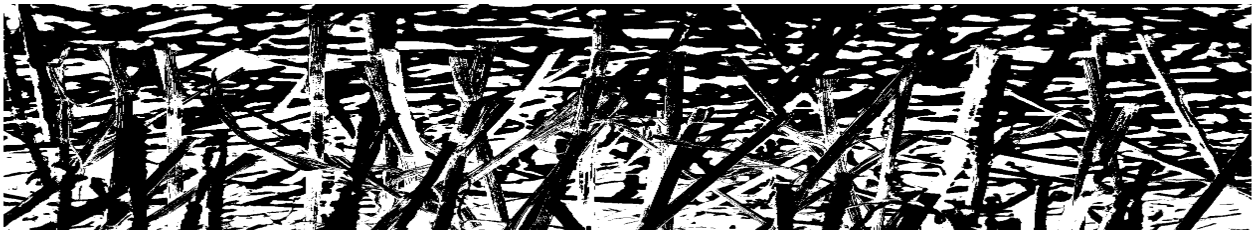

Jack Straw Fortnightly*

sporadic

Coming up on a hundred days since our previous issue, gonna have to own the "or occasional" subtitle.

But we have been keeping busy in the "real" world. Several 1041s and 5227s, a couple of 990-PFs on extension, other paying projects. A 706 we filed only for portability, but with a state return making an inconsistent QTIP election. An appraisal for the commutation of a life interest in a net income unitrust. A calculation of the corrective payment to be made after delayed funding of a testamentary unitrust, also net income.

Plus several speaking engagements with local and regional planned giving roundtables. A few of those still coming up: the Arizona conference on Friday, May 21, a lunch meeting of the Philadelphia council on Wednesday, May 26, the NACGP Leadership Institute summit on Tuesday, June 29 (not yet formally announced), alongside Kathryn Miree, who is of course a rockstar.

Also another pair of these monthly webinars with Bryan Clontz and Ryan Raffin over at Charitable Solutions, LLC later this morning and again the day after tomorrow, this time on the subject of qualified appraisals. We did a pair of these in April on charitable gifts of SPACs and NFTs,[1] and a pair back in February on prearrangement after *Dickinson*. No paywall.

fear of missing out

And actually we have not missed all that much in the intervening dozen or so weeks.

Yet another decision from the New Hampshire supreme court involving that state's pretermitted heir statute, which they again insist is not a rule of construction. Which we will discuss in our next issue, just want to get this one out.

A Tax Court memorandum decision rejecting an executor's argument that the estate should be allowed a deduction without discount for the distribution to multiple charities of fractional interests in what had been a single member limited liability company. Which we will relegate to a footnote.[2]

A result in the *Fairbairn v. Fidelity Charitable* litigation, adverse to the plaintiffs, no real surprises. A modest recovery in the

7520 rate, though at this writing the yields on mid-term Treasuries are again trending down.[3]

The formal introduction of legislation that would implement at least some portions of whatever is the Biden tax "agenda," alongside the anticipated Sanders bill rehearsing many of the transfer tax proposals we used to see in the Obama "green books," and then some, and the Warren bill[4] that would impose an annual wealth tax on folks holding more than fifty million.

Oral argument April 26 before the Supreme Court in the consolidated cases in which Americans for Prosperity and the Thomas More Law Center are challenging the California state attorney general's policy to require (c)(3)s to disclose their "substantial contributors" as a condition of soliciting deductible contributions in the state.

And just as we were going to press a result in *CIC Services*, in which a promoter of microcaptive insurance strategies had challenged the authority of IRS to require them, by way of Notice 2016-66, identifying these arrangements as "transactions of interest," to disclose their participation as material advisors.

The premise of the lawsuit was that imposing the 8886 reporting requirement, with penalties for noncompliance, should have been done through a formal regulatory process, with notice and an opportunity for public comment.

IRS argued that this kind of lawsuit is barred by the Anti-Injunction Act, and the lower courts agreed. A unanimous Supreme Court reversed, which simply sends us back to square one.

It will be awhile yet before we have a substantive ruling on the validity of the Notice itself. But Jack would argue IRS has fairly clear statutory authority to identify these transactions by notice rather than through a formal regulatory process.

