes of a rollover is the broader definition in Code Section 529(e)(2) applicable to QTPs, rather than the more narrow definition in Code Section 529A(e)(2) otherwise applicable to ABLE accounts. Finally, the Service stated that the definitions of “elementary school” and “secondary school” applicable to QTPs are the same definitions applicable to Coverdell education savings accounts under Code Section 530(b)(3)(B).
Service releases final regulations under the centralized partnership audit regime regarding partnership representatives and the election to apply the centralized partnership audit regime to prior tax years.

In T.D. 9839 (Aug. 6, 2018), the Service issued final regulations regarding the designation and authority of the partnership representative and the election to apply the centralized audit regime to tax years beginning after Nov. 2, 2015 and before Jan. 1, 2018. The regulations became effective on Aug. 9, 2018. The final regulations generally follow the proposed regulations issued in 2017, with several notable changes and clarifications. First, the final regulations confirm that disregarded entities can serve as a partnership representative and that a partnership can serve as its own partnership representative, provided that a designated individual is named. The final regulations allow for a partnership to change its partnership representative, through resignation or revocation, once it receives notice that the partnership has been selected for examination and before the issuance of a notice of administrative proceeding ("NAP"), whereas the proposed regulations required a partnership to wait until receiving a NAP. The final regulations impose additional limits on the ability of partnership representatives and designated individuals to resign, stating that resigning partnership representatives and designated individuals may not designate a successor and that neither a partnership representative nor a designated individual may resign in a filed administrative adjustment request (AAR). The final regulations also clarify that any partner, not just a general partner or managing-member of a limited liability company, who was a partner at any time during the taxable year at issue, and not simply on the last day of the year, may sign the revocation of a partnership representative. Such revocation is effective immediately upon receipt by the Service. Finally, the final regulations clarify that a partnership representative may engage a power of attorney during the administrative proceeding. See Lauren N. Page, “A Review of the Centralized Partnership Audit Regime,” in the August 2018 issue of The Will and the Way for a further discussion of these regulations.

Service issues interim guidance and requests comments regarding new unrelated business taxable income rules.

In Notice 2018-67 (Aug. 21, 2018), the Service issued interim guidance regarding the calculation of unrelated business taxable income ("UBTI") under Code Section 512(a)(6), requiring the separation of income among different trades or businesses and enacted as part of Public Law 115-97 on Dec. 22, 2017, and requested comments regarding the same before the issuance of regulations under Code Section 512(a)(6). As part of the interim guidance, the Service stated that charitable organizations may rely on a good-faith interpretation of what constitutes a separate trade or business and when the UBTI arising from such trades or businesses may be aggregated or must be separated. For purposes of this interim guidance, the use of the North American Industry Classification System (NAICS) six digit codes will constitute a reasonable good-faith interpretation of what constitutes a separate trade or business. With respect to aggregating multiple trades or businesses conducted by partnerships in which a charitable organization may own an interest, the Service provided an interim rule which will be effective until regulations are passed. If the charitable organization owns no more than a two percent interest in the partnership (the “de minimus test”) or owns no more than a twenty percent interest in and has no control over the partnership (the “control test”), then the charitable organization may aggregate the UBTI arising from the trades or businesses conducted by the partnership. In addition, with respect to partnership interests owned by a charitable organization before Aug. 21, 2018, charitable organizations may aggregate the UBTI arising from the trades or businesses conducted by the partnership even without satisfying the de minimus test or the control test. In addition, the Service noted that Code Section 512(a)(6) does not apply to UBTI under Code Section 512(a)(7), regarding disallowed deductions for transportation fringe, parking facilities, and on-site athletic facilities. Finally, global intangible low-taxed income is treated as a dividend for purposes of calculating UBTI. The period for comments ends on Dec. 3, 2018.

Social Security Administration clarifies the sole benefit rule for special needs trusts.

