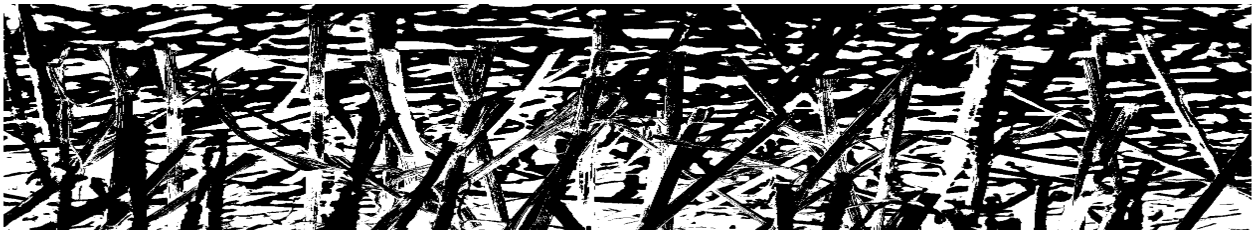

Jack Straw Fortnightly*

long time coming

We had hoped to get one more issue out before the end of the year, but as so often time has slipped away.

A couple of quick items at the top before we get into Jack's unrelenting obsession with INGs.

the permanent emergency

We had further pandemic relief stapled onto the appropriations measure that will fund the federal government through September 30. No more threatened shutdowns until the next time.

And included in that package were one-year extenders of the two charitable incentives we saw in the Cares Act back in March, the token above the line "universal" deduction for nonitemizers[1] and the "unlimited" deduction for current cash gifts by itemizers.

Of some interest is the fact that the above the line deduction has been moved from section 62(a)(22), where you would pretty much expect to find it as an adjustment to the tax base, into section 170(p), alongside the itemized deduction.

Probably the idea here is to tie this in directly to the substantiation rules, which require at least some recordkeeping for claimed deductions below $250 and a contemporaneous written acknowledgment from the recipient org for a single contribution of $250 or above.

And in that spirit, we now have language imposing a fifty pct. penalty for overstating this pittance. So if your underpayment was thirty or, let's go crazy, seventy-two dollars,[2] the penalty would be fifteen or thirty-six.

Deterrence. And a likely target for IRS enforcement efforts. Not.

Jack says the migration to section 170 and the addition of the penalty provision might actually be seen as laying the groundwork for extenders, eventual increases, maybe eventual permanent status. The sector might actually, finally have its foot in the proverbial door.

the same old story

And this being an appropriations bill, we have the usual litany of things the Congress forbids IRS to spend any money on. Without of course giving them all that much to work with anyway.

The perennial prohibitions at sections 106 and 107 on "targeting" citizens for exercising their First Amendment rights and "targeting" groups for "regulatory scrutiny based on their ideological beliefs," empty rhetoric to feed the trolls.

And then Jack's personal favorite, section 122, forbidding the agency to relaunch any regulatory project to deal with the problem of "dark money" in (c)(4) orgs. Because after all, who is paying for all this.[3]

Meanwhile, the Supreme Court has granted the separate petitions of Americans for Prosperity and the Thomas More Law Center for certiorari from the decision of the 9th Circuit federal appeals court rejecting their claims that a policy of the California state attorney general to require (c)(3)s to file copies of their federal 990 schedules B with the state was unconstitutional as applied to them, as it burdened their contributors' freedom of association.

Almost a year ago, after these petitions had been deferred through four conferences, the Court invited the (acting) solicitor general to file amicus briefs, which he finally did in November, acknowledging that the state does have a legitimate interest in regulating exempt orgs,

but arguing that the appeals court should have applied a more stringent standard in determining whether the donor disclosure requirement was sufficiently narrowly tailored to meeting that interest.[4]

bending the rules

With its annual release updating the list of issues on which it will not issue advance determinations, IRS has finally, belatedly relegated incomplete nongrantor trusts to category five, no rulings pending further study and possible, eventual formal guidance.

Attentive and/or beleaguered readers will recall that the agency took a faltering step in this direction a year ago, placing in category three, no rulings at all, period, the question whether a particular subset of INGs, obscurely defined, were in fact nongrantor trusts.[5]

With the present revenue procedure, that category has been withdrawn, and what we now have are four, count 'em, issues on which IRS will not give advance determinations, pending further study.

These are

5.01(9), whether the settlor should be treated as the income tax "owner" of "any portion of a transfer in trust that is **purported to be** an incomplete gift," emphasis supplied, regardless whether we have all these other bells and whistles,

5.01(10), whether members of a distributions committee will be treated as income tax "owners" of any portion of a trust to which their power to distribute income or principal to themselves by unanimous consent extends,

5.01(15), whether members of a distributions committee will be treated as holding general powers of appointment, either in the circumstance in which each member of the committee is replaced if she dies or her power otherwise lapses, or in the circumstance in which the committee is disbanded upon the death or other lapse of any of its members,[6] and

5.01(17), whether a transfer to a "purported" nongrantor trust can be treated as an incomplete gift at all.

Jack observes that we have been over some of this ground before, in particular items (10) and (15).

Back in 2007, when we were only a few years into this thicket and there might still have been an opportunity to set a different path, the Chief Counsel issued a request for comments on whether the handful of ING rulings that had then been issued might be inconsistent with a couple of revenue rulings from the mid-70s,

to the effect that co-holders of a power to appoint, either by unanimous consent or by majority vote, among a class that included the powerholders, would each be treated a holding a general power as to a pro rata share of the subject property, because --

-- because none of them had a substantial interest "adverse" to the exercise. But only because in the scenarios given, at the death of any powerholder she would be replaced, so that the value over which each of the survivors could exercise her power would not be increased. If you can follow all that.[7]

And of course, the default model of the ING has since changed, so that members of the distributions committee are not replaced, but if the number drops below two the committee simply disappears.[8]

Among the comments submitted, both the RPTE section of the ABA and the tax section of the New York state bar argued that as a policy matter members of the distributions committee should not be treated as holding general powers while the gift from the settlor is still treated as incomplete. Which no one was questioning at the time.

