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QUARTERLY TAX UPDATE

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

HIGHLIGHTS

- *A pro-taxpayer decision in a family split dollar insurance case.*
- *A resolution, but no new law, in a large installment sale to defective trust case.*
- *Tax Court analysis of when post-death events are considered in estate valuation.*
- *An infrequent court case on including FLP assets in a taxable estate.*
- *Were large transfers in a personal relationship gifts or income?*
- *Another court victory for the Hobby Lobby family against the government.*
- *Taxpayer shenanigans with IRAs.*
- *Continued wrestling with new basis consistency reporting.*

COURT CASES

Estate of Giustina v. Commissioner, T.C. Memo. 2016-114 (6/13/2016), on remand from 9th Cir., 586 F. App'x 417 (12/5/2014). After a reversal of a Tax Court decision from 2011, the Tax Court responded to a Ninth Circuit remand and arrived at a family limited partnership valuation result that essentially agreed with the value included in the Form 706 filed by the estate. The decedent, who died in 2005, had a 41% limited partner interest in a family business engaged in timber cutting in Oregon. The partnership controlled over 48,000 acres and actively harvested timber for sale.

In the original Tax Court decision, the court had concluded that the valuation should be based on 25% weight given to an asset value method, and 75% weight given to a cash-flow, going concern valuation method. The court had arrived at this result based on a 25% assigned probability that a liquidation of the partnership assets would occur. The estate tax return included a value of partnership interest at $12.7 million, and the IRS assessed estate tax on a value of $35.7 million. The first Tax Court decision did not strictly follow either the estate appraisal or the IRS appraisal, and arrived through a blended approach at a value of $27.5 million.

In late 2014, the Ninth Circuit disagreed and remanded the case back to the Tax Court to re-determine the value of the partnership interest based only on going concern value. The appellate court found no basis in the record before the court that supported a conclusion that a liquidation of the partnership, or its assets, might occur, or that the decedent as a limited partner could cause a liquidation to occur with a 41% interest under the terms of the partnership agreement. Rather, the court observed that the record showed the particular partnership had a history of maintaining and operating its properties, and assumptions that the partnership might change direction and sell off assets was just a hypothetical scenario. This was a key point in the case since the liquidation value of the real estate and timber was vastly in excess of the profitability of the projected cash flow and earnings.

On remand the Tax Court strictly followed the Ninth Circuit edict to not utilize underlying asset values in appraising the limited partner interest, and the new decision was 100% based on discounted cash flow of the going concern. As a result, the value of the partnership interest was only $1.3 million higher than included on the estate tax return ten years ago.

Morrissette v. Commissioner, 146 T.C. No. 11 (4/13/2016). The Tax Court agreed with the taxpayer in an IRS challenge to a split-dollar life insurance plan. The ruling was on a summary judgment motion on the law, with no facts in dispute. For decades the family of Clara Morrissette, age 93, and her deceased husband had operated a successful moving company that eventually grew into a multi-state business holding company, Interstate Group Holdings, Inc. (IGH), an S corporation with several qualified subchapter S subsidiaries. Clara transferred all of her IGH stock to her revocable trust in 1994.

In 2006 Clara was declared incompetent, and an employee of the company was named her guardian with broad authority to handle her financial affairs. A series of estate planning transactions were then put into place. Through her legal guardian, Clara established dynasty trusts for her sons. Also in 2006 Clara's revocable trust was amended to permit the trustee to pay premiums on life insurance policies acquired to fund the buy-sell provisions of IGH's business succession plan, make loans, and enter into split-dollar life insurance arrangements or make other arrangements. The amendment also authorized the trustee to transfer each receivable it was due from the split dollar arrangement back to the irrevocable trust owing the receivable or directly back to each son.

The dynasty trusts, the children, and Clara's revocable trust all entered into a shareholders' agreement for IGH 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 Clara, 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 Clara's revocable trust entered into two split-dollar life insurance arrangements. Clara's revocable trust 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 insured's (each respective son) projected life expectancy. Under the split-dollar life insurance arrangements, upon the death of the insured, Clara's 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. This was the receivable referred to in Clara's amended trust agreement. 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 IGH 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. Additionally, the dynasty trusts executed collateral assignments of the policies to

Clara's revocable trust to secure payment of the amounts owed to her trust. Neither the dynasty trusts nor Clara's trust retained the right to borrow against the policies.

