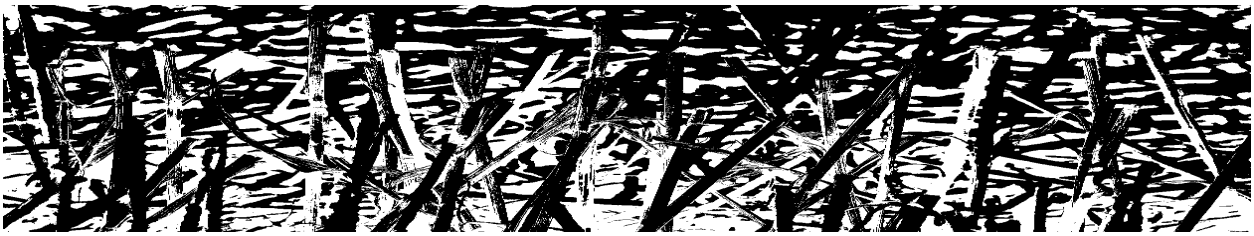

Jack Straw Fortnightly*

after

Jack extends a warm welcome to several dozen new subscribers who joined after your correspondent gave a talk for Bryan Clontz's webinar series last Tuesday and the Tuesday before that.

The recording should be posted within the next few days, alongside written responses to questions attendees raised.

Our subject was recent developments, many of which of course we have covered in these pages in more depth and with maybe a bit more attitude than was possible in that setting.

Concluding with a discussion of *Pinkert v. Schwab Charitable*, now pending appeal to the 9th Circuit. About which a bit more here.

playing with fire

Again, this is a class action on behalf of contributors to donor advised funds at Schwab, alleging that the fund sponsor has been investing these accounts in mutual funds with higher administrative fees and lower returns than they might have, with the "parent" brokerage reaping profits.

The requested relief would require the brokerage and the fund sponsor to make restitution to the funds, *i.e.*, not to the individual plaintiffs themselves, but of course also paying the plaintiffs' lawyers' fees.

The question is whether the plaintiffs have standing to pursue these claims, in light of the fact that they no longer have legal title to the contributed funds.

Their argument, in the trial court opposing motions to dismiss[1] and again on brief to the appeals court, is that they have "unique" advisory privileges that make a DAF "different" from an outright gift.

In their reply brief filed last week, the plaintiffs have advanced an argument our friend Jack would characterize as "specious."

The "dual interest" nature of a DAF, they say, with the donor retaining [enforceable] advisory privileges, is "a matter of both practical and legal necessity." Citing Code section 4966(d)(2)(A), which defines a donor advised fund as an account, quote

> with respect to which a donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor's status as a donor[,]

the plaintiffs argue that absent these advisory privileges the account would not receive "favorable tax treatment."

reality check

Pretty much the opposite is actually the case.

The function of (d)(2)(A) is to describe a fund that is subject to excise taxes on

> "taxable distributions," *i.e.*, to individuals or for nonexempt purposes, or to an entity other than a section 170(b)(1)(A) public charity unless the fund sponsor exercises "expenditure responsibility," and on
>
> "prohibited benefits" inuring to the designated advisors or members of their families.

If the donor or her designees did not have advisory privileges, the consequence would not be that the fund would not receive "favorable tax treatment." Instead, the fund would simply be treated as another component fund of the sponsor, not subject to these excise taxes.

The federal rules of appellate procedure do not provide for a surreply to the appellant's reply brief, so counsel for the brokerage and the fund sponsor will have to waste time in oral argument countering this nonsense.

In discussing this case during last week's webinars, your correspondent said these folks are "playing with fire." If the appeals court were to determine that the plaintiffs have standing to pursue these claims, IRS might well argue that a contribution to the fund was subject to what the future interests nerds call a "condition subsequent," rendering the gift incomplete, so that the deduction should be disallowed.