On April 30, 2018, the Social Security Administration ("SSA") released an updated Program Operating Manual System ("POMS"). As part of the updated POMS, the SSA provided additional guidance
regarding the administration of special needs trusts. The prior POMS provided that trusts must be administered for the “sole benefit” of the special needs beneficiary. The updated POMS provides that trusts must be administered for the “primary benefit” of the special needs beneficiary. As part of this change, the SSA provided several examples clarifying permissible uses of trust funds, including (i) travel expenses for third parties to the extent they are necessary to allow the special needs beneficiary to travel or to allow the trustee to fulfill its fiduciary duties by visiting the special needs beneficiary, (ii) expenses for companion care, including those without medical training, and (iii) the purchase of a prepaid debit card if the items purchased with such card would be permissible if purchased directly from the trust funds.

Service revokes tax-exempt status of organization deemed to have been operated for private benefit.

In PLR 201834013 (Aug. 24, 2018), the Service revoked the tax-exempt status of purported public charity when the Service found that the organization existed solely to accept contributions of restricted interests in partnerships and limited liability companies, failed to report income earned with respect to the interests received, sold those interests back to their respective donors for significantly less than the donors’ respective charitable deduction amounts originally claimed, made distributions recommended by donors without exercising any due diligence to determine whether the distributions were charitable in nature, and tried to dissolve itself and direct its assets to a new charitable organization run by the same individual. The same individual operated the charitable organization, appraised the business interests contributed, and managed the partnerships and limited liability companies, and the individual commingled the charitable organization’s assets with fees the individual received for the other purposes, as well as legal and accounting services. In general, the Service determined that the organization existed and operated to serve private and not public interests.

Allocations of GST tax exemption were void when trusts would result in no GST with respect to taxpayers.

In PLRs 201836004 and 201836007 (June 5, 2018), the taxpayer and his wife consented to split gifts with respect to transfers made to three irrevocable trusts created for the benefit of each of their children. On the filed gift tax returns, the taxpayer and his wife also allocated GST tax exemption to the trusts. The terms of the trust provide for distributions of income and principal only to the child during the child’s lifetime. At the child’s death, the child had a testamentary general power of appointment, causing the trust property to be includible in the child’s estate upon his or her death. Because no distributions can be made to skip persons with respect to the taxpayer and his wife during their children’s lifetimes and because the trust property will be includible in the children’s estates, causing the children to become the transferees for GST tax purposes before any distribution can be made to a skip person with respect to the taxpayer and his wife, the trusts have no GST potential with respect to the taxpayer or his wife. Therefore, under Regulations Section 26.2632-1(b)(4)(I), the allocations of GST tax exemption by the taxpayer and his wife with respect to the trusts created for their children are void.

Service confirms modification of post-1985 GST exempt trust that would not cause pre-1985 grandfathered trust to be subject to GST tax laws has no adverse tax consequences.

In PLR 201829005 (July 20, 2018), the Service provided that a proposed modification of a post-1985 generation-skipping transfer (GST) tax exempt trust would not affect the GST tax exempt status of the trust when the proposed modification fell within the safe harbor provisions of Regulations Section 26.2601-1(b)(4), which describes modifications of pre-1985 “grandfathered” trusts that do not cause such trusts to become subject to federal GST tax laws. The Service also reaffirmed its lack of specific guidance regarding the GST tax effects of modifications of post-1985 GST exempt trusts that do not fall within the safe harbor regulations for the modification of grandfathered trusts.

Service permits modification of trusts to correct misdrafted Crummey withdrawal rights.

In PLRs 201837005, 201837006, 201837007, 201837008, and 201837009 (Sept. 14, 2018), the Service ruled that the judicial reformation of a series of trusts to correct scrivener’s errors regarding the Crummey withdrawal rights of the beneficiaries did not have adverse gift, estate, or generation-skipping transfer tax consequences. The initial trust instruments did not limit the withdrawal rights to the applicable annual gift tax exclusion amount or limit the annual lapsing of the withdrawal rights to the greater of $5,000 or 5% of the trust assets, meaning that without the modification, with respect to each trust, the beneficiaries with withdrawal rights would have been deemed to have regifted the entire trust corpus to the trust due to the full lapsing of their unlimited withdrawal rights.

