NAEPC
Journal of Estate & Tax Planning
Click here to view Issue 29

The NAEPC Journal of Estate & Tax Planning

QUARTERLY TAX UPDATE

2ND QUARTER, 2018

Provided by Scott E. Swartz, JD, LL.M., AEP®

Wellspring Financial Advisors, LLC · Cleveland, Ohio

A sampling of recent tax developments, provided by an advisor, for advisors.

In this lull period between the passage of the Tax Cuts and Jobs Act and the coming bestseller Treasury regulations, interpreting what the Act really means, some other developments have trickled out of the IRS and the courts. Please read on to get some news regarding:

- Continuing appetite in Congress for tax legislation, some of which has passed, some of which is proposed.
- Inclusion of full GRAT value in the grantor's taxable estate.
- Better to be lucky than good, a taxpayer victory on a failed IRA rollover.
- The latest installments of contested Roth IRA arrangements involving international sales corporations.
- A heavy dose of intergenerational split dollar insurance planning with two active cases, and this time the results tilted more toward the IRS position.
- Higher court review of an important trust state income tax case.

LEGISLATION AND TREASURY REGULATIONS

Another Dose of Tax Reform. Discussion in Washington continues for "Phase 2", a follow up package of tax law changes to the Tax Cuts and Jobs Act in 2017. The Administration is working with congressional tax writers on another round of tax cuts. The latest estimated timeframe from Ways & Means Chair Brady is to have a package ready for introducing a bill at least by the return from the House August recess. It is anticipated the new bill would be more focused on individual income tax cuts, including making permanent the changes in the 2017 tax reform that expire in 2026.

Reorganization of the IRS. On April 18 (one day after the IRS system for accepting e-filing of tax returns crashed) the House passed a couple of bills aimed at reforming the Internal Revenue Service. Included in the bills is the Taxpayer First Act (H.R. 5444), with provisions to achieve a makeover of the IRS organization structure including changes to regulating when IRS may deny taxpayers' referral to administrative appeals, and the elimination of the IRS Oversight Board. Also included is the 21st Century IRS Act (H.R. 5445), which includes various IT improvements, expands use by the IRS to accept debit and credit card payments, and changing business and individual taxpayer accounts to an online digital platform. The Senate is taking up consideration of the bills for action in 2018.

The NAEPC Journal of Estate & Tax Planning Quarterly Tax Update is brought to you by the National Association of Estate Planners & Councils.
Copyright 2018 by NAEPC and The NAEPC Journal of Estate & Tax Planning. All rights reserved.
This material may not be duplicated.

New Deal between Treasury and OMB. On April 11, after some internal bickering within the Trump Administration over the roles of agencies in issuing tax regulations, the Treasury Department and the Office of Management and Budget arrived at an updated Memorandum of Agreement. For several decades, tax regulations have been granted an exception out of the regulatory process involving all other administrative agencies that requires OMB review of proposed rules. With the anticipated coming onslaught of regulations needed to deal with the TCJA legislation, a normally dry bureaucratic fight took on some mainstream interest. Under the new agreement, regulation projects that are (i) inconsistent or interfere with another agency, (ii) raise novel legal or policy issues, or (iii) have an annual non-revenue effect on the economy of at least $100 million, are subject to OMB review in addition to the normal process at Treasury. This could add a period of weeks to the issuance of large tax regulation packages.

COURT CASES

Marks v. Commissioner, T.C. Memo. 2018-49 (4/10/2018). The IRS assessed income tax and penalties or the 2013 tax year against a taxpayer who attempted to roll over an IRA distribution to a new IRA custodian. In 2005 and in 2012, the taxpayer made loans from her IRA to her father and then to a friend, both in exchange for promissory notes. In late 2013 the taxpayer attempted to deposit the promissory notes and a cash balance from the prior IRA into an IRA created at Equity Trust Co. The rollover of the two promissory notes was not successful, although the court opinion is not clear whether the lack of success was due to taxpayer error or the custodian not accepting the promissory notes as IRA assets.