All three briefs are posted to the Jack Straw landing page, Ctrl F "pinkert," so completists will not have to go behind a paywall. Oral argument has been set for 9:00 a.m. PDT, Monday, April 11 in San Francisco. Jack will be listening in.

not a precedent

In PMTA 2022-01, a deputy associate to the Chief Counsel advised a program manager at EO Rulings and Agreements that in calculating gain for purposes of calculating the 1.39 percent excise tax on net investment income on the sale of contributed property, a private foundation would use carryover basis from the donor, rather than adjusting basis to the date it had ceased to qualify as a public charity.

The memo does not indicate how this question came up, and it is not clear why anyone would have thought the result should be otherwise.

But in a footnote, counsel notes there was actually a private letter ruling released back in 1998 that did reach this result in the case of a

supporting organization that was converting to private foundation status and shedding its investments in an integrated health care system.

In retrospect, counsel now says, that ruling was probably incorrect, at least on this point.[2]

cold comfort

In PLR 202204003, IRS has given what appear to be "comfort" rulings to a private foundation, contrary to its stated policy.

The foundation is to receive a collection of artwork at the death of a substantial contributor, together with a bundle of cash. It will then be managed by the contributor's son. We do not learn whether the son will be paid a salary.

The foundation will lend the artworks, and additional artworks it may acquire, to various "museums, galleries, libraries, foundations, universities or other not-for-profit institutions," mostly in the immediate geographical vicinity, under long-term arrangements that will include publicly crediting the family by name.

The foundation will undertake the expenses of shipping, storing, and preserving the artworks.

The letter ruling confirms

(a) that neither the transfer of the artworks from the substantial contributor, nor the public acknowledgment of the family by the institutions to which the artworks will be lent, will be an act of self-dealing, and

(b) that the artworks themselves will be treated as exempt use assets for purposes of calculating the foundation's minimum investment return.

Both these determinations are already covered by longstanding revenue rulings, which are cited in the letter ruling itself:

Rev. Rul. 73-407 says a distribution by a private foundation to a public charity on condition that the charity change its name to that of a substantial contributor, and agree not to change its name again for a hundred years, is not an act of self-dealing, and

Rev. Rul. 74-498 is literally identical to the present ruling. A foundation lending artwork from its collection for exhibition at museums, universities, etc., is using the artwork to carry out its exempt purposes, and the value of the collection is therefore excluded from the calculation of its minimum investment return.

With narrow exceptions having to do with corporate reorganizations, IRS has a stated policy not to issue "comfort" rulings on issues that are

clearly and adequately addressed by statute, regulations, decision of a court, revenue rulings, revenue procedures, notices, or other authority published in the Internal Revenue Bulletin,

quoting here from Rev. Proc. 2022-3, section 4.02(9).

Why that policy should not apply here is not indicated.

your mileage may differ

There was a fairly interesting article posted to TaxNotes a couple weeks ago by a lawyer for the tax matters partner in one of these "syndicated" conservation easements, describing a process that resulted in a consent judgment in the Tax Court, under which the partnership was allowed a deduction for eighty-something percent of the value they had claimed.

Tl;dr, or if somehow the link does not work or leads to a paywall, IRS had raised the usual technical issues as to the extinguishment clause and substantial compliance with the form 8283 reporting requirements, but Judge Lauber was not buying it.[3]

In the particular case. Which Jack will assert is unusual in the extreme.

It will rarely be the case, says Jack, that the agency's own appraiser will value a "syndicated" easement at anything like the figure claimed, or that the post-contribution "improvements" for which the transferor might be compensated in a judicial extinguishment under a clause that would otherwise violate reg. section 1.170A-14(g)(6)(ii) will be of negligible value.

On the validity of that reg, of course we are still awaiting a result from the 6th Circuit in *Oakbrook Holdings*, see Jack Straw numbers three comma five and four comma five.