Transfer of S corporation stock to trust as incident to divorce decree does not cause S corporation to have second class of stock and does not prevent trust from qualifying as an electing small business trust (ESBT).

In PLRs 201834007 and 201834008 (Aug. 24, 2018), the Service ruled that the transfer of stock in an S corporation to a trust for the benefit of a divorcing couple as part of a divorce decree did not violate the requirement that the S corporation not have more than one class of stock, and the Service ruled that the transferee trust could qualify as an electing small business trust (ESBT). The terms of the trust provided that equal portions of the transferred stock were to be held in separate shares for each spouse, with the portion of the trust constituting the transferor spouse’s share to issue a promissory note to the portion of the trust holding the share for the other spouse in respect of payment of certain liabilities for which the stock had been pledged. Because the provisions of the trust were not required to be taken into account when evaluating distribution and liquidation proceeds in determining the rights of the corporation’s outstanding stock, ownership of the stock by the trust did not affect the stock’s classification for purposes of S corporation treatment. Additionally, because the transfer of the stock to the trust took place incident to a divorce decree and the liabilities assumed by the trust did not exceed the adjusted basis in the stock, the transfer was not determined to be a “purchase” of the stock under the S corporation rules, and the trust therefore could qualify for ESBT treatment.
Disclaimer made within nine months of the taxpayer learning of trust's existence is a qualified disclaimer for gift tax purposes.

In PLR 201831003 (April 23, 2018), within nine months of a relative's death, the taxpayer proposed disclaiming his interest in trust property received as a result of such relative's exercise of a power of appointment over an irrevocable trust created before 1977. Although the taxpayer was generally aware that several trusts had been created by his family members, he was not aware that he was a potential beneficiary of the trust at issue. The taxpayer had not accepted any of the benefits of the property, and the disclaimer otherwise complied with applicable state law. Under Regulations Section 25.2511-1(c) (2), the disclaimer of an interest created before 1977 is not a taxable gift if such disclaimer is made within a reasonable time after learning of existence of the interest. Under Section 2518, the disclaimer of an interest created after Dec. 31, 1976 is not a taxable gift if such disclaimer is made within nine months of the transfer creating the interest. The Service found that because nine months was found to be a statutorily reasonable period of time for the disclaimer of an interest created after Dec. 31, 1976 under Section 2518, nine months after discovery of the existence of the interest is a reasonable amount of time for the disclaimer of such interest created before 1977, and thus the proposed disclaimer is not a gift for gift tax purposes.

Service approves non-grantor incomplete gift trusts.

In PLRs 201832005, 201832006, 201832007, 201832008, and 201832009 (Aug. 10, 2018), 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 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.

Federal Cases

California's requirement that nonprofit entities disclose donor lists is constitutional as applied.

In Americans for Prosperity Foundation et al. v. Xavier Becerra, Nos. 16-55727, 16-55786, 16-56855, 16-56901 (9th Cir. Sept. 11, 2018), the Ninth Circuit reversed a district court's ruling that a California state law requiring nonprofits to disclose their lists of donors to the California Attorney General in the same manner that such information is required to be disclosed to the Service violated the First Amendment's freedom of association of the Americans for Prosperity Foundation and the Thomas More Law Center (the "Charities"). The Ninth Circuit found the same law to be constitutional on its face several years prior, and thus an "as applied" challenge was brought. The Ninth Circuit found here that requiring that Schedule B of Form 990, listing major donors of the organization, be provided to California did not violate the Charities' First Amendment rights because the collection of Schedules B was substantially related to the state's interest of policing charitable fraud and would not deter contributions or result in harassment because the information collected was not available for public use and the risk of inadvertent disclosure was minimal.

Fifth Circuit permits taxpayer to assert Fifth Amendment rights to refuse to answer certain questions from Service in examination proceeding.