But the two orgs disagreed on the threshold question whether analogous powers should be treated as general if the transfer were treated as a completed gift, that is, whether committee members had substantial interests "adverse" to the exercise of their power to distribute.

The RPTE section said yes, pointing to the facts (a) that each member of the committee was also a contingent remainderman, in default of the settlor's exercise of her reserved limited testamentary power, and (b) that each member might cooperate with the settlor in exercising her reserved power to make distributions without the participation of the rest of the committee.[9]

The NYSBA section said no, arguing that neither of these interests was sufficiently substantial to be treated as "adverse." As the reader is aware, this is where Jack has placed his marker.

No formal guidance resulted from the 2007 notice. Instead we have had a hundred plus nominally "favorable" rulings over the intervening dozen years. Enough, already.

the hard case

The Justice Department has announced that two promoters of syndicated conservation easements in of all places Atlanta[10] have pleaded guilty to felony charges of conspiring to defraud the government of more than $250 million in income tax receipts by means not only of overvaluing easements according to predetermined ratios, but also backdating payments and documents to make it appear that several transfers had occurred in a prior tax year.

We do not yet know what the recommended sentences will be, but the range is up to five years' imprisonment and fines of up to twice the amount the defendant derived from the fraudulent activity, which is said to be $1.7 million each.

One supposes that the DOJ will be recommending something at the low end in exchange for cooperation in prosecuting some of the alleged co-conspirators, who are not identified in the informations filed in these cases. These include at least three lawyers and two appraisers.

Also a couple of land trusts.

Not clear yet whether any of the co-conspirators are among those involved in the civil prosecution that has been slogging along in the federal district court in Atlanta for a couple of years already, just now getting into the early stages of pretrial discovery.

meanwhile

Among the batch of letter rulings issued in the last week of December we have an internal legal memo numbered 202053010, saying amounts paid by an investor in a syndicated easement as "premiums" on a "policy" issued by the promoter to "insure" against the risk that IRS might disallow part or all of the claimed charitable contributions deduction are not allowable under section 162(a) as ordinary and necessary expenses of a trade or business,

nor under section 212 as expenses of producing income,

not even under subparagraph (3), as expenses incurred "in connection with the determination, collection, or refund of any tax," as this would amount indirectly to a deduction for the additional tax itself, in contravention of section 275(a)(1), as the "policy" itself excludes the "cost of defense" from the definition of "loss."

Much of the underlying factual detail is redacted, as is a brief summary toward the end of anticipated litigation hazards. But Jack suggests we might eventually see this issue as part of a case arising from the disallowance of a claimed deduction for the easement itself.

fragments

[1]

Responding to whatever clamor there may have been about allowing only three hundred even on a joint return, that has now been increased to six hundred. But for 2021 only, not retroactive into calendar 2020.

[2]

In the ten or twenty-four pct. marginal rate brackets, respectively, on a claimed deduction of the full three hundred.

[3]

Jack observes that this language was added back in the Senate substitute for the House bill, which had omitted it. Therefore it is possible

[4]

And some kind of argument that because the state attorney general himself is not the taxing authority something something something. Because otherwise we might be asking why IRS should have this authority.

In the end, these cases may turn on the facts

(a) that in the past the attorney general has rarely used the info from these filings in his investigations, and

(b) that even after the present litigation was underway, the systems the state had in place to prevent inadvertent public disclosure of these filings were imperfect.

As they had in the 9th Circuit, the Philanthropy Roundtable filed an amicus brief here, arguing that the disclosure requirement somehow deters anonymous giving. Jack is biting his tongue.

Arizona and a dozen other "red" states filed an amicus brief saying, hey, we do not require (c)(3) to report their substantial donors, and we are able to enforce our laws without that info.

Why the state of New York, which prevailed in an essentially identical case back in 2018, did not file an amicus brief Jack does not understand.

[5]

There were a couple of batches of ING rulings released during 2020, but the request and issue dates preceded the publication of the "no rule" position.

[6]

Omitting for some reason the more common circumstance in which the remaining committee members continue to serve until there are fewer than two or until the trust settlor dies.

[7]

The result appears to follow from the literal text of reg. section 20.2041-3(c), which says pretty much the converse, *i.e.*, that if at the death of one co-holder her power in effect passes to the remaining co-holders, they do have adverse interests, because each then has an incentive not to allow an exercise in favor of another.

[8]

The entire arrangement is constructed to produce specified tax effects, based on the fiction that the settlor has retained only those controls that will render the gift incomplete, while not causing trust income to be taxed to her.

Jack has suggested that the ING not be taxed as a trust at all, but as a corporation.

[9]

At the time, the typical distributions committee had only two members, and the settlor's reserved "consent" power was exerciseable with the consent of either.

Subsequent to the 2007 notice, the typical arrangement is to have multiple members of the distributions committee, and to require the settlor to secure cooperation of a majority to exercise her reserved "consent" power. And to disband the distributions committee altogether if the number falls below two.

[10]

The court proceedings are in North Carolina, where at least one of the easement transactions took place. The individual defendants are accountants based in Atlanta.

Jack says, the sandcastle virtues are all swept away