Recent Developments

By the Trusts and Estates Team of Moore & Van Allen PLLC (April – June) and
By the Trusts and Estates Team of Young, Moore and Henderson, P.A. (July – Sept.)

Lead Developments

United States Supreme Court confirms that North Carolina law taxing irrevocable trusts on the exclusive basis of a beneficiary’s residence in North Carolina is unconstitutional.

In N.C. Dept. of Revenue v. Kimberly Rice Kaestner Family 1992 Family Trust, U.S. Sup. Ct. No. 18-457 (June 21, 2019), the United States Supreme Court, in a 9-0 decision, confirmed the previous rulings of the North Carolina Supreme Court, the North Carolina Court of Appeals, and the North Carolina Business Court that North Carolina’s statute taxing irrevocable trusts that have North Carolina beneficiaries violated the Due Process Clause of the United States Constitution as applied to a trust whose sole connection to North Carolina was the residence of a beneficiary. The trust in Kaestner was created by a grantor from New York and was administered under New York law by a trustee in Connecticut. At the time of the trust’s creation, no trust beneficiary lived in North Carolina, though a family of trust beneficiaries later moved to North Carolina. The Supreme Court found that North Carolina did not have a minimum connection to the trust that was rationally related to its claim to tax the trust’s income and therefore that its taxation of the trust violated the Due Process Clause. The court focused on the “extent of the [North Carolina beneficiaries’] right to control, possess, enjoy, or receive trust assets,” and found that the North Carolina beneficiaries in Kaestner received no distributions from the trust during the applicable tax years, had no right to demand or withdraw assets from the trust, had no vested right to future trust distributions, did not have the power to direct trust investments, and were restricted from divesting their beneficial interests in the trust due to a spending limit clause. The Court declined to determine whether the North Carolina statute taxing trusts on the basis of the residence of beneficiaries was unconstitutional on its face. Justice Sonia Sotomayor provided the court’s opinion, but Justice Samuel Alito (joined by Justices John Roberts and Neil Gorsuch) wrote separately to clarify his belief that the court’s decision in Kaestner was simply an application of existing precedent and represented no development in the law. United States Supreme Court denies certiorari for Fielding case regarding Minnesota income taxation of irrevocable trust.

On June 28, 2019, the United States Supreme Court declined to hear the case of Baurly v. Fielding, U.S. Sup. Ct. 18-664, which was an appeal from the Minnesota Supreme Court’s ruling in Fielding v. Minnesota Comm’r of Revenue, Minn. Sup. Ct. A17-1177 (July 18, 2018) that Minnesota did not have the minimum connection to a trust required by the Due Process Clause of the United States Constitution to tax the trust’s non-Minnesota sourced income when the trust was created by a Minnesota grantor, was prepared and executed in Minnesota, was governed by Minnesota law, owned stock in a Minnesota S corporation, and had at least one Minnesota beneficiary, which beneficiary received distributions from the trust during the tax year in question, but the trust had no Minnesota trustee, and no portion of the administration of the trust occurred in Minnesota.

Federal Statutes

Taxpayer First Act sets goals for Service’s customer service, modernization, and cyber-security.

On July 1, 2019, President Trump signed the Taxpayer First Act, Pub. L. 116-15, which sets goals for the modernization of the Service’s operation and its interaction with taxpayers. The law targets increased opportunities for the electronic filing of tax returns and focuses the Service on protecting taxpayers’ electronically-stored personal information. The law also dictates certain changes to the Service’s internal procedures and operations and restricts certain seizure and debt collection activities the Service may pursue.

Federal Administrative Developments

Service releases Modernization Plan.

In Fact Sheet 2019-9 (April 2019), the Service issued a Modernization Plan centered on four major goals: modernize operations, provide simplified and proactive services for taxpayers, provide complete and integrated data to taxpayers with respect to their accounts and interactions with the Service in real time, and protect taxpayer data that is stored electronically. The Service described the plan as a six-year initiative with a cost of $2.3 billion to $2.7 billion.

Service issues proposed regulations for opportunity zone program.

In 84 Fed. Reg. 18652 (May 1, 2019), the Service issued proposed Regulations Sections 1.1400Z-2(a)(1) through 1.1400Z-2(g)(1) regarding the qualified opportunity zone program, which includes:

- Providing that a transfer of a qualified opportunity fund (QOF) interest as a gift, other than a gift to a grantor trust, is an inclusion event that results in recognition of a taxpayer’s deferred gain invested in the QOF.
- Providing that a change of grantor trust status as a result of a grantor’s death for a trust owning a QOF interest will not be an inclusion event, but any other change to grantor trust status during a grantor’s lifetime will be an inclusion event.
- Providing that dispositions of a QOF interest upon its owner’s death under an estate or trust will not result in an inclusion event.

Services releases final regulations and safe harbors regarding deductions for state and local taxes.

On Aug. 27, 2018, the Service issued proposed regulations regarding the limitations on deductions for state and local taxes and the
treatment of state and local tax credits granted for charitable deductions. In TD 9864 (June 13, 2019), the Service issued final regulations, making only clarifying and technical changes to the proposed regulations. In Rev. Proc. 2019-12 (Dec. 28, 2018) and Notice 2019-12 (June 11, 2019), the Service released guidance regarding two safe harbors for the participation in state and local tax credit programs. In JX-35-19 (June 24, 2019), the Joint Committee on Taxation released a report providing further background and explanation of these final regulations and safe harbors. The first safe harbor applies to C corporations and other entities taxed separately from their owners and provides that the payment to charity made as part of a state and local tax credit program may be treated as an ordinary and necessary business expense for purposes of Code Section 162(a). The second safe harbor applies to individuals and provides that individuals may treat the portion of their charitable contribution that is not deductible pursuant to Regulations Section 1.170A-1 as payment of a state or local tax for purposes of Code Section 164.

Service finalizes regulations authorizing disclosure of business return information to Census Bureau.

In TD 9856 (April 9, 2019), the Service finalized temporary regulations authorizing the Service’s disclosure of certain business tax return information to the United States Census Bureau for purposes of its data collection activities. Examples of the information subject to such disclosure include expenses, deductions, dividends, losses, liabilities, research activities, wage information if a business has stopped paying wages, whether a business is a seasonal employer, and certain information regarding income-producing real estate.

Service releases final regulations for Code Sections 4963, 6011, and 6071.

On Nov. 7, 2018, the Service issued proposed regulations for Code Sections 4963, 6011, and 6071 regarding the imposition of excise taxes on tax-exempt organizations. In T.D. 9855, April 5, 2019, the Service adopted these proposed regulations without change as the final regulations for the aforementioned Code sections. The final regulations provide that a Form 4720 is required for paying excise taxes issued under Code Sections 4960, 4966, 4967, and 4968 and that such return is due by the fifteenth day of the fifth month after the end of the taxable year of the tax-exempt organization owning such excise tax. In addition, excise taxes imposed under Code Sections 4966 and 4967 applicable to donor advised funds were characterized as first-tier taxes subject to abatement under Code Section 4962.

Service will stop faxing tax transcripts and will stop providing them to certain third parties.

In IR-2019-101 (June 4, 2019), the Service announced that to help protect against identity theft, it will no longer fax tax transcripts to anyone. Taxpayers and their agents may obtain transcripts online or by mail. The Service also announced that third parties like lenders and colleges will no longer be permitted to request tax transcripts from the Service in order to verify a taxpayer’s income. The Service referred such third parties to its Income Verification Express Service.

Service will issue determination letters involving formation of retirement plans.

In Rev. Proc. 2019-20 (May 1, 2019), the Service announced that it will accept requests for determination letters from retirement plan sponsors regarding individually defined statutory hybrid plans, defined in Regulations Section 1.411(a)(13)-1(d)(3), for the period from Sept. 1, 2019 through Aug. 31, 2020 and regarding plans resulting from the merger or consolidation of two or more plans into a single individually designed plan on an ongoing basis.

Service confirms automatic allocation of GST exemption to misreported transfers.

In PLRs 201921004 and 12 (May 27, 2019), two taxpayers created trusts for the benefit of their grandchildren, misreported gifts to the trusts as indirect skips instead of direct skips, and opted out of the automatic allocation of their generation-skipping transfer (GST) exemptions to the transfers to the trusts. The taxpayers later requested that the Service rule that the taxpayers’ GST exemption had been automatically allocated to the transfers. The Service acquiesced, ruling that the taxpayers’ election out of automatic allocation of GST exemption applied only to indirect skips and therefore did not actually apply to their gifts to the trusts, which were direct skips.