Analysis of the proposed tax legislation can wait. At this point all that is just speculation.[5] And we can talk about the Supreme Court stuff sometime in the next few weeks.

but first these words

What actually brought your correspondent back to the writing table, finally, after all these weeks, was a chief counsel memo released two weeks ago, CCA 202118008, dealing with the transfer tax consequences of what was characterized as a "commutation" of a testamentary QTIP trust, but with gifts from the two kids back to the surviving spouse of the present value of their remainder interests, so that she ended up holding the entire proceeds.[6]

They all filed gift tax returns, and these were under audit. The examiner was asking counsel to respond to the taxpayers' argument that any deemed gift by the spouse to the remaindermen per section 2519 was "offset" by the gifts from the remaindermen back to her.

Tl;dr, counsel said the gifts did not offset one another. But the path from here to there is a bit thorny.

But before we even get to section 2519, it might be useful to remember that every other day of the week the commutation of a trust is treated as a sale of the term interest, a capital asset in which the income beneficiary has a basis of zero.

This is the position IRS asserted in Rev. Rul. 72-243, very belatedly acquiescing in the 1946 decision of the 2d Circuit federal appeals court in *McAllister*, which had allowed the taxpayer a capital loss, but noting that with the enactment of section 1001(e) as part of TRA '69, and with implementing regs finalized in 1971, the rules on basis had changed.

For their part, if the remaindermen sell their interests, they still have an "adjusted uniform basis" that increases, per reg. section 1.1014-5(a), as the present value of the intervening life estate decreases. Which would typically mean their reportable gain would be negligible.

But the chief counsel memo does not get into any of that.[7]

a zero sum game

To critique this advice memo we first have to understand what section 2519 is all about.

The estate tax marital deduction is a matter of deferring some portion of the transfer tax, not avoiding it altogether. Sort of treating the couple as though they were a single taxable unit. With portability closing the circle.

If we are allowing a deduction in the estate of the first decedent spouse, we need to assure that the subject property will be part of the survivor's transfer tax base. Which in the case of a terminable interest it would not, absent the election, because she has at best a limited power to appoint the remainder.

This is why we have inclusion per section 2044(a) at the survivor's death, with section 2519 serving an analogous function with respect to lifetime transfers.[8]

Okay, you ask, but how does that apply here? The surviving spouse did not "dispose" of her interest, the remaindermen disposed of theirs.[9] She ended up with everything.

IRS has got you covered there, kinda. First, with reg. section 25.2519-1(f), which begins innocently enough talking about, well, what if the spouse exchanges, say, a legal life interest for a qualifying income interest in trust. As unlikely as that scenario might seem. Not a "disposition," says the reg.

But "on the other hand," the reg says, if you sell the qualified "property," *i.e.*, the income interest itself, and distribute the proceeds to the spouse, that is itself a "disposition." Even though obviously she still has a right to the income from property she now owns outright.

This position arguably has support in the legislative history, specifically at pages 161-162 of the House report, which says a "disposition" of the qualifying income interest "by gift, sale, or otherwise" will trigger the transfer tax. Which kinda makes sense, if the spouse is receiving only the present value of her income interest, and if we have no other mechanism for capturing the value of the remainder at her death.[10] But maybe not otherwise.

And then there is Rev. Rul. 98-8, which deals with a situation in which the surviving spouse purchases the remainder with a promissory note, which she then pays off from the proceeds of the sale of the trust corpus. This, says IRS, is a also "disposition" of the qualifying income interest.

How so? Well, because we are applying the term "broadly," to any circumstance "in which the surviving spouse's right to receive the income is relinquished or otherwise terminated." Citation to the legislative history just quoted and reference to an example in the reg involving the sale of the spouse's life interest to the remaindermen. [11]

Jack is willing to concede the point, on policy grounds: if we do not treat a commutation as a taxable transfer of the remainder, we have allowed the tax incidence to slip a generation.

difference without distinction

However, that is not what is going on here, in the chief counsel advice memo. The entire value of the trust corpus remains with the surviving spouse. Or has been restored to her transfer tax base by way of a gift from the remaindermen, however you want to frame it.

Despite the unfortunate framing the parties themselves gave to this transaction, see footnote [9], Jack would argue the substance should prevail over form. The kids made a gift to their mother so she could engage in yet more aggressive planning than the QTIP could afford. The estates merged, leaving her holding the property outright.

You want to treat that as an upstream gift, okay, though one could argue it does not augment her estate, but there is no tax policy rationale for treating the spouse as having made a gift of the qualified income interest or a deemed gift of the remainder. We simply have not shifted the tax incidence to a lower generation.[12]

We might have more to say on this advice memo as Jack continues to ruminate, and/or we might throw something together for publication in one of the journals.

asides

[1]

Following that presentation, your correspondent was invited to submit a piece to Bloomberg for its "tax insights" feature, focusing specifically on the implications of a contribution of a nonfungible token. This should appear sometime in the next few weeks, and we will then provide a link to an "attribution" copy so you will not have to go behind a paywall to read it.