The IRS assessed income tax for 2013 on the value of the promissory notes, and a 10% penalty for a premature taxable distribution from the prior IRA. The taxpayer challenged the assessment in Tax Court, advancing an argument that the rollover was completed. Upon hearing both sides positions, the Tax Court followed with directions to the parties to file briefs on the issue of whether the loans in the old years were prohibited transactions (which both parties then agreed they were). Thus, the first loan in 2005 caused the account to cease to be a qualified IRA. This caused the IRS to concede that there was no premature distribution from an IRA in 2013, since there was no IRA at that point in time. Completing the circle, the 2005 tax year was closed under the statute of limitations, so the IRS could not assess tax on that year for the distribution.

In the end, the taxpayer's result was - no tax due for 2013, no 10% penalty for early distributions, no negligence penalty, judgment for taxpayer. The rest of the story may be for the IRS to pursue the taxpayer for an excess contribution to the new IRA in the open year.

The NAEPC Journal of Estate & Tax Planning Quarterly Tax Update is brought to you by the National Association of Estate Planners & Councils.
Copyright 2018 by NAEPC and The NAEPC Journal of Estate & Tax Planning. All rights reserved.
This material may not be duplicated.

1120 Chester Ave., Ste. 470 · Cleveland, Ohio 44114 · (866) 226-2224 · www.NAEPC.org · admin@NAEPC.org

Badgley v. United States, 121 AFR 2d 2018, No. 17-cv-877-HSG (N.D. CA 5/17/2018). An estate sought a refund of estate taxes paid, specifically related to the inclusion in the gross estate of all asset value in a grantor retained annuity trust (GRAT) at the date of death. The tax refund claim was for $3.8 million.

The deceased had created a GRAT in 1998 with a 15 year term, funding it with a 50% general partner interest in a family general partnership holding real estate interests. She retained an annual annuity, paid in quarterly installments, from the GRAT equal to 12.5% of the initial gift value. Based on the annual annuity amount reported in the court opinion, the gift value at funding was about $2.4 million. The trust instrument called for any post-death annuity payments remaining to be paid to the trust created under the grantor's revocable trust agreement. Due to the profitable performance of the commercial real estate in the partnership, income received by the GRAT each year from partnership distributions far exceeded the scheduled annuity payments to the grantor.

The grantor died in 2012 with only one more quarterly annuity distribution due. Five months after filing the estate tax return that included the GRAT assets in the gross estate, and paying the estate tax, the estate filed a claim for refund. The IRS took no action on the refund claim so the estate proceeded to file the refund suit in District Court in California. In the refund action, the estate took the position that no portion of the GRAT value was includable in the gross estate because (i) Code Section 2036(a)(1) does not apply to a GRAT, and (ii) Regulation Section 20.2036-1(c)(2)(i) is overly broad and invalid to the extent that it apples to the GRAT.

Code Section 2036(a)(1) provides that the gross estate will include the value of all property where the decedent made a transfer (except for a bona fide sale) while retaining, for a period not ending before the decedent's death, the possession or enjoyment of or the right to the income of the transferred property. The Section 2036 regulation cited above provides Treasury's interpretation for determining the portion of the remaining trust property includable in the gross estate. The approach under the regulation is that the includable portion of the trust is that amount necessary to satisfy the retained annuity at the time of death, as determined by using the applicable federal rate in effect at death. However in any event, the amount includable under the formula shall not exceed the fair market value of the trust principal. Examples in the regulations illustrate that the annual annuity payment is divided by the current interest rate to arrive at the result.

The estate argued that had Congress intended that the Section 2036 reference to "income" to include an annuity, then Congress would have used the term "annuity". The estate argued that an annuity yet to be distributed was not the same as the right to trust income, as the income of the trust could be lower or higher at any given time, and the retention of an annuity was not a right to income. While acknowledging there was no binding authority squarely addressing the issue of this case, the court disagreed with the estate's position. The court looked to aging Supreme Court decisions for guidance, including *Commissioner v. Church's Estate*, 335 U.S. 632 (1949), *Spiegel's Estate v. Commissioner*, 335 U.S. 701 (1949), and *Helvering v. Hallock*, 309 U.S. 106 (1940), concluding that the annuity interest in a GRAT, in substance, fit within the retained use and enjoyment and right to income standards of Section 2036(a)(1).