Similarly, in PLRs 201924001-2 (June 14, 2019), PLR 201924016 (June 14, 2019), PLR 201925001 (June 21, 2019), and PLR 201925013 (June 21, 2019), taxpayers created trusts for the benefit of their respective descendants but misreported their gifts to their trusts as gifts subject only to gift tax instead of indirect skips and made no representation regarding the application of their GST exemptions to the transfers. The Service ruled that the taxpayers’ GST exemptions were automatically allocated to their respective transfers.

Trust modification effective to prevent inclusion of proceeds of trust-owned life insurance policy insuring trustee’s life in trustee’s gross estate.

In PLRs 201919002-3 (May 10, 2019), the Service confirmed that when a trust owned a life insurance policy insuring the life of its trustee (who was also a beneficiary of the trust), the trustee would not have any incidents of ownership with respect to the policy (which if present would cause the insurance proceeds to be includible in the trustee’s gross estate for federal estate tax purposes) if the trust were modified to remove the trustee’s non-fiduciary testamentary power of appointment with respect to the trust property and to appoint another trustee (the “Insurance Trustee”) to exercise the powers of the trustee with respect to the policy. The modified terms of the trust permitted the trustee to remove and replace the Insurance Trustee but prohibited the trustee from appointing a successor Insurance Trustee who is related or subordinate to the trustee within the meaning of Code Section 672.

Correction of beneficiaries’ testamentary general powers of appointment to testamentary limited powers of appointment effective to prevent inclusion of trust property in beneficiaries’ gross estates.

In PLRs 201920001-3 (May 17, 2019), a grantor created separate trusts for the grantor’s grandchildren. Each trust terminated at the death of the grandchild for whom it was created, each grandchild had a testamentary general power of appointment with respect to such grandchild’s trust. The trusts were later modified to amend the testamentary general powers of appointment to testamentary limited powers of appointment on the basis of a scrivener’s error, with the modified trusts still terminating upon the death of the applicable grandchild. The Service here confirmed that the modi-
fictions did not constitute gifts by the grandchildren and were effective to prevent the trust property from being includible in the respective gross estates of the grandchildren for estate tax purposes. The Service further provided that the grantor's GST exemption was automatically allocated to the grantor's contributions to the trusts, as was the GST exemption of the grantor's spouse with respect to gifts the spouse was deemed to have made to the trusts. The Service did not address whether the modifications had any GST tax consequences.

**IRA payable to surviving spouse's revocable trust is eligible for a spousal rollover.**

In PLR 201923002 (March 4, 2019), the beneficiary of a decedent's IRA was the decedent's surviving spouse's revocable trust. The surviving spouse had the right to withdraw net income and/or principal of the trust, to modify, amend, or revoke the trust, and to distribute the IRA proceeds to herself from the trust at any time. For these reasons, the Service found that the decedent's surviving spouse was effectively the person for whom the IRA was maintained for purposes of Code Section 408(d)(3)(A). Therefore, because the IRA was maintained for the decedent's surviving spouse, if the surviving spouse received a distribution of the IRA from the trust, the surviving spouse could perform a spousal rollover provided that the remaining requirements of Code Section 408(d)(3)(B) were satisfied.

**Surviving spouse may roll over decedent's IRA paid to estate.**

In PLR 201931006 (Aug. 2, 2019), the taxpayer requested rulings (i) that decedent's IRA would not be treated as an inherited IRA under Section 408(d), (ii) that taxpayer would be permitted to roll over the proceeds of decedent's IRA to an IRA in her own name, and (iii) that taxpayer will not be required to include any timely rollover in her gross income for federal tax purposes. At decedent's death, decedent's IRA did not have a beneficiary designation and thus was payable to decedent's estate. Decedent died intestate and decedent's surviving spouse was both the sole heir to decedent's estate and the administrator of decedent's estate. The surviving spouse intended to distribute the IRA to the estate, pay such proceeds to himself, and roll over the proceeds into an IRA in his own name within sixty days of receipt.

**Service rules rollover of decedent's 457 plan distribution is tax-free.**

In PLR 201936009 (Sept. 6, 2019), the Service concluded that the taxpayer was eligible to roll over the distributions from the deceased spouse's 457 Plan account to an IRA in the spouse's name and would not be required to include the amount distributed in her gross income for tax purposes for the calendar year in which the distribution and rollover occurred. The taxpayer's spouse named his estate as the sole beneficiary of an account established under Section 457(b). Upon decedent's death, the taxpayer was both the Executrix and sole beneficiary of decedent's residuary estate. She planned to roll over decedent's account to her own IRA. The Service noted that while decedent's estate was the beneficiary of his account in the Plan, because decedent's surviving spouse was the Executrix and sole beneficiary of his residual estate, a direct rollover to her IRA would be treated as paid from the Plan to the decedent's spouse for purposes of Section 402(c).

**Service denies tax-exempt status to organization raising funds for patients prescribed THC and CBD treatments and educating the public about such treatments.**

In PLR 201917008 (April 29, 2019), the Service found that a non-profit corporation organized to (i) provide financial aid to individuals who could not afford the costs of prescribed THC and CBD medical treatments, (ii) educate the public about THC and CBD medical treatments, and (iii) support research into THC and CBD medical treatments did not qualify as a tax-exempt organization under Code Section 501(c)(3). Under Rev. Rul. 75-384, the purposes of a charitable organization may not be illegal or contrary to public policy. Because it is illegal under federal law to knowingly manufacture, distribute, or dispense marijuana or possess marijuana for such purposes, the Service found that the corporation's purpose was against public policy as it advocates and supports the distribution of marijuana, and thus the corporation did not qualify as a tax-exempt charitable organization under Code Section 501(c)(3).

**Charity requests clarifications regarding tax on executive compensation for tax-exempt organizations.**

In a letter to the Service dated June 18, 2019 and in accordance with the Service's request for comments in Notice 2019-09, the Alliance for Charitable Reform requested clarity and provided suggestions for proposed regulations regarding the tax under Code Section 4960 on highly compensated executives of tax-exempt organizations or their affiliates. The Alliance highlighted a situation whereby for-profit corporations encourage their highly paid executives to provide volunteer services or services for minimal compensation to related tax-exempt organizations. The Alliance notes that under Code Section 4960 as currently written, tax could be required to be paid under Code Section 4960 for individuals for whom a tax-exempt organization itself provides minimal or no compensation. Furthermore, the Alliance notes that compensation paid to certain executives that provide services to a tax-exempt organization in early years would continue to be subject to tax under Code Section 4960 even if that executive is no longer providing services, volunteer or otherwise, to the tax-exempt organization. The Alliance requested that the Service address these issues in proposed regulations issued under Code Section 4960.

**Sale of asset from grantor trust to spouse's grantor trust does not result in capital gains/losses.**

In PLR 201927003 (July 5, 2019), the Service provided that a sale from one spouse's grantor trust to a grantor trust created by the other spouse does not result in the recognition of capital gain or loss. Specifically, Spouse 1 proposed to sell a percentage of a limited partnership interest to a trust created by Spouse 2. Spouse 1 also purportedly created a grantor trust (Trust 1), and the trustee of that trust proposed to sell a portion of a limited partnership interest to the purported grantor trust (Trust 2) created by Spouse 2. The Service noted that because the trusts were grantor trusts, the sale and purchase would be treated for federal tax purposes as though they were made by the spouses. The Service cited Code Section 1041(a)(1), which provides that no gain or loss shall be recognized on a transfer of property between spouses. The Service also cited Section 1041(b), which provides that in such case, the property is treated as though it was acquired by gift, and the basis of the transferee will be the adjusted basis of the transferor, thus, the basis of the property acquired from Trust 1 by Trust 2 would be the same as the adjusted basis in property in the hands of Trust 1.
Service addresses estate, gift and GST tax issues related to division of trust.

In PLR 201928004 (July 12, 2019), the Trustee proposed to divide a son's trust into five subtrusts for the benefit of son and each of son's five children and their respective issue. The terms of each subtrust were to be identical and unchanged from the original trust terms, except that each subtrust would be held for the benefit of son and his respective child for whom the subtrust was created and such child's issue. Any distributions to son from a subtrust would be pro rata from each subtrust. The personal representative sought and received six rulings from the Service: (i) the proposed division of trust into subtrusts and the pro rata allocation of the assets of the trust among the subtrusts will not cause the trust or any of the subtrusts to lose its grandfathered status for purposes of the GST tax, or otherwise become subject to GST tax; (ii) the proposed division of trust will result in each subtrust having different primary beneficiaries, so as long as each subtrust is separately managed and administered, they will be treated as separate trusts for federal income tax purposes; (iii) the proposed division of trust is not a distribution under Section 661 or Section 1.661(a)-2(f) and will not result in the realization of gain or loss under Section 61 or Section 1001 or cause the trust, subtrusts, or beneficiaries to recognize any income, gain, or loss under Section 662; (iv) the basis and holding period of the assets received by the subtrusts will be the same as the respective basis and holding period of the assets held by the trust under Section 1015 and Section 1223(2), respectively; (v) the proposed division of trust and the pro rata allocation of the assets of trust among the subtrusts will not cause any portion of the assets of the subtrusts to be includible in the gross estate of any of the beneficiaries of the subtrusts under Sections 2035–2038; and (vi) the proposed division of trust and the pro rata allocation of trust among the subtrusts will not result in a transfer by any beneficiary of trust that is subject to the gift tax under Section 2501.