From 2006 to 2009, gift tax returns were filed by Clara 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. The amount of each gift reported was (i) the cost of the current life insurance protection for the year as determined using IRS Table 2001, less (ii) the amount of each premium paid by the respective dynasty trust. So after the total transfer of $29.3 million from Clara to the dynasty trusts, Clara reported taxable gifts for the four years in question in a total amount of about $630,000.

Clara died in 2009. Included on her estate tax return was the value of the receivables due from the dynasty trusts to Clara's revocable trust 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 Clara had made gifts of $29.3 million in 2006, and in the alternative that the split-dollar arrangements were subject to the loan regime regulations under Regulations Section 1.7872-15.

The issue for the Tax Court was whether the split-dollar agreements conformed to the economic benefit regime regulations under Code Section 61, the question being whether the dynasty trusts were conferred any additional economic benefit other than the cost of the current life insurance protection. The court concluded that the arrangements conformed to the regulations put in place in 2003. It observed that the instant case was identical to an example included in the preamble to those regulations. The dynasty trusts did not have access to the cash value of the policies or any other economic benefit. Clara's 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 her 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.

Estate of Woelbing v. Commissioner, Tax Ct. Docket No. 20361-13 (3/25/2016). A stipulated decision has been entered in U.S. Tax Court, signaling a settlement that ends the much publicized *Woelbing* cases. There were companion docketed cases that have been settled for both Donald Woelbing's estate, for estate tax and gift tax assessments, and his surviving spouse' estate for gift tax assessments. This case was to consider a high profile sale to a grantor trust by Mr. Woelbing of nonvoting stock in his closely held corporation. The sale was for $59 million

The settlement decision itself offers little detail, other than stating that for certain years there is no gift tax or penalties due, and there is not additional estate tax or penalties due for the estate tax return that was filed. This infers a complete capitulation by the IRS on the issues in dispute. Post-decision commentary in the tax press indicates the IRS even accepted defined value formula language used for the installment sale price (similar to the formula used in *Wandry v. Commissioner*, T.C. Memo 2012-88 (3/26/2012), and penalties and interest were avoided. However as part of the settlement more shares of stock were retained by the seller due to the value of the stock agreed to in the court settlement. This will have the effect of increasing the taxable estate of the surviving spouse by including more shares of the company that were subject to the formula sale.

The IRS also conceded its Code Section 2702 argument that the sale was really a failed GRAT, probably because the taxpayer had at least 10% of the sales price in the trust prior to the sale, but again the reasoning is not shown in the stipulated decision. The IRS also conceded that Code Section 2036 did not apply to cause inclusion of all the assets of the trust in the grantor's gross estate.

Estate of Victoria Dieringer v. Commissioner, 146 T.C. No. 8 (3/30/2016). The Tax Court has agreed with the IRS that an estate tax deduction for a charitable contribution under a decedent's revocable trust is limited due to post-death events occurring prior to the transfer to charity. At the time of her death in April 2009, Victoria Dieringer held over 80% of the voting and the nonvoting shares of a closely held C corporation, Dieringer Properties, Inc. The corporation was engaged in the management of commercial and residential real estate mostly located around Portland, Oregon. Two of her twelve children held the remaining shares of stock. Her husband was previously deceased. There had been preliminary discussion of succession planning by the family and redemption of Victoria's shares, but nothing was agreed or put in place.

Victoria's estate plan documents consisted of a pour-over Will to a revocable trust. The trust provided for some charitable bequests of fixed dollar amounts, then nothing to the children beyond her tangible personal property, and the entire residue to pass to the Bob and Evelyn Dieringer Family Foundation, a non-operating private foundation. An appraiser was retained to value her stock in the corporation as of the date of death. The valuation was prepared for estate administration purposes and the only valuation discount used was a 5% discount on the nonvoting stock. Otherwise the stock was valued based on the adjusted net asset value of the corporation. The result was a value of $1,824 per share for her voting stock and $1,733 per share for her nonvoting stock. The estate tax return was filed in July 2010 using those share values for the gross estate, as well as for the charitable deduction claimed for the stock to be distributed to the private foundation.