We covered the 11th Circuit's decision, adverse to IRS, in issue five comma one.

missing inaction

Essential reading posted to SSRN by Daniel Hemel, a law professor at the University of Chicago, in the form of a letter to Rep. Bill Pascrell (D-NJ), chair of the Ways and Means subcommittee on Oversight, responding to a followup question Rep. Pascrell had posed after a hearing in December on "the Pandora papers and hidden wealth."

Neatly summarized in a pinned thread on Prof. Hemel's twitter feed.

Rep. Pascrell had introduced legislation last March that would treat a transfer by gift or at death as a recognition event, and more to the immediate point would treat an irrevocable "grantor" trust as includible in the estate of the settlor.

His followup question to Prof. Hemel was, what if anything IRS might do, absent such legislation,

> to prevent high-net-worth individuals and families from avoiding income, estate, and gift taxes on intergenerational transfers of wealth.

In his letter, Prof. Hemel identifies two tax avoidance strategies, both involving the so-called "intentionally defective grantor trust," that IRS could take "targeted measures" to shut down without further legislation.

One is the reporting of a basis adjustment to date of death values of assets held in IDGT, despite the fact the trust assets are not includible in the settlor's estate.

We covered this briefly in Jack Straw four comma seven, pages 4 and following, noting that even the proponents of this strategy do not seem to believe in it.

We noted that the question had been on the IRS "no rule" list since 2015, and that in an advice memo released in 2009, the chief counsel had said they "strongly disagree[d]" with the taxpayer's argument that assets in an IDGT should get a basis adjustment at the settlor's death.[4]

What we did not mention, which Prof. Hemel does mention in his letter to Rep. Pascrell, is that IRS had also carried this item in its priority guidance plan since 2015, as a matter on which they intended to issue formal guidance. Someday.

But that they have dropped it from this year's plan without comment.[5]

take this, brother

The other "targeted measure" Prof. Hemel suggested IRS might take relative to IDGTs has to do with swapping in low basis property for high. IRS has long taken the position this is a nonrecognition event because the trust is a disregarded entity as to the settlor for income tax purposes.

Prof. Hemel is not alone in suggesting Rev. Rul. 85-13, in which IRS staked out this position, should be withdrawn.

That ruling was issued as a nonacquiescence to the opinion of the 2d Circuit federal appeals court in *Rothstein*, 735 F.2d 704 (2d Cir. 1984), which as Prof. Hemel observes was based on "idiosyncratic, case-specific" reasoning. The ruling has "facilitate[d]," in his words, "a dazzling array of tax avoidance techniques."

This subject requires more discussion than we have allowed space for in this issue of the Straw, and it is likely a worthy subject for public comment from the Greystocke Project. The reader might expect to see further in these pages in coming weeks.

addenda

[1]

The amended complaint, the memos supporting and opposing the motions to dismiss, and the dismissal order itself are posted to the Jack Straw landing page in connection with issue four comma six.

Again, Ctrl F "pinkert" or "schwab."

These and other documents your correspondent and others have downloaded from behind the PACER paywall are now also available on docket pages maintained by courtlistener.com through its RECAP archive project, which Jack urges his readers to support.

[2]

Jack observes that some of the other components of the 1998 ruling were also unnecessarily generous.

[3]

A copy of Judge Lauber's order of March 02, 2021 denying cross motions for summary judgment is posted to the Jack Straw landing page, not because the reader could not access this by paging through the online docket, but because the court does not provide stable, external links to these documents.

[4]

Prof. Hemel also notes with some dismay a letter ruling released in 2012 that appears to give credence to the idea that assets in a "grantor" trust might get a basis adjustment at the settlor's death even if there is no estate tax inclusion.

But Jack observes that in the particular case, the trust assets would have been includible under section 2036, except that the settlor was a nonresident alien.

[5]

In fairness to Jack, the 2021-22 plan was released a couple of weeks after four comma seven had gone to press.

Jack says,
there's a garden growing, and a million weeds