The NAEPC Journal of Estate & Tax Planning Quarterly Tax Update is brought to you by the National Association of Estate Planners & Councils.
Copyright 2018 by NAEPC and The NAEPC Journal of Estate & Tax Planning. All rights reserved.
This material may not be duplicated.

As to the Treasury's regulation method for determining the amount of the trust property to include in the gross estate, the court more easily dismissed the estate's arguments in following the approach of the regulations. The court citied *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984) for the position of deference to Treasury regulations, and concluded that the Section 2036 regulation at issue was drafted as a reasonable interpretation of the statute. The regulation was not invalid for failing to differentiate between an annuity paid from current income and an annuity paid from accumulated income of the trust.

The estate argued that under *Lafargue v. Commissioner*, 689 F.2d 845 (9th Cir. 1982), the IRS position in this case would result in all private annuities being included in a decedent's gross estate. The court differentiated between sale or exchange involving a purchased annuity contract, and annuity interests retained from transferred property in a gift transfer, referencing the bona fide sale exception to estate inclusion under Section 2036. The court concluded that the formula in the regulation was a reasonable approach to determining the includable portion of the GRAT, and dismissed the refund claim.

The numerical result in this case is striking. With one quarterly payment left on the GRAT, and as a result of the grantor's death occurring when the AFR was down to 1.0%, the formula in the regulations led to the entire GRAT value (probably close to $11 million based on the tax amount in controversy) being included in the gross estate.

Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue, NC Supreme Ct. No. 307PA15-2 (6/8/2018), *affg*. ___ N.C. App. ___, 789 S.E.2d 645 (2016). The North Carolina Department of Revenue had another go at a state income tax assessment on a trust, following taxpayer-favorable opinions in lower courts. The state lost again and the trust's claim for a refund of income taxes paid was upheld by the North Carolina Supreme Court. A county court in North Carolina had held in 2015 that the state did not have sufficient nexus to impose state income tax on a trust where the presence of the trust in the state consisted only of a trust beneficiary living in North Carolina. The trust had no other connections to North Carolina, and the beneficiary did not receive distributions of income from the trust in the tax year in question. The trustee, the trust administration, the investment advisory services, and the settlor of the trust, all were located outside of North Carolina. Under the trust instrument, distributions to the beneficiary were in the discretion of the trustee. Notably, the meetings between the beneficiary and the trustee occurred out of the state.

The trust had paid North Carolina income tax on undistributed trust income for the 2005 through 2008 tax years, then later filed for a refund of collectively over $1 million. The trial court, affirmed in a state Court of Appeals, found that the assessment of state income tax on the trust in this situation was a violation of the nexus standards required to impose tax under the U.S. Constitution's Due Process Clause and Commerce Clause.

The NAEPC Journal of Estate & Tax Planning Quarterly Tax Update is brought to you by the National Association of Estate Planners & Councils.
Copyright 2018 by NAEPC and The NAEPC Journal of Estate & Tax Planning. All rights reserved.
This material may not be duplicated.

The arguments at the state Supreme Court level centered on whether the trust had sufficient nexus based on a minimum connection to the state. The state Supreme Court court extensively discussed and relied on the minimum contacts tests that had been established by the U.S. Supreme Court in *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904 (1992). The court differentiated the trust and the trust beneficiary as having separate legal existence for tax purposes, and minimum contacts with the state by the beneficiary did not equate to minimum contacts by the trust itself.

Post script – it is left for conjecture what would now be the result for state *income* taxation of trusts in light of this month's U.S. Supreme Court opinion in the sales tax case of *South Dakota v. Wayfair, Inc.*, No. 17-494 (6/21/2018), which overrides the physical presence component of the minimum connections standard in *Quill*.