However, in between the date of death and the filing of the estate tax return there were a variety of events that occurred related to Victoria's stock. Her three sons that were active in the business proceeded to engage in some business succession and tax planning. They were aware that when the private foundation became owner of Victoria's stock there would be an annual 5% distribution requirement which would be difficult to meet, and eventually an excess business holdings issue for the private foundation. They entered into a stock redemption plan and some tax planning that included (i) electing S corporation status, (ii) to avoid the foundation being subject to UBTI on its share of the S corporation income, redeeming the stock held in trust prior to its transfer to the foundation, and (iii) the sons subscribing to additional shares of stock being issued to them by the corporation. All of these transactions and documents were entered into in November 2009.

The family engaged the same appraiser as had been used for the estate tax return appraisal, in order to value the stock for purposes of the stock redemption plan. For the updated valuation the appraiser was instructed to value the block of stock as a minority interest in the corporation. The appraiser's report included both the voting and nonvoting stock held by Victoria's trust as being subject to combined 50% discount for lack of marketability and lack of control, as well as the 5% nonvoting stock discount for those shares. As a result, the voting stock was assigned a value of $916 per share and the nonvoting stock a value of $870 per share. The stock redemption documents were later amended in April 2010 to have the corporation redeem less than all of the nonvoting stock based on the corporation's ability to pay for the stock.

As a result of the audit of the estate tax return, the IRS reduced the charitable deduction claimed on the return to equal the stock value determined by the appraiser in November 2009, not the date of death appraisal. The IRS did so under the authority of the regulations to Code Section 2055, providing that the date of death value is generally used for estate valuation but the value can be limited based on the portion of the trust property that actually benefits the charitable organization. The estate argued that date of death value should control for the charitable deduction because as of the date of death, there was no plan in place for redemption of the stock on any given terms or price, and the November 2009 transactions were business decisions occurring after death.

The decedent's son, Eugene, testified at trial that the reduction in value of the stock from the date of death to the time of the stock redemption was due to declining business conditions in the real estate market. The court disagreed with the taxpayer that market conditions were the cause of the lower stock value. The court agreed with the IRS that the estate should not receive a charitable deduction equal to date of death value of the stock where post-death events occurred that caused the charitable foundation to receive less than date of death value. In the court's view, the trust did not transfer to the foundation the trust property that was bequeathed, or a value equal to that trust property. This was particularly the case where it was the family who entered into the transactions causing the lower stock value, leading to the foundation receiving a lower distribution from the trust. The court upheld the IRS adjustment to the charitable deduction, and agreed to the 20% negligence penalty.

Estate of Sarah Holliday v. Commissioner, TC Memo. 2016-51 (3/17/2016). The IRS prevailed in this Tax Court case on the issue of including all the assets of a family limited partnership in the taxable estate of the decedent. Sarah Holliday died in 2009 at the age of 84, a Tennessee resident. Three years prior to that her family had assisted her with some estate planning, including the creation of a family partnership. She gave her two sons, Joseph and Douglas, power of attorney over her financial affairs, and although she signed all legal documents related to the plan, her sons took care of planning and implementing the structure of the partnership, Oak Capital Partners, LP.

On November 30, 2006, Sarah executed the certificate of limited partnership, the limited partnership agreement, the articles of organization for OVL Capital Management, LLC (a single member LLC formed to be general partner of Oak Capital), and the operating agreement for OVL. A week later Sarah contributed about $6 million in marketable securities and cash to the partnership, a portion of which was on behalf of and attributed to OVL's capital contribution as general partner. She retained a substantial amount of assets in personal name outside of the partnership.

On the same day as the funding, Sarah assigned her ownership of the OVL interest to her two sons in exchange for $3,000 from each of them, equal to the pro rata value of the general partner interest. Also on that day she assigned by gift a 10% limited partnership interest to an irrevocable trust, retaining the other 89.9% limited partner interest.

After her death, the estate tax return included in her taxable estate only the 89.9% limited partner interest, with valuation discounts. The IRS assessed $785,000 in estate taxes on the basis that under Code Section 2036(a), the entire partnership should be included in her taxable estate. The only issue before the Tax Court was whether Code Section 2036(a) applied. The estate denied the existence of an implied or oral agreement that allowed Sarah to retain control of the partnership assets, argued that as of her death she did not retain possession or enjoyment of or a right to income from those assets, and argued she had no right to designate who would enjoy the partnership assets. The IRS argued that she retained possession of the property, retained a right to the income as evidenced by the partnership agreement, and that there was an implied agreement that Sarah could access the partnership income.