Estate can defer payment of estate tax under Section 6166(a)(1).

In PLR 201928007 (July 12, 2019), the Service ruled that multiple operating units of a single closely-held corporation qualified as the "carrying on of a trade or business” within the meaning of Section 6166(a)(1). At the time of decedent's death, his revocable trust owned shares in a closely-held corporation with six operating units that filed a single consolidated income tax return. Several of the units were comprised commercial real estate leased to tenants. Several units provided management services, including procurement of new tenants and negotiating and executing leases; the extent to which the corporation's employees were actively involved in finding new tenants and negotiating and executing leases; the extent to which the corporation's employees provided services beyond the mere furnishing of leased premises; the extent to which the corporation's employees personally arranged for, performed, or supervised repairs and the maintenance of property (whether or not performed by independent contractors); and the extent to which the corporation's employees handled tenant repair requests and complaints.

Service rules on distribution of assets from CLAT.

In PLR 201928005 (July 12, 2019), the Service ruled that a distribution of assets from a charitable lead annuity trust ("CLAT") to a foundation as a result of a state court order was not a distribution in satisfaction of a right to receive a distribution of a specific dollar amount or in specific property other than the distribution, and was not a distribution in satisfaction of a general claim for ascertainable value, so no gain or loss was recognized by the CLAT as a result of the distribution. The trust required annual annuity payments to a state law non-profit corporation (the "foundation"). At the conclusion of a set number of years, the remaining interest would revert to a named beneficiary or its assigns. The beneficiary assigned its remainder interest to the foundation. Under state law, the annuity interest and remainder interest merged, but the trust did not terminate. The parties proposed to terminate the trust and distribute the trust property to the foundation. Reg. Section 1.661(a)-2(f)(1) provides that if property is paid, credited or required to be distributed in kind by a trust or estate, no gain or loss is realized by the trust or estate by reason of the distribution, unless the distribution is in satisfaction of a right to receive a distribution in a specific dollar amount or in specific property other than that distributed. The distribution by a trust of appreciated securities in satisfaction of its obligation to pay a fixed annuity to a charitable organization results in taxable gain to the trust. However, the Service ruled that the Trust's distribution of its assets to the foundation as a result of the termination was not a distribution in satisfaction of a right to receive a distribution of a specific dollar amount or in specific property other than that distribution, nor was it a distribution in satisfaction of a general claim for an ascertainable value and therefore no gain or loss was recognized by the trust as a result of the distribution.

Service rules that termination of CLAT does not result in termination tax under Section 507(a).

In PLR 201930017 (July 26, 2019), the Service ruled that the termination of a charitable lead annuity trust ("CLAT") on a stated date in accordance with the governing instrument and not discretionary with trustee would not result in imposition of termination tax under Section 507(a). The CLAT was created and funded upon the death of the grantor and a charity was given a guaranteed annuity interest. The CLAT was to last a specified period of time in accordance with a prescribed formula and, upon expiration of that period, the remainder interest was to be distributed to the grantor's children. The grantor's estate received an estate tax charitable deduction based on a percentage basis of the initial value passing to the CLAT. The Service explained that to determine whether the trust will properly terminate, a termination date must be calculated under Section 7520 so that the present value of the charities’ guaranteed annuity interest equals the percentage of the trust’s initial value. That determination may require a final payment or partial payment that occurs between
otherwise scheduled payment dates. The Service determined the termination date and found that the trust would terminate on the required termination date. The Service then explained that Section 507 did not apply to split-interest trusts if they terminated by reason of any payment to a beneficiary that is directed by the terms of the governing instrument and is not discretionary with the trustee, which was the case with the CLAT in this case.

CLAT formula clause satisfies guaranteed annuity requirement for term of years.

In PLR 201933007 (Aug. 16, 2019) the taxpayer requested rulings that (i) a trust's formula provision for establishing and funding a CLAT satisfied the requirements for a guaranteed annuity for a specified term of years under Section 2055(e)(2)(B) and (ii) that the estate of the surviving spouse would be entitled to a federal estate tax deduction for the present value of the annuity interest payable to charity. The grantor's trust provided that upon grantor's death and after payment of debts and expenses, a portion of the assets of the trust were to be distributed to a GST exempt credit shelter trust. The remainder of the assets were to be distributed to a QTIP trust if grantor's spouse survived, and if not, to a CLAT. The QTIP trust provided that upon the death of grantor's spouse, grantor's spouse possessed a special power of appointment to appoint the QTIP trust assets among various individuals and charities. If grantor's spouse failed to exercise that power, the assets passed to a CLAT. The terms of the CLAT provided that the charitable interest would be an annuity amount equal to five percent of the fair market value of the initial trust estate (as finally determined for federal estate tax purposes in the estate of the survivor of the grantor and grantor's spouse). A second formula determined the specific term of years for which the annuity payments would be made. That computation was based in part on the amount of the net fair market value of the assets passing to the CLAT on the later of the grantor or the grantor's spouse date of death. The Service ruled that the term of the CLAT was therefore ascertainable on the spouse's date of death and satisfied the "specified term" requirement of 20.255-2(e)(2)(iv). The Service further ruled that if the surviving spouse would have been made and thereafter the personal representative acted reasonably and in good faith by reasonably relying on a qualified tax professional and that such tax professional failed to make, or advise the taxpayer to make, the election.

Service rules on income and GST tax implications of trust termination.

In PLRs 201932001-201932009 (Aug. 9, 2019), the taxpayers requested that the Service rule on the income and generation-skipping transfer tax ("GSTT") consequences of a trust termination. The subject trust was a grandfathered GST exempt trust created for the benefit of the settlor's son. The trust provided that all income was to be distributed to son for his lifetime but no principal distributions could be made to son. Upon son's death, the trust property was to be distributed to son's issue, per stirpes. Son had four living adult children and eight living grandchildren. The beneficiaries entered into an agreement for termination of the trust with each beneficiary receiving his or her actuarial interests in the trust calculated as of the termination date. The Service ruled that the proposed termination would not cause the distributions to be subject to GSTT as long as the actuarial interests were properly calculated. Likewise, the beneficiaries will not be treated as making a taxable gift as long as the actuarial interest were properly calculated. For income tax purposes, the Service ruled that son and his children would recognize long-term capital gain on account of the proposed distribution of their interests. The proposed distribution takes the form of a distribution of the present values of the respective interests of the beneficiaries. The Service determined that the termination was, in substance, a sale of the son's and his children's interest to the grandchildren under Rev. Rul. 69-486 and 72-243.

Service rules individual substantially complied in allocation of GST tax exemption.

In PLR 201936001 (Sept. 6, 2019), the Service concluded that, for purposes of Section 2642(g)(2), the taxpayer substantially complied with the requirements of Section 2632(a) to timely allocate his GST exemption to the transfer to a trust. Taxpayer created an irrevocable trust that had GST tax potential. Taxpayer's law firm timely filed a Form 709 in which Taxpayer elected out of the automatic allocation rules with respect to the transfer to Trust and instead allocated GST exemption to the transfer on Schedule C, Part 2, Line and attached a copy of the trust to the return. However, the law firm failed to attach a Notice of Allocation with the Form 709 for the transfer. The Service found that for purposes of Section 2642(g)(2), the information provided on the Form 709 in combination with the terms of the trust substantially complied with the requirements of Section 2632(a) for Taxpayer to timely allocate his GST exemption to the transfer to the trust.

Failure of trustee to make ESBT election constitutes inadvertent termination of S-corporation status.

In PLR 201933001 (Aug. 16, 2019), the Service held that transfers by individual of S corporation stock to five (5) separate trusts that each met the requirements to make an election to be treated as an Electing Small Business Trust (ESBT), but no such elections were actually made due to the inadvertence of the Trustee, caused an inadvertent termination of the corporation's S election under Section 1362(f) of the Code. Additionally, the Service held that where the trustee of a grantor trust shareholder which ceased to be a grantor trust upon the death of the grantor, also failed to timely make an ESBT election, such failure also resulted in an inadvertent termination. The Service ruled that the corporation would continue to be treated as an S corporation despite such inadvertent termination provided the trusts made the appropriate ESBT elections for the periods at issue.

Service allows estate extension of time to make alternate valuation date election.