Estate of Cahill v. Commissioner, T.C. Memo. 2018-84 (6/18/2018). Prior to death in 2011, an elderly California resident entered into a family split dollar insurance plan with his son and family. The arrangement did not involve any business succession issues. In this case, contracts were entered in 2010 between revocable trust of the deceased, Richard, and an irrevocable trust of which Richard was the grantor. Patrick, the son of the deceased is the trustee of the revocable trust. A cousin of Patrick is the trustee of the irrevocable trust, known as the MB Trust.

The split dollar plan called for the revocable trust to purchase three large policies on the lives of Patrick and his wife, Shannon, with a combined face amount of $79.8 million and a lump sum premium of $10 million. The premiums were financed by Richard personally and the revocable trust borrowing $10 million from Northern Trust, pledging the policies as collateral.

Under the agreed plan, Richard's revocable trust would be entitled to receive from a policy's proceeds the greater of the following amounts upon the death of the insured: (i) any remaining balance of the loan related to the relevant policy, (ii) the total premiums paid by the revocable with respect to that policy, or (iii) the cash surrender value of the policy immediately before the insured's death. The MB Trust was entitled to retain all insurance proceeds in excess of the amount paid back to the revocable trust under those terms. Under each of the three contracts, the agreements could be terminated by agreement of the trustees of each trust, in which case the MB Trust could either retain the policies and reimburse the decedent and his revocable trust for the premiums paid, or relinquish the policies to Northern Trust as the collateral.

As to tax reporting, Richard included on a gift tax return for 2010 a gift of $7,578 to the MB Trust, calculated using the rules of the split dollar economic benefit regime under Reg. Section 1.61-22. Upon his death in 2011, the combined cash surrender value of the policies was over $9.6 million. On the estate tax return, Richard's interests in the three policies included in the gross estate was reported as $183,700. The determination of that value is not fully detailed in the summary judgment opinion, although it is stated the amount was a determination of the present value of the decedent's interest in the eventual reimbursement upon Patrick's and Shannon's deaths.

The NAEPC Journal of Estate & Tax Planning Quarterly Tax Update is brought to you by the National Association of Estate Planners & Councils.
Copyright 2018 by NAEPC and The NAEPC Journal of Estate & Tax Planning. All rights reserved.
This material may not be duplicated.

Thus, in exchange for taking personal liability to borrow $10 million to pay insurance premiums, the decedent recognized estate and gift transfers of under $200,000. The IRS assessed estate tax on the basis of the estate inclusion being equal to the combined CSV of the policies. As support for the estate tax assessment, the IRS depended on estate inclusion of the entire value of the policies under Sections 2036 or 2038, or alternatively under Section 2703(a) that the restrictions in the split dollar agreements were to be disregarded for estate and gift valuation. In this summary judgment motion, the estate requested that the court find none of those statutes applied to the split dollar agreements. Unlike the *Morrissette* case covered below, there is no dispute between the parties that the economic benefit regime applies in this case.

The court declined to grant the estate motion that Section 2036(a)(2) does not apply to the cash surrender value of the policies. Using the family limited partnership case of *Estate of Powell v. Commissioner*, 148 T.C. No. 18 (5/18/2017) as support, the court concluded that the termination rights held by the trustee of Richard's revocable trust, held in conjunction with the trustee of the MB Trust, constituted a right under Section 2036(a)(2) in conjunction with others to designate the persons who shall possess or enjoy the property transferred or the income therefrom. For the same reasons, the court also declined to grant the estate motion that Section 2038(a)(1) does not apply to the policies, finding that the Richard retained a right in conjunction with another to alter, amend, revoke or terminate a transfer during life.

The court found that without factual development of a trial, it could not conclude there was a bona fide sale for adequate and full consideration as an exception to the above estate inclusion rules. The court demonstrated skepticism that there could have been the necessary consideration received for transferring rights to the cash surrender value, when the stated value of what the estate retained was less than 2% of the value of the policies as of the date of death.