The court followed the Code Section 2036(a) analysis that has been used in prior court cases, most notably *Estate of Bongard v. Commissioner*, 124 T.C. 95 (2005), and applied in *Estate of Jorgensen v. Commissioner*, T.C. Memo. 2009-66, aff'd 432 F. App'x 544 (9th Cir. 2011). Code Section 2036(a) applies if (i) the decedent made an inter vivos transfer of property, (ii) the decedent retained an interest or right enumerated in Section 2036(a), and (iii) the transfer was not a bona fide sale for adequate and full consideration. As is normally the situation in such cases, the focus of the court was on the third element, particularly if the transfers to the partnership constituted a "bona fide sale".

The court evaluated the bona fide sale analysis by assessing if the decedent had a legitimate nontax business purpose for creating and funding the partnership. Under the *Bongard* approach, objective analysis must show that a nontax reason was a significant factor motivating the creation of the partnership, the justification being actual and not just theoretical. The court reviewed the estate's arguments for the presence of legitimate nontax reasons and the actual facts of the case and concluded that (i) asset protection was not an actual motivation but was theoretical, the decedent not being in any danger from creditors and not having been sued before, (ii) protection of her assets from caregivers exhibiting undue influence was not legitimate when Sarah had two sons managing her financial affairs, despite testimony that such influence had occurred in the case of an extended family member, (iii) the partnership was not necessary for preservation since assets of her deceased husband had been adequately managed in trust form, (iv) the decedent did not actually believe the partnership was necessary because she was completely uninvolved in the creation other than signing papers as directed, (v) she was on both sides of the transaction with no negotiations or bargaining, (vi) the partnership failed to maintain books and records, hold meetings, or keep minutes, and otherwise operated without regard to the terms of the partnership agreement, and (vii) the assets of the partnership were not actively managed after contribution of the marketable securities. The estate tax assessment was upheld.

Gemperle v. Commissioner, T.C. Memo. 2016-1 (1/4/2016). The Tax Court ruled that a charitable deduction was not allowed for a conservation easement where the taxpayers did not include the written appraisal with the tax return. David and Kathryn Gemperle reside in a certified historic structure in Chicago. After receiving information from the Landmarks Preservation Council of Illinois, they pursued obtaining a façade easement on their residence. An appraiser was retained to value the easement restriction, and valued the easement at $108,000. The taxpayers further made a cash donation to Landmarks of 10% of the easement value.

When filing their 2007 income tax return, the taxpayers did not include the appraisal report with the tax return. They did attach Form 8283, Noncash Charitable Contributions, the instructions of which disclose the requirement to attach the appraisal. The IRS disallowed the charitable deduction and asserted penalties. The Tax Court agreed with the IRS that the taxpayers could not introduce the appraisal report at trial as evidence of the charitable gift, citing language in Code Section 170 requiring the report to be included in the tax return. The IRS expert appraiser valued the easement at $35,000, and the court accepted this value. The court further upheld the IRS imposition of substantial valuation misstatement penalty of 40%.

Blagaich v. Commissioner, T.C. Memo. 2016-2 (1/4/2016). The Tax Court ruled against a taxpayer on a question of whether the IRS should be prevented from assessing unpaid income taxes. The taxpayer argued that the matter of whether she received a gift or income was already litigated in state court, and the IRS should be bound by that ruling. The court declined to grant summary judgment to the taxpayer to dismiss the case in her favor.

Diane Blagaich, age 54, was on romantic terms with Lewis Burns, age 72. During 2010, Lewis made several large gifts to Diane, including $200,000 wired from his account, a Corvette, and various other checks. In November 2010, they each signed a document that memorialized their understandings of the relationship and formalized their "respect, appreciation and affection for each other." Intending not to be married, they agreed in the document "to respect each and continue to spend time with each other consistent with their past practice", that both would "be faithful to each other and refrain from engaging in intimate or other romantic relations with any other individual." The agreement provided for an immediate payment of $400,000 from Lewis to Diane.