In PLR 201938002 (Sept. 20, 2019), the IRS concluded that the personal representative of decedent's estate is granted an extension of time to the date the supplemental Form 706 was filed to make the alternate valuation election under Section 2032. The personal representative of Decedent's estate had retained a law firm to prepare Form 706, which return was timely filed. The law firm did not advise the personal representative to elect alternate valuation under Section 2032 on the Form 706 and thus such an election was not made. In preparing the account for Decedent's estate, the law firm determined that such an election should have been made and thereafter the personal representative filed a supplemental Form 706 making the alternate valuation election under Section 2032. The Service concluded that the standards of Sec. 301.9100-1 and 301.9100-3 had been satisfied because the personal representative acted reasonably and in good faith by reasonably relying on a qualified tax professional and that such tax professional failed to make, or advise the taxpayer to make, the election.
Service rules that judicial modification of trust does not affect GST tax exempt status.

In PLRs 201938004-201938006 (Sept. 20, 2019), the Service ruled that the judicial modification of a grandfathered generation-skipping transfer tax exempt trust would not cause the trust to become subject to GSTT. Prior to Sept. 25, 1985, decedent created a trust for the benefit of son during his lifetime. Son was entitled to income distributions but not principal distributions. Upon son’s death, the principal of the trust was to be distributed to son’s issue, per stirpes. The trust was judicially modified to provide that upon son’s death the assets in the trust would not be distributed outright to son’s child but would instead be held in further trust for the benefit of son’s child. No general power of appointment was given to son’s child. Later, the trust was again judicially modified to provide that son’s child had a testamentary general power of appointment over the trust property and further provided that no accounts or final accounts would be required to be filed with the court. The Service ruled that it was clear that the decedent intended son’s child to have a general power of appointment over the assets and that the elimination of the accounting requirement was administrative in nature. Accordingly, there was no shift of a beneficial interest in the trust to a lower generation and the trust remained exempt.

Office of Chief Counsel advises on impact of pending merger on gift valuation.

In Chief Counsel Advice 201939002 (Sept. 27, 2019), the Office of Chief Counsel stated that, under the fair market value standard as articulated in Reg. Section 25.2512-1, a hypothetical willing buyer and seller of a publicly-traded company would consider a pending merger when valuing stock for gift tax purposes. This holding is discussed in Philosophy 101 – What is Reasonable Knowledge by Elie J. Foy in this issue of The Will & The Way.

Federal Cases

Tenth Circuit confirms that Service may assert additional penalties in answers to taxpayer-initiated Tax Court actions.

In Roth v. Com’r, 10th Cir. No. 18-9006 (April 29, 2019), the Tenth Circuit affirmed a 2017 Tax Court case ruling that (i) the Service may assert additional penalties against a taxpayer in an answer to a taxpayer-initiated Tax Court proceeding and (ii) the repayment of previously collected sale proceeds by a taxpayer entitles the taxpayer to an income tax deduction with respect to the year of repayment but not with respect to the year of the original sale. The taxpayers here had overstated the value of a conservation easement for charitable income tax deduction purposes, and the Service’s initial notice of deficiency had asserted a 40% gross valuation misstatement penalty. The Service’s Appeals Office later purported to affirm the first notice of deficiency but recited only a 20% accuracy-related penalty. When the taxpayers contested the Service’s finding in Tax Court, the Service asserted the 40% penalty in its answer, which assertion was found to be permissible. The taxpayers had also acquired and sold state tax credits in connection with the contribution of the conservation easement and had to repay some of the sale proceeds pursuant to the valuation overstatement. The taxpayers had wanted to deduct the repayment amounts with respect to the year of the sale but were denied.

Federal government not constrained by state statute of limitations when collecting taxes.

In U.S. v. Johnson et al, 2019 WL 1414049 (10th Cir. March 29, 2019), a class of estate beneficiaries agreed to collectively assume the burden of the estate’s unpaid but properly deferred estate taxes in order to facilitate the distribution of the estate assets to the beneficiaries. The beneficiaries later defaulted on their obligation under the agreement to pay the estate taxes, and the federal government sued them in the capacity of a third-party beneficiary of their agreement. Though the federal district court ruled that the government’s claim was time-barred by a six-year state statute of limitations, the Tenth Circuit here found that, in accordance with U.S. Supreme Court and Tenth Circuit precedent, the United States government was not subject to state statutes of limitations when proceeding in its sovereign capacity to collect taxes. The Tenth Circuit found that the ten-year statute of limitations prescribed by the Code did apply, but the taxpayers did not plead the Code’s statute of limitations as an affirmative defense to the government’s claims and therefore were not protected by it.

Common law “mailbox rule” inapplicable in determining timely filing of tax returns.

In Baldwin v. U.S., 9th Cir. No. 17-55115 (April 16, 2019), the Ninth Circuit ruled that the common law “mailbox rule” used to determine when legal documents are deemed to be delivered does not supersede the requirements of Code Section 7502 that a federal tax return is only timely delivered if (i) the Service actually receives the return under a timely postmark or (ii) the taxpayer proves that the taxpayer timely deposited the return with the United States Postal Service as registered mail or with a qualified private delivery service that maintains adequate transmission records. In contrast to Code Section 7502, the common law mailbox rule allows circumstantial and testimonial evidence as to whether a document was properly deposited with the United States Postal Service or another delivery service.

Ninth Circuit confirms that estate undervalued dirty but rare paintings.

In Kollsman v. Com’r, 123 AFTR 2d 2019-2296 (June 21, 2019), the Ninth Circuit confirmed a Tax Court ruling that an estate undervalued rare paintings for estate tax purposes by overstating discounts to the paintings’ values based on dirtiness. The Ninth Circuit agreed with the Tax Court that cleaning the paintings would have been “a well-advised and low-risk undertaking” and that a hypothetical buyer would have understood the low impact of the dirty state of the paintings.

QDRO issued after plan participant’s death was effective to pass 401(k) to surviving former spouse.

In Miletello v. RMR Mechanical, Inc., 921 F.3d 493 (5th Cir. 2019), the Fifth Circuit affirmed a trial court’s ruling that a qualified domestic relations order (“QDRO”) issued after a plan participant’s death was valid to transfer a portion of the plan participant’s 401(k) balance to his surviving former spouse. Pursuant to the divorce settlement between the plan participant and his former spouse, the former spouse was entitled to a portion of the plan participant’s 401(k) plan. After the divorce settlement, the plan participant remarried.
Several months later, the plan participant died in a plane crash. Two days after the plan participant's death, the state court entered a judgment of partition incorporating the divorce settlement into the divorce decree. Fifteen months after the judgment of partition was entered, the state court issued a domestic relations order (“DRO”) with respect to the plan participant’s 401(k). Pursuant to 29 U.S.C. Section 1056(d)(3)(H)(i)(–v), if a DRO is issued within eighteen months of a divorce, the DRO may qualify as a QDRO, sufficient for purposes of ERISA to transfer a 401(k) from someone other than the plan participant’s surviving spouse. 29 C.F.R. Section 2530.206(c)(2) provides further that a DRO can qualify as a QDRO even if it was not issued until after the plan participant’s death, provided that it satisfies the other requirements necessary to qualify as a QDRO. Therefore, because the DRO was issued within eighteen months from the divorce, as required under ERISA, the surviving former spouse was entitled to receive the portion of the plan participant’s 401(k) as set out in the divorce settlement, incorporated into the DRO.

**Court of Appeals affirms denial of charitable deduction for failure to provide cost basis of property contributed.**


Bankruptcy Court finds assets involved in an IRA rollover were exempt in Chapter 7 bankruptcy.

In In re: Richard L. Jones, Bankr. S.D. Ill. No. 18-31532 (April 15, 2019), the Bankruptcy Court for the Southern District of Illinois found that assets in a debtor’s IRA were exempt assets for Chapter 7 bankruptcy proceedings even though the debtor had withdrawn funds from the IRA and contributed different assets fifty-nine days after the initial withdrawal. Relying heavily on Zaklama, et. al. v. C.I.R., T.C. Memo, 2012-346 (2012) and In re Chaudury, 581 B.R. 279 (Bankr. M.D. Tenn. 2018), the court found that because assets were re-contributed to the IRA within sixty days of the initial withdrawal, the withdrawal and re-contribution constituted an IRA rollover for purposes of Code Section 408 and thus the IRA remained a qualified retirement plan for purposes of Code Section 408. Because, under Illinois law, a debtor’s interest in a “plan…intended in good faith to qualify as a retirement plan under applicable provisions of the Internal Revenue Code” is exempt from bankruptcy proceedings, the debtor’s interest in his IRA was an exempt asset for purposes of his bankruptcy proceeding.

Finding of self-settled trust is unnecessary but specificity in pleadings is required under bankruptcy fraudulent transfer laws.