As to Section 2703, the court declined to grant the estate's motion that the statute does not apply. The estate generally argued that Section 2703 was intended for buy sell agreements and similar arrangements, and not split dollar plans such as presented here. The court found no such limited language in the statute. For summary judgment purposes, the court dismissed the argument that the split dollar plan at issue could not be found under Section 2703(a) to be an agreement to acquire or use property at a price less than fair market value, or contain a restriction on the right to sell or use such property. Therefore the estate would have to successfully demonstrate that the exceptions of Section 2703(b) do apply, meaning that the plan was a bond fide business arrangement, was not a device to transfer property to the family for less than fair value, and was comparable to similar arrangements in arms' length transactions. These are factual determinations that were not yet addressed by the parties.

The NAEPC Journal of Estate & Tax Planning Quarterly Tax Update is brought to you by the National Association of Estate Planners & Councils.
Copyright 2018 by NAEPC and The NAEPC Journal of Estate & Tax Planning. All rights reserved.
This material may not be duplicated.

1120 Chester Ave., Ste. 470 · Cleveland, Ohio 44114 · (866) 226-2224 · www.NAEPC.org · admin@NAEPC.org

Morrissette v. Commissioner, T.C. Docket No. 4415-14 (Order dated 6/21/2016). An updated, nonprecedential order has been issued in this Tax Court litigation involving an IRS challenge to a split-dollar life insurance plan. In 2016 the Tax Court had ruled favorably for an estate, on a summary judgment motion, that a family split dollar insurance plan was subject to the economic benefit regime set forth in Regulation Section 1.61-22. *Morrissette v. Commissioner*, 146 T.C. No. 11 (4/13/2016). The current order is a continuation of the same case, and addresses a summary judgment motion by the plaintiff estate asking the Tax Court to rule that the valuation rules of Code Section 2703(a)(2) do not apply to disregard, for gift tax valuation purposes, any termination restrictions in the split dollar insurance plan. The court has denied the estate's motion, and stated that the restriction on the decedent's termination rights is a restriction for purposes of Section 2703(a)(2) causing the restriction to be disregarded for valuation purposes. The court relied on its reasoning and ruling issued a few days earlier in *Estate of Cahill* that is summarized above.

The Tax Court opinion in 2016 was on a summary judgment motion solely regarding whether the split dollar plan in question was subject to the economic benefit regime of Reg. Sec. 1.61-22, and not to the loan regime. The court did not consider at that time the issue of the correct valuation of the receivable included in the estate tax return of the deceased.

To review the underlying case and compare to *Estate of Cahill*, the decedent established dynasty trusts for her sons. The dynasty trusts, the children, and the decedent's revocable trust all entered into a shareholders' agreement for a family business corporation entity with buy-sell provisions. The buy-sell obligations were to be funded with life insurance under a split-dollar arrangement. The agreement provided that upon the death of any of the three sons of the decedent, the surviving siblings and their dynasty trusts would purchase the shares of the deceased son or in the deceased son's trust. To provide the dynasty trusts with liquidity to meet the stock purchase obligations, each dynasty trust purchased two universal life insurance policies, one on the life of each other brother (6 policies total).

To fund the purchase of the policies, each dynasty trust and the revocable trust entered into two split-dollar life insurance arrangements. The revocable trust of the decedent transferred $29,300,000 in equal shares to each dynasty trust The dynasty trusts then used that money to pay a lump-sum premium on each universal life policy to maintain that policy for the insureds' (each respective son) projected life expectancy. Under the split-dollar life insurance arrangements, upon the death of the insured, the revocable trust would receive a portion of the death benefit from the respective policies insuring the life of the deceased son, equal to the greater of (i) the cash surrender value of that policy, or (ii) the aggregate premium payments toward that policy. Each dynasty trust would receive the remaining balance of the death benefit under the policy it owned on the life of the deceased, which would be available to fund the purchase of the family corporation stock owned by or for the benefit of the deceased. The split-dollar agreements specifically stated that the arrangements were to be treated under the economic regime split dollar final regulations, and that the only economic benefit to the dynasty trusts was death benefit insurance protection. Neither the dynasty trusts nor Clara's trust retained the right to borrow against the policies.