After the agreement the relationship deteriorated such that by March 2011, Diane moved out of Lewis' residence. Lewis sent Diane a written notice of termination of the agreement. Somehow Lewis came to believe that Diane had violated the monogamous aspects of the agreement and filed a lawsuit in a local Illinois court, seeking return of the

Corvette, a diamond ring, and the prior cash transfers, all totaling over $700,000. He filed a Form 1099-MISC with the IRS for 2010, reporting a sum paid to Diane of $743,819. The state court issued a ruling in 2013 that the various transfers to Diane were gifts, with the exception that Diane owed Lewis' estate (he died after the trial) the $400,000 amount, which she paid in 2014.

The executor of Lewis' estate filed an amended Form 1099 with the IRS, reducing the amount reported to $400,000. On audit for 2010 the IRS had issued a tax assessment against Diane for income of $743,819. In Tax Court, Diane now argued (i) the IRS should be estopped from arguing any amount above the $400,000 returned is income, and (ii) the $400,000 is not income under the doctrine of rescission, because ultimately she was bound to repay it in a later year. The IRS argued it was not a party to the state court action, and can maintain its position on what was income to Diane at the Tax Court level. The court agreed with the IRS that it was not prevented from maintaining its action on the "gift portion" of the Form 1099, and found the doctrine of rescission not applicable since the amount was not repaid in the same year.

David and Barbara Green 1993 Dynasty Trust v. U.S., 117 AFTR 2d 2016-____ (DC OK 2/10/2016). In further court action involving this trust, following a November decision allowing an income tax charitable tax deduction, the District Court in the western district of Oklahoma addressed issues related to the trust's pursuit of tax refunds on charitable contributions. The Green Dynasty Trust was a 99% limited partner in Hob-Lob Limited Partnership, an entity that owned and operated most Hobby Lobby stores. The trust instrument stated that the trustee had the power to "distribute to charity such amounts from the gross income of the Trust as the trustee determines appropriate." In 2004, over $4.5 million in cash was contributed to a couple of public charities, but the taxpayer argues the payments were made by mistake from unintended accounts.

The Trust argues in this case that although the cash was contributed by checks issued on Hobby Lobby stores accounts, the contributions were intended to be made by Hob-Lob Limited Partnership. The taxpayer argued that this error was due to an internal shared accounting system and when the error was discovered, corrections to all of its reporting were made, and Hob-Lob Partnership reimbursed the Hobby Lobby stores accounts.

The IRS filed for summary judgment and argued that as a matter of law allowing the charitable deduction to be recognized allows the taxpayer in effect to rewrite its transactions after the fact for its benefit, and would not follow the taxpayer's chosen transactions. The District Court again held for the taxpayer, finding that disallowing the charitable deduction because of a clerical error goes against the "liberal policy of encouraging charitable giving."

Thiessen v. Commissioner, 146 T.C. No. 7 (3/29/2016). This is another case of a taxpayer trying to increase the usefulness of the tax deferral with IRAs, with the IRA taking ownership of a controlled business venture. James Thiessen retired out of 30 years of work at Kroger Co. Through a business broker he found a seller of Ancona Job Shop, a metal fabrication business. The business broker advised Thiessen that he could use his retirement account to acquire Ancona by forming a new C corporation that would be owned by his rollover IRA and which would purchase Acona.

Thiessen proceed to form Elsara Enterprises, Inc., and sold the stock to his IRA for over $431,000, approximately the balance of the IRA. Elsara then purchased the asset of Ancona for $600,000, funded by a $60,000 escrow deposit from Thiessen's personal bank account, $342,000 from the IRA, and a promissory note executed by Elsara for the balance. The note was guaranteed by Thieseen personally.

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The IRS audited and assessed income taxes on a deemed distribution from the IRA of $431,000, arguing that the guarantee of the note was an indirect lending of money or extension of credit to the IRA, a prohibited transaction under Code Section 4975. The prohibited transaction caused the deemed IRA distribution. The Tax Court agreed with the IRS position. The three year statute of limitations had expired but the court agreed with the IRS that the six year statute applied due to substantial understatement of gross income, without adequate disclosure, on the taxpayer's income tax return.