In In re Cyr, Bankr. W.D. Tex. No. 18-50102-CAG (April 1, 2019), a bankruptcy trustee brought an action claiming that assets held in an irrevocable trust for the benefit of a debtor and his wife should be includible in the debtor’s bankruptcy estate under several theories of fraudulent transfer under federal bankruptcy law and Texas state law. The court did not grant the trustee of the irrevocable trust’s motions to dismiss the fraudulent transfer claims alleged by the bankruptcy trustee under 11 U.S.C. Section 548(e)(1), finding that the focus of the trustee’s argument was on whether the trust was self-settled as to the debtor under Texas law, which the court found was irrelevant as 11 U.S.C. Section 548(e)(1) grants a bankruptcy the power to void transfers to a “self-settled trust or similar device.” Nevertheless, the court granted the trustee’s motions to dismiss the fraudulent transfer claims alleged by the bankruptcy trustee under 11 U.S.C.S. Section 548(a)(1) because the bankruptcy trustee failed to plead with specificity whether it was bringing claims of actual or constructive fraud under 11 U.S.C.S. Section 548(a)(1) and failed to plead actual fraud with specificity as required by Rule 9(b) of the Federal Rules of Civil Procedure.

**Trust treated as nominee of debtor for purposes of federal tax lien.**

In Saepoff v. North Cascade Trust Services, Inc., 2019 WL 1759836 (W.D. Wash. April 19, 2019), the court found that property that had been transferred to a trust by quitclaim deed by a taxpayer was subject to a federal tax lien for outstanding tax liabilities of the taxpayer. The taxpayer transferred the property to the trust for no consideration when the taxpayer had outstanding unpaid tax liabilities. Furthermore, the taxpayer continued to live on the property and pay expenses associated with the property. As such, the court found that the trust was merely the nominee for the taxpayer. Therefore, the taxpayer continued to own the property under Washington law, and a federal tax lien could attach.

**Assets in a West Indies self-settled trust are not considered in calculating a taxpayer’s ability to pay for purposes of an offer in compromise.**

In John F. Campbell v. Comm’r, T.C. Memo 2019-4 (Feb. 4, 2019), the tax court found that the Service could not consider assets transferred to an off-shore trust in calculating the taxpayer’s ability to pay for purposes of granting or denying offer in compromise based on doubt as to collectability. Under the Internal Revenue Manual, in determining a taxpayer’s reasonable collection potential, the Service considers the taxpayer’s (a) assets, including dissipated assets, (b) future income, (c) amounts collectible from third parties, and (d) assets available to the taxpayer but beyond the reach of the Service. The court found that the trust assets did not constitute dissipated assets of the taxpayer because the taxpayer had not transferred them to avoid his payment of tax liability as, when the taxpayer transferred $5,000,000 to the trust, the taxpayer’s remaining net worth was approximately $19,000,000, which was sufficient to pay any potential tax liability. Furthermore, the trust assets did not constitute amounts collectible from third parties or assets available to the taxpayer but beyond the reach of the Service.

**Charitable deductions denied for everyday evangelizing.**

In Robert A. Oliveri v. Comm’r, No. 6792-15, T.C. Memo 2019-57 (May 28, 2019), the tax court denied charitable deductions for the vast majority of expenses incurred in the daily activities of an evangelist. The evangelist claimed deductions for expenses such as travel...
expenses, meals, telephone and internet access, and flying lessons. The court noted that these expenses were largely incurred for the evangelist’s personal activities and were not coordinated with the charitable organization that the evangelist formed or the Catholic Church, and that the evangelist did not receive contemporaneous written acknowledgment for expenses in excess of $250. The court also found that the evangelist was liable for the addition to tax under Code Section 6651(a)(1) because he did not file his tax return until ten months after the extended filing deadline. Nevertheless, the court found that the Service presented no evidence to suggest that the evangelist was liable for an accuracy related penalty under Code Section 6662. The court rejected the evangelist’s arguments that the Service’s audits violated his First Amendment rights to freely express his religion, finding that the Service was not contending that the evangelist’s activities were not religious in nature but rather merely that they were not deductible as charitable contributions.

**Tax Court holds unreported income flowed to and from “sham” trust.**

In *Wegbreit v. Commissioner*, T.C. Memo 2019-82 (July 8, 2019), the Tax Court found in a memorandum opinion that taxpayers had unreported income after establishing ‘trust’ sham businesses and insurance policies to shield their income. The court found that the trust was a sham because the taxpayers maintained control of the assets and could not document any initial contribution to the trust. The taxpayers controlled the flow of funds to and from the trust, and none of the trustees, one of which was the taxpayers’ law firm, were actual trustees or permissible trustees under the trust documents. Further, three versions of the trust instrument with differing dates were submitted to the Service from different sources. The taxpayers used the trust’s funds to disguise the taxpayers’ purchase investments and condominiums. The court determined that the trust lacked “any semblance of economic substance [and] was a mere alter ego” of the taxpayers.

**Rollover treatment allowed where late repayment of IRA distribution due to bookkeeping error.**

In *Burack v. Commissioner*, T.C. Memo 2019-83 (July 8, 2019), taxpayer, Nancy Burack, had an IRA held with Capital Guardian, LLC/Pershing, LLC. Pershing was the custodian of the account, and she had a financial advisor at Capital Guardian. On June 25, 2014, the taxpayer received a $524,981.89 distribution from the IRA for the purchase of a new home, and she intended to the roll over the distribution back into her IRA within sixty days of her receipt of the funds from the sale of her former home. The sale of the taxpayer’s home closed on Aug. 21, 2014, and based on assurances from her financial advisor, the taxpayer overnighted a check for the amount of the IRA distribution to Capital Guardian that same day. It was undisputed that the check arrived at Capital Guardian on Aug. 22, 2014, fifty-eight days after taxpayer received the IRA distribution. For unknown reasons, the check was not deposited at Pershing into the taxpayer’s account until Aug. 22, 2014, fifty-eight days after taxpayer received the IRA distribution. The service determined that the taxpayer was required to include the distribution in her 2014 gross income. Citing *Wood v. Commissioner*, 93 T.C. 114 (1989), the Tax Court held that the late deposit was attributable to a bookkeeping error because the check was received by Capital Guardian during the rollover period, and thus the distribution and repayment qualified for rollover treatment.

**Payment of personal expenses of shareholder deemed constructive dividend.**

In *Combs v. Commissioner*, T.C. Memo 2019-96 (Aug. 5, 2019), the Tax Court held that the payment by a corporation of its sole shareholder’s personal living expenses amounted to unreported, constructive dividends. The taxpayer at issue was a motivational speaker and performer and transferred payments for his performances into the account of Good Thinking, Inc., a corporation established by the taxpayer and of which the taxpayer was the sole shareholder and director and also was the president, chief executive officer, chief financial officer and treasury. The funds were then used to pay the taxpayer’s personal expenses but were deducted as business expenses by the corporation. The taxpayer conceded the scheme was devised for tax avoidance purposes in accordance with the “Private Tax Excepted Self Supporting Ministry” concept, which was promoted by one, Robert Holcomb (who is now incarcerated for the commission of various financial crimes). The taxpayer offered into evidence hundreds of pages of unsorted ledgers and receipts documenting the payments which the Tax Court found were not linked in any meaningful way to the adjustments made by the Service and provided no reasonable means to determine which if any of the expenditures in question were ordinary and necessary business expenses. Further, the Petitioner did not identify any category of the challenged expenses that did not benefit him personally, and conceded that many of the expenses were for items that were not business related including child care.

**Decedent’s tax refund claim denied because power of attorney failed to file taxes.**

In *Stauffer v. Internal Revenue Service*, 939 F.3d 1 (1st Cir. 2019), the Court of Appeals affirmed the District Court’s judgment dismissing the Estate’s tax refund complaint for lack of jurisdiction. Hoff Stauffer had filed suit on behalf of his father’s estate against the IRS, alleging that the IRS had improperly denied his April 2013 claim for his father’s 2006 tax refund as untimely. Stauffer had asserted that the applicable statute of limitations for the filing of the tax refund claim was tolled due to his father’s financial disability. The District Court disagreed and dismissed the Estate’s complaint for lack of jurisdiction because no tax refund claim had been timely filed. On appeal, Stauffer alleged that the “look back period” was tolled during his father’s financial disability because although he had authority to file tax returns as his father’s power of attorney, he had no duty to do so absent actual knowledge of the need to do so and because he had renounced his obligations under the power of attorney. The Court of Appeals held that (i) son was a person “authorized to act” on his father’s behalf in financial matters under IRC Section 6511(h)(2)(B), such that his father’s mental condition did not toll the time for him to file a tax refund claim, and (ii) the District Court did not clearly err in finding that son had not positively and unequivocally renounced durable power of attorney.