The NAEPC Journal of Estate & Tax Planning Quarterly Tax Update is brought to you by the National Association of Estate Planners & Councils.
Copyright 2018 by NAEPC and The NAEPC Journal of Estate & Tax Planning. All rights reserved.
This material may not be duplicated.

From 2006 to 2009 when the date of death occurred, gift tax returns were filed by the decedent for the transfers to the dynasty trusts. The amount of the taxable gifts were determined using the economic benefit regime set forth under the regulations under Regulations Section 1.61-22. After the total transfer of $29.3 million from the decedent to the dynasty trusts, she reported taxable gifts for the four years in question in a total amount of about $630,000.

Included on the estate tax return was the value of the revocable trust's receivables due from the dynasty trusts under the terms of the split-dollar agreements. An independent appraiser valued the receivables at a total of $7.48 million. After audit the IRS issued notices of deficiency to the estate for unpaid *gift* taxes of $13.8 million, plus penalties, arguing primarily that the decedent had made gifts of $29.3 million in 2006.

The revocable trust had retained a right to receipt of the split-dollar receivables, including all of the policy cash value, either at her death or in the event of a termination of the arrangement prior to the grantor's death. The court dismissed IRS' reliance on its Notice 2002-59, in part finding this case was entered into for legitimate business succession planning purposes, not solely for tax avoidance.

There is surely more to come on this continuing case.

Benenson v. Commissioner, No. 16-2066 (1st Cir. 4/6/2018) *rev'g* T.C. Memo. 2015-119 (6/29/2015). The First Circuit reversed a Tax Court decision for the IRS in a case involving the same taxpayers that were before the Sixth Circuit over a year ago (*Summa Holdings, Inc. v. Commissioner*, No. 16-1712 (6th Cir. 2/16/2017). The case involved taxpayer planning that placed ownership of a domestic international sales corporation (DISC) in Roth IRAs. The taxpayers had lost at the Tax Court level, and chose a strategy of appealing the case to three different appellate courts, since the corporation and related individuals involved had domicile in different circuits.

Summa Holdings was a parent corporation for a group of companies engaged in industrial manufacturing. Two of the Summa shareholders created Roth IRAs, contributing $3,500 each. Within weeks, each Roth IRA paid $1,500 for 1,500 shares of JC Export, a new DISC. Further, the Roth IRAs transferred the JC Export stock to a newly formed corporation, JC Holding. So during a six year period ending with the year of IRS audit, the Roth IRAs each owned 50% of JC Holding, which was the sole shareholder of the DISC company, JC Export.

Following the business plan of DISCs, Summa Holdings, the underlying operating company controlled by the family, paid commissions to the DISC for international sales, followed by the DISC distributing cash received from the commission earnings to JC Holding as its 100% parent corporation. JC Holding paid corporate income tax on the dividends and distributed the balance to the Roth IRAs, its shareholders. During a six year period, over $5 million was transferred into the Roth IRAs under the structure created by the taxpayers.

On audit, the IRS asserted under the substance over form doctrine that the plan really amounted to dividends paid by Summa Holdings to its individual shareholders, followed by deemed contributions to the their Roth IRAs. If so those contributions would be well in excess of IRA contribution limitations (zero in the year under audit, 2008, because the individuals were ineligible due to very high taxable income). The Service assessed

The NAEPC Journal of Estate & Tax Planning Quarterly Tax Update is brought to you by the National Association of Estate Planners & Councils.
Copyright 2018 by NAEPC and The NAEPC Journal of Estate & Tax Planning. All rights reserved.
This material may not be duplicated.

excise tax for excess contributions, and penalties. The Tax Court agreed with the IRS, although it ruled against the accuracy related penalties. The purchase price of the DISC stock was not reviewed by the IRS as to proper valuation of the stock purchased by the IRAs.