Polowniak v. Commissioner, T.C. Memo 2016-31 (2/25/2016). The taxpayer, through Strategies, his wholly-owned S corporation, entered into a $680,000 consulting agreement with Dephi Automotive Systems. Soon thereafter, Polowniak formed Bevco, a C corporation, then directed his Roth IRA to purchase 98% of the stock of Bevco. Strategies entered into a subcontracting agreement with Bevco to provide consulting services, which would be provided by Polowniak. The agreement called for Strategies to pay Bevco 75% of its revenue that Strategies received from Delphi. Delphi was not aware of the subcontract agreement. Bevco had no other source of revenue, no address, or phone number.

Payments by Delphi to Strategies were later deposited into a Bevco checking account. Strategies filed an S corporation tax return that did not report the income from Delphi. The IRS audited and assessed tax against Polowniak as the shareholder of the S corporation for underreporting of the Delphi income. The IRS also assessed a Code Section 4973 excise tax for excess contributions to the Roth IRA, on the basis that the income assigned to Bevco (98% owned by the Roth IRA) was really a contribution to the IRA by Polowniak. The Tax Court agreed with the IRS that the transactions as a whole were a mechanism to direct funds into the Roth IRA in excess of allowed limits. There was no independent substance to the Bevco contract with Strategies, no normal business dealings, no invoices, and no records of services performed.

LEGISLATION AND TREASURY REGULATIONS

Charitable Gift Reporting Regulations Withdrawn. (REG-1383444-13 withdrawn 1/8/2016). Last fall the IRS issued proposed regulations establishing a new method for charities to satisfy Code Section 170(f)(8)(D), an exception to contemporaneous written acknowledgement of a donor gift. Under the regulations, in lieu of the contemporaneous letter required for the donor's charitable tax deduction, the charity could file information with the IRS that included the donor's name, address, and taxpayer ID number.

Substantial public comment was received on the issue, and the IRS has withdrawn the proposed regulations, citing concern expressed about charities collecting the taxpayer information. The exception under that Code section remains unavailable.

Specified Foreign Financial Asset Reporting, T.D. 9752, Reg. Sec. 1.6038D-6 (2/22/2016). Final regulations have been issued that add to previously proposed regulations and now provide the requirements for domestic corporations, partnerships, and trusts to report specified foreign financial assets (SFFA). Code Section 6038D includes the rules for U.S. individuals to report foreign assets, which is achieved by filing IRS Form 8938. The same statute gives the IRS authority to issue regulations on how the reporting rules will apply domestic entities. The IRS issued proposed regulations on that issue in 2011, which have now been finalized and are effective for 2016. Under the regulations if a domestic entity owns SFFAs, then it must be determined if the entity is a "specified domestic entity" (SDE).

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A domestic trust is an SDE if it has one or more specified persons as a current beneficiary entitled to discretionary or mandatory distributions. A current beneficiary also includes a specified person holding a general power of appointment. However, the regulations exempt from the filing requirements domestic trusts that have corporate trustees who have authority or fiduciary obligations over the SFFAs in the trust. Grantor trusts are also exempt from the rules.

A domestic corporation or partnership is subject to the filing rules if it is closely held by a "specified individual" (U.S. citizen or U.S. resident) and either 50% or more of the entity gross income is passive or 50% of the entity assets produce passive income. To be deemed closely held, at least 80% of the stock of the corporation (by vote or value), or 80% of the capital or profits interests of a partnership, are held by a specified individual on the last day of the year.

Private Foundation Program-Related Investments, T.D. 9762, Reg. Sec. 53.4944-3 (4/21/2016). Final regulations have been issued providing further guidance on the ability of private foundations to use program-related investments (PRIs) as investments for charitable purposes and avoid the excise tax due to treatment as jeopardy investments under Code Section 4944. The final regulations replace proposed rules from 2012, the changes basically being amendments to some of the examples that had been part of the proposed regulations. The amendments clarify among other issues how the IRS intends to treat a foundation's continued holding of equity in a business venture that becomes profitable, investments in businesses at sell product at fair market value.