In U.S. v. Durham, E.D. Mo. No. 4:18-mc-00137 (July 9, 2018), the taxpayer had not timely filed income tax returns for two separate years that were under examination by the Service, and the taxpayer refused to answer questions from the Service in two separate interviews during the examination proceedings, though between the proceedings the taxpayer delivered an affidavit to the Service answering the Service's questions from the first interview. The court determined that the taxpayer could in general refuse to answer the Service's questions in the interviews because the taxpayer was facing a "real and substantial risk of criminal prosecution" due to the illegality of attempting to evade tax or willfully failing to file a tax return. However, the court ruled that the taxpayer had waived his Fifth Amendment rights with respect to any questions regarding the subject matter of the answers in the taxpayer's affidavit.

Emotional distress damages are awarded for the Service's willful violation of an automatic stay under the bankruptcy code.

In Jonathan Eldon Hunsaker et ux. v. United States, No. 16-35991 (9th Cir., Aug. 30, 2018), the taxpayers alleged that they suffered emotional distress damages when the Service sent threatening collection letters during the automatic stay on collections granted to the taxpayers under Section 362 of the Bankruptcy Code after they filed for bankruptcy. The U.S. Court of Appeals for the Ninth Circuit reversed the district court's reversal of the bankruptcy court's award of emotional distress damages. The district court's reversal of the bankruptcy court asserted that sovereign immunity barred the taxpayers’ claim for damages. In reversing the district court, the Ninth Circuit found that Section 106(a) of the Bankruptcy Code waived sovereign immunity for a “judgment awarding a money recovery, but not including an award of punitive damages” under certain sections of the Bankruptcy Code, including Section 362, and that prior case law held that emotional distress damages are actual damages under Section 362 and not punitive damages. The Ninth Circuit remanded the case to the district court for a determination of actual damages. The Ninth Circuit's opinion conflicts with a prior
First Circuit opinion holding that the waiver of sovereign immunity applied only to remedies available at the time of the waiver and that because a claim for emotional distress damages was not recognized in case law until ten years after the statutory waiver was enacted, sovereign immunity was not waived with respect to emotional distress damages.

**Commissioner abused his discretion in failing to review all issues raised by taxpayers in a collection proceeding.**

In Loveland v. Commissioner, 151 T.C. No. 7 (Sept. 25, 2018), the Tax Court found that the Service abused its discretion by failing to consider an offer-in-compromise, a proposed installment agreement, and a claim of economic hardship raised by taxpayers during the collections process. The court found that the taxpayer’s previous negotiations regarding an offer-in-compromise but failure to appeal the rejection of the offer in a collections due process hearing did not rise to the level of a prior hearing, which would have precluded re-examination of the offer, and, thus, the Service abused its discretion by failing to consider the offer. In addition, the court found that the taxpayers’ submission of their Form 433-A (OIC), containing financial information necessary for the determination of an offer-in-compromise, was sufficient disclosure of financial information for the Service to review the taxpayers’ proposed installment agreement and failure to do so was an abuse of discretion. Finally, the court found that taxpayers explicitly raised the issue of economic hardship due to their health issues and home foreclosure, and the Service’s failure to evaluate this issue was an abuse of discretion.

**Charitable deduction for contribution of conservation easement denied in part due to overstatement of value and in part due to failure to preserve value of easement for charitable purposes in perpetuity.**