**Taxpayer’s early IRA withdrawal is taxable; penalty tax applies.**

In *Rosenberg v. Commissioner*, T.C. Memo. 2019-124 (Sept. 19, 2019), the Tax Court held that a taxpayer’s withdrawal of funds from an IRA, even funds that were only placed there temporarily, was a taxable withdrawal and would be subject to the 10% early withdrawal penalty pursuant to Section 72(t)(1) of the Internal Revenue Code. In this case, an order filed upon plaintiff’s divorce required taxpayer’s former spouse to pay taxpayer $10,000 from the proceeds of the
former spouse's retirement account. Instead of taking $10,000 out of her IRA and paying the taxpayer cash, taxpayer's former spouse deposited the property into taxpayer's IRA. Within a week, taxpayer withdrew the funds and closed the account. Taxpayer did not report the withdrawal as income or pay the 10% early tax. The Tax Court noted that gross income generally includes distributions from an IRA under Sections 72 and 408(d). There is an exception for distributions made to an alternative payee under a qualified domestic relations order, but those were not the circumstances in this case. The taxpayer essentially argued that his former spouse was the one to put the funds in his IRA, that she did so over his objection, that the order indicated his former spouse needed to provide him with a cash payment and that he did not think the interim transaction would convert the payment to a taxable event. He argued that, accordingly, the Court should treat the transaction as a payment of cash. The Tax Court held that they could not create an equitable exception to the statutory scheme in Section 72. Consequently, the Court held that the taxpayer's withdrawal was includable in the taxpayer's gross income and was subject to the 10% additional tax.

District Court dismisses refund suit for lack of subject matter jurisdiction.

In *Carter v. U.S.*, 124 A.F.T.R.2d 2019-5467 (N.D. Ala. 2019), the Court dismissed the estate's refund claim for lack of subject matter jurisdiction. On Sept. 21, 2007, the decedent died owning shares of stock valued at $17,604,767. Within six months from the decedent's date of death, the value of the stock had declined to $8,548,947. On June 19, 2008, the estate filed a federal estate tax return and paid $6,261,530. On April 26, 2009, the estate filed an amended return reporting a slightly lower tax of $6,169,892. The Service issued a refund on the basis of the amended return. On Sept. 13, 2013, the estate filed a refund claim with the Service alleging overpayment of its estate tax by $3,731,616, due to a criminal fraud perpetrated against the company by one of its customers. The Service denied the claim. Thereafter, the estate commenced a federal district court action seeking a refund of the overpaid tax. That suit was voluntarily dismissed without prejudice. On Aug. 26, 2016, the estate refiled the refund claim on the same grounds except that the filing contained a medical opinion by a physician stating that the executor suffered from a medical impairment for over five years which prevented her from managing the affairs of the estate. The government claimed the district court lacked subject matter jurisdiction and that the estate's claim lacked merit. In ruling for the government, the court found that the estate failed to file a timely claim for refund with the Service under Section 6511(a). The Court further found that the financial disability exception to Section 6511(h) did not apply. That exception applied only to “individuals” and an estate is not an individual within the meaning of that section. Finally, the Court found that the value of the company stock on the six month anniversary of the date of death controlled. While the criminal acts of the customer were present, a market existed and the price was set by the market value on the applicable date. The market for the stock did not collapse until more than one year after the estate's valuation date.

Tax Court approves tax-affecting valuation of partnership and S corporation interests.

In *Estate of Aaron U. Jones v. Commissioner*, T.C. Memo 2019-101 (Aug. 19, 2019), the Tax Court approved tax-affecting the valuation of closely-held limited partnership and S corporation interests. On May 28, 2009, the taxpayer made gifts of voting and non-voting stock in Seneca Sawmill Co. ("SSC"), a closely-held S corporation, and limited partnership interests in Seneca Jones Timber Co. ("SJTC"). The Service determined a deficiency in gift tax of $44,986,416. At the time the gifts were made, the ownership and management of both companies was substantially similar. SCC engaged in the operation and manufacture of lumber. SJTC was formed to acquire, hold, and manage timberlands and real property. SCC held the sole 10% general partner interest in SJTC. SCC purchased 32% of the logs it milled directly from SJTC and an additional 24% of its logs indirectly through SJTC. SJTC sold 51% of its timber to SSC, which comprised all of the timber that SCC could manufacture. SJTC also borrowed against its assets and would transfer funds, in the form of a loan, to SSC to support its operations. This borrowing arrangement was particularly significant in 2009 due to the state of the housing market and the decreased demand for SCC's lumber. The taxpayer timely filed Form 709 reporting values of $325 per share for SCC's class A stock, $315 per share for SCC's class B nonvoting stock, $350 per unit for SJTC limited partnership units. In response, the Service claimed the actual value was $1,395 per SCC class A share, $1,325 per SCC class B share, and $2,511 per SJTC limited partnership unit. Thereafter, the taxpayer asserted the fair market value of the interests was $390, $380, and $380 respectively based on a second valuation opinion.

The parties primarily disputed whether an income approach or an asset-based approach was appropriate for SJTC. Additionally, the parties disputed the use of certain interim financial projections used in 2009, the propriety of “tax-affecting” of the interests, the proper treatment of intercompany loans, the property treatment of SCC's 10% general partner interest in SJTC, and the appropriate discount for lack of marketability.

**Income vs. Asset-based Approach.** The taxpayer argued that SJTC was an operating company that sold products (i.e., logs) and should be valued as a going concern. The Service argued that SJTC was a natural resource holding company and the value of its assets should be given primary consideration. The Court found that SJTC had aspects of both on operating company and an investment or holding company. The likelihood that SJTC would sell its timberlands was a significant factor in weighing an asset-based approach. The Court found that SCC control general partner made it unlikely that SJTC would sell its assets. Moreover, SCC and SJTC, while separate legal entities, have an interdependent relationship that weighed in favor of a going concern value. The Court therefore found the taxpayer's income-based approach more appropriate.

**Tax-Affecting.** The taxpayer's expert “tax-affecting” SJTC's earnings using 38% as a combined federal and state tax burden to the owners of SJTC. The expert then adjusted both the earnings used to calculate SJTC's net cash flow and the cost of debt capital to determine the appropriate discount rate. Further, he computed the benefit of the dividend tax avoided by estimating the implied benefit for SJTC's partners in prior years and considering an empirical study analyzing S corporation acquisitions. Finally, the expert applied a 22% premium to SJTC's weighted business enterprise value to reflect that benefit. The Service argued that tax-affecting was inappropriate. After noting that the Service's experts were "nota-
bly silent” on the issue of whether tax-affecting generally was appropriate and that the Service's defense of its position was a “fight between lawyers” and not valuation experts, the Court noted that the tax-affecting rejected in the prior cases of Gross v. Comm., 1999 WL 549463 and Estate of Gallagher v. Comm., T.C. Memo 2011-148, 2011 WL 2559847, was not a rejection of the appropriateness of tax-affecting. Instead, those cases were a rejection of the methodology used by the experts in those cases. In this case, however, the Court found that the taxpayer’s expert’s methodology was more accurate. The expert’s adjustments included a reduction in the total tax burden by imputing the burden of the current tax that an owner might owe on the entity’s earnings and the benefit of a future dividend tax avoided that an owner might enjoy.

**District Court holds donee and heir liable for unpaid gift and estate tax.**

In U.S. v. Widtfeldt, 124 A.F.T.R.2d 2019-xxxx (D. Neb. 2019), the District Court ruled that the heir of an estate and donee of a gift was personally liable for unpaid federal gift and estate taxes. In 2004, the defendant's mother had gifted two parcels of real property valued at $1,041,987, to the defendant. The mother died in 2006 with a taxable estate and the defendant was named personal representative of the estate. The defendant was also the sole heir of the estate. No gift or estate tax return was filed. The Service notified the defendant, as personal representative, of the non-filing and assessed gift tax and estate tax. The defendant challenged the assessment in the United States Tax Court which ruled against him and upheld the gift and estate tax assessments. The United States subsequently filed suit requesting that the defendant be held personally liable for the unpaid taxes pursuant to Section 6342 and that it be permitted to enforce the judgment against real property owned by the defendant. The court found that there was no genuine issue of material fact as to whether the defendant was personally liable for the tax as the prior decision in the Tax Court precluded the re-litigation of the defendant’s claims in the present action. Further, the court found that Section 7403 granted the court the authority to order a sale of the defendant’s property to satisfy the unpaid tax.