The First Circuit essentially followed the Sixth Circuit in taking the taxpayer view. The court found every component of the taxpayer's plan is allowed in the Code. The court could find no prohibition against an IRA owning or controlling a DISC. The court concluded the IRS was using the substance over form doctrine to rewrite statutory language, to "re-characterize the meaning of statutes, to ignore their form, theirs words, in favor of [the Service's] perception of their substance" as the Sixth Circuit had described. Inclined to disagree with the IRS approach, the First Circuit also reversed in favor of the taxpayer.

Given the timing of this opinion issued in April, the court did address the result in *Mazzei v. Commissioner* 150 T.C. No. 7 (3/5/2018), distinguishing that case which was favorable for the government. In *Mazzei*, members of a family had each created Roth IRAs that purchased stock in a new foreign sales corporation (FSC). The Tax Court declined to follow the Sixth Circuit reasoning in *Summa Holdings* and instead applied a narrow factual holding that the individual taxpayers, not the Roth IRAs, were the substantive owners of the FSC. Here, the First Circuit referenced differences between a DISC and an FSC, and that unlike *Mezzei*, this case did not involve an IRS challenge to the valuation of the stock transferred into the Roth IRAs.

IRS RULINGS, ANNOUNCEMENTS AND DETERMINATIONS

Charitable Contributions in lieu of State Tax Payments. With Notice 2018-54, 2018-24 IRB 1 (5/23/2018), the IRS has issued an early indication (warning?) that it will in the near future propose regulations on the subject of taxpayers claiming charitable deductions for contributions to organizations in connection with reduction of state tax liabilities. The Tax Cuts and Jobs Act passed in December included a new limitation on deducting state and local taxes, capped at $10,000 per year. Some states with high state and local tax bases have been working on changing their local laws to benefit their resident taxpayers relative to the new federal deduction cap. An example of the legislation states have passed or are proposing, provides that in exchange for a taxpayer making a donation to a charitable organization that disburses funds for government-related purposes, the state will allow the taxpayer up to a dollar-for-dollar reduction in state income taxes otherwise due.

The state governors and legislators have been very straightforward that the proposed laws are directly related to the federal cap on state and local tax deductions, since federal deductions for charitable contributions are not capped in the same manner. The IRS is inserting itself into the situation through this Notice and will do so later through regulations. The Notice itself is vague and without much detail. It does state that the IRS intends to issue regulations "addressing the federal income tax treatment of certain payments made by taxpayers for which taxpayers receive a credit against state and local taxes." The IRS goes on to state that the

Copyright 2018 by NAEPC and The NAEPC Journal of Estate & Tax Planning. All rights reserved.
This material may not be duplicated.

regulations will “make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment of such transfers.”

Guidance on Charitable Contributions. In Revenue Procedure 2018-32, 2018-23 IRB (5/17/2018), the IRS has consolidated a series of prior pronouncements on taxpayer reliance on IRS identification of the tax-exempt status of organizations and foundations, when making donations and claiming charitable deductions. Superseded by Rev. Proc. 2018-32 are the following: Revenue Procedure 81-6, Revenue Procedure 81-7, Revenue Procedure 89-23 and Revenue Procedure 2011-33, all of which had contained various safe harbors that taxpayers could rely upon in determining if an organization had valid tax-exempt status to receive tax-deductible contributions. New Rev. Proc. 2018-32 consolidates the prior pronouncements into one set of rules for use by taxpayers. The safe harbor rules include taxpayer reliance on IRS published listings and databases as to the tax-exempt status of an organization.

The NAEPC Journal of Estate & Tax Planning Quarterly Tax Update is brought to you by the National Association of Estate Planners & Councils.
Copyright 2018 by NAEPC and The NAEPC Journal of Estate & Tax Planning. All rights reserved.
This material may not be duplicated.