In PBBM-Rose Hill, Ltd. v. Comm’r, 5th Cir. No. 17-60276 (Aug. 14, 2018), the Fifth Circuit affirmed a Tax Court ruling denying an income tax deduction for the contribution of a conservation easement because the easement’s terms violated Regulations Section 1.170A-14(g)(6)(ii), which provides that if the conservation easement is later extinguished (such as by court order), the charitable easement owner is entitled to a proportional share of the proceeds of any later sale of the property equal to the ratio of the value of the conservation easement upon its contribution to the value of the conserved property immediately prior to the contribution of the conservation easement, thus preserving the perpetual nature of the charitable benefit of the easement. The easement in this case provided that in the event of the extinguishment of the easement and subsequent sale of the property, the value of any improvements made to the conserved property would be deducted from the sale proceeds before the calculation of the charity’s proportional share. Though a private letter ruling for a different taxpayer directly supported the donor’s position, the court found that the donor’s position directly contradicted the plain meaning of the regulation and awarded no deference to the private letter ruling due to its non-binding nature and seeming inconsistency with the regulation. The Fifth Circuit further upheld a 40% gross valuation misstatement penalty assessed against the donor. The donor represented that the value of the conservation easement was $15,160,000, but the Service determined that the value of the easement was $100,000. The donor’s value relied on an assumption that the property, which was zoned for residential use, could be rezoned for commercial use. The Service determined that assumption to be speculative and ultimately unlikely; the Tax Court agreed, and the Fifth Circuit found no error with the Tax Court’s ruling. The donor argued that no penalty should apply because of case law holding that no gross valuation misstatement penalty applies to deficiencies attributable to non-valuation reasons, such as the violation of the sale proceeds regulation. However, citing superseding case law, the Fifth Circuit upheld the Tax Court’s ruling that the penalty applied to the difference between the taxpayer’s claimed deduction ($15,160,000) and the deduction that would have been permissible absent the non-valuation reason for denial ($100,000), but not the portion of the deduction denied for non-valuation reasons ($100,000).

**Lessee of conserved property barred from claiming conservation easement charitable deduction because leasehold interest impaired was not perpetual.**

In Harbor Lofts Assoc. v. Comm’r, 151 T.C. No. 3 (Aug. 27, 2018), the long-term commercial lessee of a historical building joined with the building’s fee owner to make a charitable contribution of a conservation easement preserving the features of the building’s facade. The lessee claimed a charitable deduction with respect to its portion of the contribution, but the Service denied the lessee’s deduction because the lessee’s interest in the conserved property was time-bound by its lease, and therefore the lessee could not contribute any perpetual interest in the property, meaning that the lessee’s contribution did not meet the requirement of Regulations Section 1.170A-14(b)(2) or Code Section 170(h)(5) that the conservation purpose of the contributed interest be protected in perpetuity.

**Charitable deduction for contribution of conservation easement denied when donor’s basis in property subject to easement was not reported.**

In Belair Woods, LLC v. Comm’r, T.C. Memo 2018-159 (Sept. 20, 2018), a limited liability company contributed a conservation easement and claimed a charitable deduction the amount of which indicated a fair market value of the conserved property prior to the easement that was nearly 13 times the company’s basis in the property, which basis derived from the purchase of the property by one of its owners just two years prior to the contribution of the easement. The company did not disclose its basis in the property in claiming the deduction despite the required Form 8283’s demand for such basis information. The company relied on advice from an attorney, relayed through a consulting group, indicating that the basis disclosure was not required because the company had a “reasonable cause” for failing to disclose the basis, that cause being that the basis was not required to calculate the amount of the charitable deduction. The Service denied the deduction due to the company’s failure to comply with the reporting requirements prescribed by the applicable regulations. The Tax Court agreed that the company neither strictly nor substantially complied with the reporting requirements, as legislative history indicated the importance of the basis disclosure to prevent fraud, and the company’s failure to include the basis information was not due to inadvertence. The court also rejected the company’s argument that it complied with the basis disclosure requirement because the company’s basis in the property was implicitly disclosed through previously filed partnership tax returns, noting that permitting that...
type of indirect disclosure would place an undue burden on the Service. The court granted summary judgment to the Service on the foregoing issues and permitted additional fact-finding to determine whether the company could defend its lack of compliance due to reasonable reliance on the advice of a tax professional.