In the meantime, we have posted a brief piece on the same subject to LinkedIn "pulse," sketching an argument that an NFT is not a "collectible" for federal income tax purposes, so the deduction for contributing a token to a (b)(1)(A) public charity should not be limited to adjusted basis, assuming a long term holding period.

[2]

This footnote right here in fact. The case is *Estate of Warne*, T.C.Memo. 2021-17. The link, unfortunately, is not to the text of the decision itself, but to the online docket, which includes a link to the decision that cannot be exported. This is an artifact of the conversion of the court's electronic filing and document management system back in December.

The result is pretty much dictated by the 9th Circuit appeals court opinion in *Ahmanson Foundation*, 674 F.2d 761 (9th Cir. 1982), which we mentioned in our discussion of the *Dieringer Foundation* case back in February 2019. The single member entity is included at its full value, but the distribution of fractional interests triggers discounting.

The executor in *Warne* argued that *Ahmanson* should be distinguished on the ground that in that case the 99 pct. nonvoting interest went to the foundation and the one pct. voting interest went to the decedent's son, whereas here each of two exempt orgs received voting interests adding to one hundred pct. Unfortunately that argument finds no support in the text of the *Ahmanson* opinion itself.

We do not have a final order yet in *Warne*, but your correspondent predicts the taxpayer will not appeal.

[3]

Or were, until we got a brief spike following the Bureau of Labor Statistics report showing a 4.2 pct. rise in consumer prices over the past year, 0.8 in April alone. The one month rise was largely attributable to an increase in the price of used cars.

[4]

There are seven original co-sponsors, including Sen. Whitehouse (D-RI), who chairs the tax subcommittee of the Finance committee, on which Sen. Warren also sits. On April 27, the subcommittee on fiscal responsibility, which Sen. Warren chairs, staged a hearing at which some of these ideas were discussed.

[5]

Though how some of the proposed changes might affect charitable gift planning is actually the subject of two of the talks I am giving in coming weeks.

[6]

Apparently a significant portion of the assets of the QTIP trust were two classes of stock in a closely held corporation and fractional interests in several limited liability companies.

Immediately following the "commutation," the spouse transferred some of the stock to "dynasty" trusts for the children and their descendants, and sold some of the stock, together with an interest in one of the LLCs, to those same trusts in exchange for promissory notes. Presumably these were "grantor" trusts as to the spouse, so that these sales would not be recognition events.

In a footnote, the chief counsel says she is not addressing the transfer tax implications of the transfers in exchange for promissory notes, but in another footnote, she also observes that these notes paid interest only over a term that was longer than the spouse's probable life expectancy.

In yet another footnote, counsel observes that the spouse's transfers to these other trusts were at least nominally independent of the commutation. Jack asks whether it might have been better to include the whole thing in one package, possibly strengthening arguments that would treat this as a sale or exchange rather than as nonreciprocal gifts.

[7]

Or possibly these folks are also facing taxes on realized gains, which are simply beyond the scope of the advice memo. Compare *Estate of Kite*, T.C.Memo. 2013-43, which is discussed in the memo.

[8]

Future interests lawyers are used to thinking in these terms. The vested and contingent and executory interests have to somehow add up to a fee simple absolute. If there is a possibility of reverter, there must be a condition subsequent somewhere, etc.

[9]

Here Jack observes that in documenting this transaction the parties, or their advisors, included language needlessly characterizing the transfer tax consequences, using terminology like "commutation" and "deemed gift," rather than simply describing the transfer and the intended result, *i.e.*, that the surviving spouse would end up holding the trust assets outright.

[10]

The House report goes on to say that if the spouse makes a lifetime gift of her income interest, presumably to the remaindermen, the amount of the gift is the entire amount of the trust corpus, minus whatever she might receive in exchange.

[11]

Citation also to *Estate of Novotny*, 93 T.C. 12 (1989), which however is not on point. That case had to do with whether a legal life estate in real property qualified as QTIP despite restrictions requiring the life tenant to pay various expenses including property taxes and payments under an existing mortgage.

The court did mention in passing that the life tenant and the remainderman had sold the property to a third party, and said this would trigger a gift tax per section 2519, but this was not actually at issue in the case. What lawyers call "dictum."

[12]

Jack would also observe that in two footnotes and related text we learn that applicable rate from Table S for valuing the remainder was 0.90828, indicating the spouse was 85 years old at the time of the transfer, which occurred in October or November 2016. This info probably should have been redacted.