**Sixth Circuit upholds lower court ruling regarding tax lien on estate’s unpaid taxes.**

In Bennett et al. v. Susan Bennett Bascom et al., 124 A.F.T.R.2d 2019-5914 (9th Cir. 2019), the Sixth Circuit Court of Appeals affirmed the U.S. District Court for the Eastern District of Kentucky finding that an IRS tax lien for an estate’s unpaid taxes takes precedence over a creditor’s unrecorded security interest. The Sixth Circuit found that the IRS was entitled to $2 million in proceeds held in escrow from the sale of the assets of two limited partnerships in which the Decedent held interests. In 2006, the Decedent died owing nearly $2.3 million in outstanding loans to two limited partnerships of which he was the general partner and majority owner. Upon his death, the Decedent’s estate owed approximately $2.8 million in federal estate taxes and the IRS filed notice of its tax lien. The court found that there was no genuine issue of material fact as to whether the Decedent was personally liable for the tax as the prior decision in the Tax Court precluded the re-litigation of the Decedent’s claims in the present action. Further, the court found that Section 7403 granted the court the authority to order a sale of the Decedent’s property to satisfy the unpaid tax.

The IRS intervened claiming priority rights to the escrowed funds based on its tax lien. The Court agreed. In doing so, the Court rejected KER’s argument that it executed a “strict foreclosure” on the escrowed funds as the Estate had made an authenticated objection thereto within twenty days. The Court also rejected KER’s contention that its security interest was superior to the IRS’s lien under Section 6323(a) as the underlying security interest originally held by the limited partners was never perfected as they had never filed a financing statement. Thus, KER had purchased a loan that was not secured by a perfected security interest and thus was not “protected” for purposes of Section 6323(h)(1), and therefore, KER’s interest did not have priority of the IRS lien.

**District Court finds assessment of late filing penalty against estate was arbitrary and capricious.**

In Estate of Agnes R. Skeba v. U.S., 2019 WL 4885697 (D.C.N.J. 2019), the court held that the Service's decision to impose a late filing penalty was arbitrary. On June 10, 2013, Agnes Skeba died. The due date for her federal estate tax return was March 10, 2014. On March 6, 2014, the estate, through counsel, filed IRS Form 4768 Application for Extension of Time to File a Return and/or Pay U.S. Estate Taxes and included a partial payment toward anticipated estate taxes of $725,000. The application was accompanied by a letter explaining that full payment could not be paid due to illiquidity in the estate and the failure of a pending refinancing to close prior to the payment deadline. In addition, the letter explained that pending litigation over the validity of the will prevented a return from being filed. On March 18, 2014, the estate paid the balance of $2,745,000 which was the estimated estate tax liability. On June 25, 2014, the Service granted an extension of time to file the estate tax return until Sept. 10, 2014. On July 8, 2014, the Service granted an extension of time to pay the estate taxes until Sept. 10, 2014. Neither correspondence granting the extension acknowledged the prior payments. On June 30, 2015, the estate filed its federal estate tax return showing an overpayment of $941,162. In response, the Service assessed a late filing penalty of $450,949.50 and issued a refund of the balance. The late filing penalty comprised 25% of the “unpaid amount” of $1,803,838 on March 10, 2014. The estate requested a penalty abatement request with a simple explanation that “pending litigation is not reasonable cause.”

On cross-motions for summary judgment, the estate argued that Sections 6651(a)(1) and 6651(b) prevent the assessment of a late filing penalty because the taxes were paid prior to the Sept. 10, 2014 payment date. In response, the Service argued that the filing deadline was March 10, 2014, and that consideration of the subsequent extension was not permissible under Section 6151.

The Court found that the language of 6651(a)(1) and 6651(b) was more specific regarding the due date of the tax and that the taxpayer’s argument should prevail. In addition, the Court found that the Service's curt and simple response to the facts presented by the estate to demonstrate reasonable cause was arbitrary without any further investigation of the facts.
Offshore self-settled asset protection trust subject to Florida law and settlor's creditors.

In In re Rensin, 600 B.R. 700 (S.D. Fla. 2019), a Florida bankruptcy court held that the assets of a Belize self-settled asset protection trust (“Belize Trust”) were available to satisfy the creditors of the settlor-beneficiary. The Chapter 7 Trustee filed an adversary proceeding requesting that the court find that the assets held in the Belize Trust were property of the bankruptcy estate. The Belize Trust was originally established under the law of the Cook Islands but the situs and governing law were changed to Belize. The Chapter 7 Trustee did not argue that the settlor's transfers to the Belize Trust constituted fraudulent conveyances. Instead, the Chapter 7 Trustee argued that Florida law applied to determine the enforceability of the self-settled nature of the trust and, under Florida law, a self-settled trust violated public policy. The court found that Florida law applied to the enforceability of the trust and that Florida law had a strong public policy against self-settled spendthrift trusts. Accordingly, applying Florida's version of the Uniform Trust Code, the Belize Trust was available to satisfy the creditors of the settlor-beneficiary.

North Carolina Cases

Intestate succession properly determined by clerk of special proceeding over estate administration and not trial court determining paternity of decedent.

In Swint v. Doe, N.C. Ct. App. No. 18-964 (April 16, 2019), decedent died with no will, and plaintiff who, at the time of decedent's death was a minor, sought to (1) establish decedent's paternity through a guardian ad litem during the administration of decedent's estate, which involved a special proceeding among his relatives litigating the terms of administration, and (2) obtain a declaration that she was entitled to share as an intestate heir in decedent's estate. The trial court granted summary judgment in favor of plaintiff for both items. The Court of Appeals found that granting summary judgment as to the order of paternity was correct, but summary judgment as to a declaration that plaintiff was to inherit as an intestate heir de decedent's estate was not proper as it should have been adjudicated by the clerk involved in the special proceeding.

Court of Appeals holds affidavits by defendant beneficiaries disputing executrix's claims preclude summary judgment.

In Voliva v. Dudley, 832 S.E.2d 479, (N.C. Ct. App. 2019), the North Carolina Court of Appeals reversed the lower court's grant of summary judgment to plaintiff in a breach of contract claim. In this case, though the decedent's will provided that certain real property should be sold, the Executrix and the beneficiaries filed a petition in Superior Court to allow them to divide a parcel of real property before it was sold, the Executrix and the beneficiaries filed a petition in Superior Court to allow them to divide a parcel of real property between the three beneficiaries. The Superior Court entered an Order allowing the conveyance. The Executrix-plaintiff filed an application seeking commission, which was granted, and later filed a final account in Superior Court. In March 2018, plaintiff filed a complaint to enforce the terms of a promissory note executed by the beneficiaries. The note provided that the beneficiaries were to become jointly and severally liable to plaintiff in the amount of $15,000 “for value received,” but it did not specify what value was provided in exchange for the beneficiaries' promise to pay. Both parties subsequently filed motions to dismiss. Plaintiff filed a motion for summary judgment under Rule 56, arguing that there were no genuine issues of material fact. Plaintiff included two affidavits in her motion including one from her and another from the attorney who both helped plaintiff administer the decedent's estate and prepared the note on behalf of the beneficiaries. Plaintiff claimed in her affidavit that she never had any conversation with the beneficiaries regarding the real estate transaction or the note and that rather her son (who was also a beneficiary) had negotiated a settlement arrangement. Thereafter, defendants filed verifications in which they stated that their prior motion to dismiss and answer was "true of [their] own knowledge, except as to those matters and things stated on information and belief," which Defendants stated they believed to be true. In that prior motion to dismiss, they specifically asserted that plaintiff refused to allow the partition of the property until the defendants executed the note. Defendants therefore claimed the note was unenforceable (and ultimately not a valid contract) due to lack of consideration as well as fraud, duress and/or undue influence. In determining whether there was a genuine issue of material fact, the Court noted that as the Executrix of decedent's estate, plaintiff had a fiduciary duty to defendant-beneficiaries and accordingly, plaintiff was prohibited from putting her own interests above the defendants' interests. Because of the affidavits and verifications on each side, the Court found that there was a genuine issue of material fact as to whether plaintiff violated a fiduciary duty to defendants, which, if proved, might make the note an unenforceable contract.

Court of Appeals addresses the interpretation of will and per capita and per stirpes distribution.

In Brawley v. Sherrill, 833 S.E.2d 36 (N.C. Ct. App. 2019), the Court of Appeals was required to interpret the following provision of the will of Zoie Deaton:

ITEM I: I give devise and bequeath all of my estate and property . . . to my children, Billie Cress Sherrill Brawley and Bobby Ray Sherrill, if they are living at the time of my demise, to be theirs absolutely and in fee simple, share and share alike.

ITEM II: If either of my children shall predecease me, I direct that either his or her share shall go to my grandchildren, per stirpes.