**Charitable deduction denied for contribution of conservation easement over private golf club.**

In *Champions Retreat Golf Founders, LLC v. Comm'rs*, T.C. Memo 2018-146 (Sept. 10, 2018), the Tax Court upheld the Service’s denial of a charitable income tax deduction for the contribution of a conservation easement with respect to a private golf club. The court found that the easement was not contributed “exclusively for conservation purposes,” within the meaning of Code Section 170(h) and the regulations thereunder, rejecting the donor’s arguments to the contrary (any one of which, if successful, would have validated the deduction) as follows:

(a) The easement did not in general protect a “relatively natural habitat” for plants and animals within the meaning of Code Section 170(h)(4)(ii) because only 16% of the easement area was undisturbed, the remainder having been developed for the golf course, and the golf course was landscaped with non-native grass and treated with significant chemicals, some of which could be toxic to animals;

(b) The easement did not meet the safe harbor for consideration as a relatively natural habitat under Regulations Section 1.170A-14(d)(3)(ii) as a habitat for rare, endangered, or threatened animal or plant species because no animal species and only one plant species on the property were consistently identified as threatened among the scientific experts consulted, and the one threatened plant species was present on less than 17% of the conserved property;

(c) The easement did not meet the safe harbor for consideration as a relatively natural habitat under Regulations Section 1.170A-14(d)(3)(ii) as a natural area that contributes to the ecological viability of national park, in this case a natural forest across the river from the conserved property, because the conserved property was primarily not a natural area, the use of chemicals in the easement area did not contribute to the ecological viability of any area, and it was unclear whether any animal species actually traveled between the national forest and the conserved property, as the donor suggested;

(d) The easement did not “preserve open space” for the “scenic enjoyment of the general public” within the meaning of Code Section 170(h)(4)(iii) because the golf course was only accessible to members and guests, and the view of the conserved area from the adjoining river was limited; and

(e) The easement did not “preserve open space...pursuant to a clearly delineated [governmental] conservation policy” within the meaning of Code Section 170(h)(4)(iii) because none of the following policies identified by the donor met the requirements for such a policy: (i) a general state statute directing its department of natural resources to promulgate standards for the protection of the environment, because it was not an “identified conservation project” as required by Regulations Section 1.170A-14(d)(4)(iii)(A), (ii) a county implementation of a state “Greenspace Program,” because the program has not identified the golf course as “worthy of protection for conservation purposes,” and (iii) a county planning commission plan showing the golf course as open space, because the plan was focused on land development as opposed to conservation.

**Executor who resigned but was not discharged by probate court still liable for estate taxes.**

In *U.S. v. Paulson*, S.D. Ca. No. 3:15-cv-02057 (Sept. 7, 2018), among other rulings, the court found that an executor who had purported to resign but who had neither completed a full settlement of the executor’s accounts for the probate court nor received a discharge from the probate court, as required under state law for release from fiduciary responsibility as executor, was still the executor of the decedent’s estate for federal estate tax purposes and had not been discharged of fiduciary liability for estate tax with respect to such estate under Code Section 2204.

**North Carolina Cases**

**Alleged oral agreement to alter disposition of property under will was unenforceable.**

In *Barrett v. Coston*, N.C. Ct. App. No. 18-16 (Sept. 18, 2018), a decedent owned two pieces of real property: a condominium (the “condo”) and a house. Under the terms of the decedent’s will, the decedent specifically devised the house to his wife’s sister, and the residuary of the decedent’s estate, including the condo, was designated to pass to his sister. Evidence was presented that after the execution of his will, the decedent orally agreed to transfer the condo to his wife’s sister and the house to his sister, contrary to the terms of the will. Pursuant to this alleged agreement, the decedent executed a deed conveying the condo to his wife’s sister, but the decedent did not amend his will to remove the bequest of the house to his wife’s sister or otherwise transfer the house to his sister. As such, upon the decedent’s death, under the terms of the un-amended will, the house passed to the decedent’s wife’s sister. The decedent’s sister filed a caveat stating that the house should have passed to her pursuant to the oral agreement altering the disposition of the decedent’s property. The Court of Appeals upheld the lower court’s rejection of the decedent’s sister’s arguments stating that (i) the statute of frauds prevented the oral disposition of real property, (ii) the decedent’s wife’s sister was not unjustly enriched because the decedent’s sister provided no uncompensated benefit to the decedent’s wife’s sister, (iii) a constructive trust was inappropriate as the decedent’s wife’s sister did not engage in wrongdoing to receive the property, and (iv) there was no mutual mistake as the deed transferring the condo to the decedent’s wife’s sister was not missing any information nor did it contain any misleading information.