IRS RULINGS AND ANNOUNCEMENTS

Gift Tax Adequate Disclosure, CCA 201614036 (4/1/2016). Under Code Section 6501(c)(9), there is an unlimited statute of limitations for the assessment of gift tax where the taxpayer fails to report or adequately disclose the gift. In this Chief Counsel Advice, the IRS National Office responded a field agent inquiry about the application of the unlimited statute to later gift tax returns that subsequently underreport prior years' taxable gifts. The IRS concludes in the opinion that if the only understatement in a gift tax return is the underreporting of prior year taxable gifts, the unlimited statute of limitations under Section 6501(c)(9) does not apply, and the IRS must assess any additional gift tax on those later returns under the normal three year statute (six years for substantial omission of items).

Automatic Extensions of Portability Returns. Through information posted to the IRS website, the Service has confirmed that Form 4768 may be used to obtain an automatic six month extension period to file an estate tax return riled solely for the purposes preserving portability of the deceased spouse's unused exclusion amount (DSUEA). The DSUEA of the first spouse to die can only be preserved by the surviving spouse via a complete and properly prepared estate tax return that is timely filed. The Q&A in the website posting states that if the deadline, or extended deadline, is not met for filing an estate tax return that has not met the filing threshold level based on the gross estate and adjusted taxable gifts, a request for late approval may be filed in the form of a private letter ruling request under the Section 301.9100-3 relief regulations. However this relief is not available for electing portability for late returns where the gross estate/adjusted taxable gifts filing threshold is exceeded.

Basis Consistency Reporting – Continued Delay and Questions. In the summer of 2015, new legislation created new Code Section 1014(f) and Section 6035. The combined effect of these statutory additions is a required basis consistency standard, where tax basis of an asset acquired from a decedent may not exceed the value of the asset as

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determined for federal estate tax purposes. The law imposes a reporting requirement on administrators of estates regarding basis in assets received by heirs. Effective for estate tax returns *filed* after July 31, 2015, the administrator must file with the IRS, and provide to the recipients of estate assets, the value used for estate tax purposes.

The IRS then issued Notice 2015-57, granting additional time for taxpayers to begin complying with the reporting requirements. The IRS stated that required notices under Code Section 6035 were not required to be filed prior to February 29, 2016. Then the IRS issued Notice 2016-19, delaying the effective date to March 31, followed by Notice 2016-27, delaying the effective date to June 30, 2016.

In early March of this year, proposed and temporary regulations were issued, and they received immediate scrutiny. T.D. 9757; REG 127923-15 (3/4/2016). Public commentary followed with many questions as to how to comply with the law. The regulations state that estate tax returns filed solely for the purpose of portability of unused estate tax exemption (or only to allocate GST exemption) do not trigger the need to file Form 8971 with the IRS and the asset recipients. Certain assets do not need to be included on the form, such as cash, IRD items, tangible personal property with a value of less than $3,000 (the same as the threshold for a required appraisal), and property that is not ultimately distributed to an estate or trust beneficiary (such as if it is sold or disposed of by the estate/trust).

The source of current debate is completing the new IRS Form 8971, "Information Regarding Beneficiaries Acquiring Property From a Decedent". It is a two page form, the second page of which is the Schedule A that is given to the beneficiary. In some estate administrations an issue can arise on this filing where by the time of the of the due date for the Form 8971, it is not yet determined which beneficiary is receiving which assets identified on the estate tax return. In that case, the regulations provide that the Schedule A submitted to the beneficiary list all possible assets the beneficiary might receive, resulting in potential duplicative reporting. If a beneficiary cannot be located by the due date, Schedule A is still filed with the IRS, with explanation of the efforts to locate the beneficiary.

While impermissible under the new law for a beneficiary to report a basis of an asset that is inconsistent with the values reported on the estate tax return, there are post-death adjustments to basis permitted under other Code provisions, and the regulations clarify that those adjustments are not prohibited for this reporting purpose. One such situation might include an election under Code Section 643(e)(3) to recognize gain upon a distribution of property from the estate to a beneficiary.

Also, Code Section 1014(f) basis consistency does not apply to property that qualifies for the marital or charitable deduction, i.e. the rules only apply to assets that would increase estate tax liability. An additional question on which practitioners could need further guidance include the filing obligations by trustees of continuing trusts, i.e. trusts that receive assets from the estate and later distribute to beneficiaries. Similarly, it remains to be seen how a Code Section 645 election might alter the status of a trust as a beneficiary of an estate for Form 8971 purposes.

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