At the time of the decedent's death, Bobby Ray Sherrill, was not living but was survived by a child, Bobby Vance Sherrill. The decedent was also survived by two other grandchildren. The Executrix instituted a declaratory judgment action for construction of the will, specifically to determine if Bobby Ray Sherrill's share vested solely in Bobby Vance Sherrill or in all three of the decedent's grandchildren. The trial court found that the decedent's intent was to create “two branches for distribution purposes” and consistent with that intent, Bobby Ray's one-half share vested solely in Bobby Vance, to the exclusion of the other two grandchildren, Rebecca and Bradley Brawley.

Rebecca Brawley appealed on the grounds that the will unambiguously directs that Bobby Ray's one-half share be divided equally among all of the grandchildren. The majority held that the language of Item II of the Will identified a specific class of comprised of the decedent's grandchildren and not of the issue of a predeceased beneficiary. With the addition of the term “per stirpes”, the Court held that the share of Bobby Ray must be distributed amongst the grandchildren by representation “with the percentages varying based not
upon the total headcount of surviving grandchildren (per capita), but upon the root from which the particular grandchild descends (per stirpes).” Thus, Bobby Ray would receive one-fourth of the estate (one-half of his father’s share) and the other two grandchildren would receive one-eighth each.

Judge Inman dissented arguing that the majority’s interpretation of the term “per stirpes” to permit Rebecca and Bradley to take from their uncle when their mother was living, modifies the term in a manner “that has never before been contemplated”, and that conflicts with the historical interpretation of the term.

**Remaindermen vs. life tenant; broker not liable for good faith acceptance of POA.**

In *Jackson v. Don Johnson Forestry, Inc.*, 830 S.E.2d 840 (N.C. 2019), the North Carolina Supreme Court denied discretionary review of the Court of Appeals decision (830 S.E.2d 659) which held that: (i) Decedent's express grant to life tenant of right to remove trees with at least twelve-inch diameter severed trees from estate remaindermen were entitled to inherit; (ii) remaindermen were entitled to damages from harm caused by removal of smaller trees; (iii) fact issue regarding whether any tree timber buyer removed from property had diameter of fewer than twelve inches precluded summary judgment; (iv) statute entitling entities to be reimbursed for damages incurred in removing timber from property under contract obligated life tenant’s estate to indemnify buyer; (v) estate of life tenant's spouse was obligated to indemnify buyer; and (vi) statute providing that person who accepts power of attorney in good faith is not responsible for misapplication of property shielded broker from liability.

**Other State Developments**

**Connecticut and Illinois adopt Uniform Trust Code.**

Connecticut enacted the Uniform Trust Code (“UTC”) on June 24, 2019 via Conn. Pub. Act 19-137, and Illinois followed suit on July 12, 2019 via Ill. Public Act 101-0048. The two states are the 33rd and 34th states to enact the UTC.

Connecticut’s UTC differs from North Carolina’s in certain ways; for example, an irrevocable trust modification as to which the settlor and beneficiaries agree will require court approval in Connecticut, whereas court approval is not necessary for such a modification in North Carolina. In the same act as the UTC, Connecticut also passed legislation enabling self-settled asset protection trusts and providing limited liability for Trustees in the context of a directed trust.

Illinois’ UTC also differs from North Carolina’s in certain ways; for example, under the Illinois UTC, the holder of a general power of appointment or a limited power of appointment exercisable in favor of anyone but the power-holder, the power-holder’s estate, the power-holder’s creditors, or the creditors of the power-holder’s estate may represent any beneficiary whose interests in the trust are subject to such power, regardless of any conflict of interest. North Carolina’s companion provision only permits representation by the holder of a general power of appointment. The Illinois provision also goes further to permit the holder of any other limited power of appointment to represent beneficiaries whose interests are subject to such power to the extent there is no conflict of interest between the power-holder and persons represented. North Carolina has no such provision. By contrast, Illinois has stricter provisions than North Carolina regarding

**Florida enacts electronic wills act.**

On June 10, 2019, the governor of Florida signed House Bill 409, providing the requirements for the electronic signature, witnessing, and notarization of legal documents, which will go into effect on Jan. 1, 2020. Signatures to a will may be satisfied by electronic signatures. In addition, instead of requiring actual physical presence, the new law provides that witnesses may be present by audio-video communication technology meeting certain requirements.

**New Maine law permits physician-assisted suicide for terminally ill patients.**

Maine Public Law 2019, ch. 271 (June 12, 2019), titled the “Maine Death with Dignity Act,” enables physicians in Maine to prescribe lethal medication to Maine residents with terminal illnesses who are medically determined to have less than six months to live. Such patients are required to wait fifteen days after orally requesting such lethal medication before executing a written request for such lethal medication, and after another two-day waiting period can be permitted to obtain and self-administer the lethal medication. After the death of a patient by such lethal medication, “a person who has custody of or control over any unused medication” must dispose of such unused lethal medication either by personally delivering it to a qualified facility or, if such delivery is not practicable, dispose of it “by any lawful means.” In a bout of semantics, the law specifically declares that the actions it authorizes do not constitute “suicide” or “assisted suicide” but instead constitute “obtaining and self-administering life-ending medication.” Physicians are not required to comply with requests by patients for lethal medication.
South Carolina authorizes “Physician Orders for Scope of Treatment” (POST) forms.

The South Carolina “Physician Orders for Scope of Treatment (POST) Act,” S.C. 2019 Act. No. 89 (May 24, 2019), permits a person to carry a standardized form providing directions for such person’s treatment in the event of an illness or condition that is medically determined to be likely to be terminal within one year. POST forms constitute medical orders from the carrier’s physician, made after such physician’s consultation with the carrier, and must be executed by the carrier’s physician. Health care providers who act in good faith in accordance with the instructions of a valid POST form are not liable for such actions. The act directs the South Carolina Department of Health and Environmental Control to develop a standardized POST form “based on the standards recommended by the National Physician Order for Life-Sustaining Treatment (POLST) paradigm.”

New Jersey life insurance policy intended to benefit strangers to insured was void ab initio.

In Sun Life Assurance Co. of Canada v. Wells Fargo Bank, N.A. (N.J. Sup. Ct. A-19-17 080669), the Supreme Court of New Jersey found that a life insurance policy obtained by the insured’s grandson as trustee of a trust was void ab initio when the policy was purchased with funds obtained by “investors” in the trust who were unrelated to the insured, the grandson resigned as trustee in favor of the investors five weeks after the policy was issued, and the trust later sold the policy and distributed nearly all the proceeds to the investors. The policy included an “incontestability” provision intended to prevent the insurer from challenging the policy on any basis other than non-payment of premiums once two years had passed since the policy’s issuance, and the sale of the policy and the action to void the policy took place after such two years had elapsed; however, the court found that such incontestability provisions do not bar actions based on lack of insurable interest and that the incontestability provision here had no bearing because the policy was void from onset. Wells Fargo Bank, N.A. (“Wells Fargo”) had obtained the policy in a bankruptcy proceeding and paid all premiums due during its ownership, but when the insured died and Wells Fargo attempted to collect the insurance proceeds, the insurer investigated the policy and refused to pay on account of the initial policyowner’s effective lack of insurable interest (deeming the policy “STOLI,” or “stranger-originated life insurance,” which is against public policy in New Jersey). As indicated above, the insurer was successful, but the court found that Wells Fargo, as an innocent purchaser of the policy, was entitled to a refund of the premiums it paid.

Florida court finds that assets in Belize self-settled trust are subject to Florida bankruptcy proceedings.

In In re Resin, Bankr. S.D. Fla. No. 17-11834-EPK (May 3, 2019), the bankruptcy court for the South District of Florida, West Palm Beach Division, found that a trust established by a Florida settlor of which the settlor was also the primary beneficiary and that was administered in Belize and, under the terms of the trust instrument, governed by the laws of Belize was subject to Florida law for the purposes of determining whether assets of the trust could be included in the bankruptcy estate of the Florida resident. The court noted that the choice of law in a contract or trust instrument is binding unless that choice of law offends Florida public policy. The court held that, because self-settled asset protection trusts are highly disfavored in Florida but permitted in Belize, the choice of law provision offends Florida public policy and thus the court would apply Florida, and not Belize law, in matters involving the trust. Furthermore, under Florida law, if a trustee has the discretion to distribute all of the income and principal to the settlor, as the trustee does in the trust instrument at issue, creditors of the settlor can reach the assets of the trust to the extent the trust had not been created. Therefore, all of the assets of the trust were includible in the settlor’s bankruptcy estate, unless otherwise exempt. The court went on to apply bankruptcy law in determining whether the assets of the trust were exempt.

Authorship and editing are provided by Wilson Loftis, Sara Page Waugh, and Thomas A. Cooper of the Trusts and Estates Team of Moore & Van Allen PLLC for developments from April through June, and Chadwick McCullen, Stephanie Poston, Lori Allen, and Stephen Brown of the Trusts and Estates Team of Young Moore and Henderson, P.A. for developments from July through September.

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