**529 plan is marital property subject to equitable division in divorce.**

In *Beren v. Berens*, NC COA 17-1189 (Aug. 7, 2018), the defendant
to the beneficiaries of the revocable trust, which did not include the checking account in preparation for the overall cash to be distributed of deposit to cash and consolidated that cash with the cash in the successor trustee of the revocable trust converted the certificate beneficiary of the checking account. When the grantor died, the granddaughter. The granddaughter complained that the grantor’s death should have caused her to become the owner of the certificate of deposit and the checking account, but the court found that because a trust, even if revocable, cannot “die,” following the grantor’s death, the checking account remained titled to the revocable trust, and the trust remained a joint owner of the certificate of deposit and had proper legal authorization to convert the certificate of deposit to cash and claim the proceeds.

Other State Cases

Bequest to testator’s fiancée is not revoked when the couple is later married and divorced.

In Gordon v. Fishman, Fla. Ct. of App. 2D17-1488 (Aug. 24, 2018), the decedent executed a will leaving all of his property to his fiancée, if she survived him. Two years after the execution of his will, the decedent and his fiancée were married. Several years later, the couple divorced. The decedent never updated his will after the divorce. Florida Statutes Section 732.507(2) states that “any provision of a will executed by a married person that affects the spouse of that person shall become void upon the divorce of that person…After the … divorce…, the will shall be administered and construed as if the former spouse had died at the time of the … divorce.” One of the remaining beneficiaries of the decedent’s will brought an action requesting that the decedent's former fiancée be deemed to have predeceased the decedent under the decedent’s will. “Unlike Michigan, North Carolina law specifically provides in N.C.G.S. Section 31-3.1 that a will is invalid unless it complies with the requirements of Article 1 of Chapter 31 of the North Carolina General Statutes, which currently only provides for attested written wills, holographic wills, and nuncupative wills declared in front of two witnesses immediately before the person’s death.

Kentucky accounts co-owned by grantor’s revocable trust and grantor’s descendants did not automatically transfer to descendants upon grantor’s death.

In Coe v. Schick, Ky. Ct. of Appeals No. 2015-CA-000731-MR (June 29, 2018), a grantor funded his revocable trust during his lifetime, and, as trustee of the revocable trust, purchased a certificate of deposit payable to either the revocable trust or the grantor's granddaughter. Interest payments from the certificate of deposit were placed into a checking account in the revocable trust's name. The grantor designated the granddaughter as the “payable on death” beneficiary of the checking account. When the grantor died, the successor trustee of the revocable trust converted the certificate of deposit to cash and consolidated that cash with the cash in the checking account in preparation for the overall cash to be distributed to the beneficiaries of the revocable trust, which did not include the

Retired taxpayer is domiciled where his wife resides.

In Matter of Patrick, N.Y. Div. of Tax Appeals Nos. 82688 and 826839 (June 15, 2017), the New York Division of Tax Appeals found that the taxpayer, who retired and moved from New York to France to live with his wife, was no longer a domiciliary of New York for income tax purposes. For many years, the taxpayer lived in Connecticut and worked in New York. After his divorce, the taxpayer purchased an apartment in New York to be closer to his office. Three years before the first tax year in issue, the taxpayer remarried, and his new wife permanently resided in France. On March 1 of the first tax year in issue, the taxpayer remarried, and on March 2 of that year, the taxpayer moved to France to live with his wife in an apartment that they owned. The taxpayer returned to New York frequently to receive specialty medical treatment that was unavailable in France. In addition, the taxpayer returned to the United States a dozen times over the two year period at issue to attend board meetings. Nevertheless, the taxpayer applied for and received the longest declaration of residency available in France and paid French income and wealth taxes. The court found that the taxpayer terminated his New York domicile when he moved to France to live with his wife and that his long stays in New York were not evidence of domicile but rather necessary for his health and unavailable elsewhere.

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