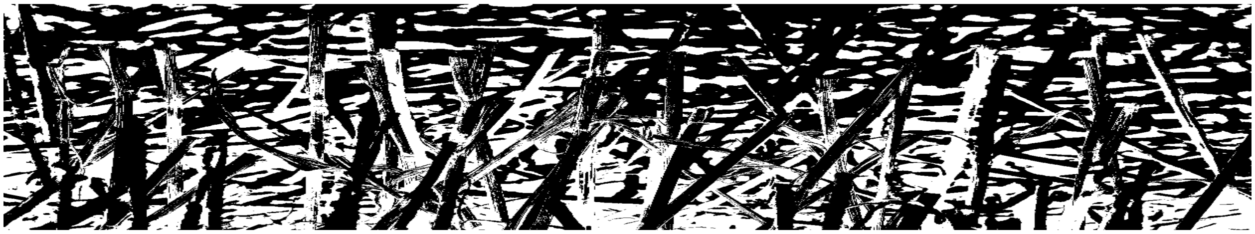

Jack Straw Fortnightly*

into the woods

We had hardly hit "send" on the previous issue when IRS released yet another batch of five ING letter rulings, PLRs 202006002 through 202006006, again identical verbatim. A sixth letter from the same batch was released a week later as PLR 202007010.

The issue date on these rulings was last September 18, just over five months from the date of the request. Pretty good turnaround time, but then again, the substantive content of these rulings is almost entirely copy and paste.

But inquiring minds want to know: would the scenario described in this batch of rulings have made it past the "no rule" position articulated in Rev. Proc. 2020-03, which was the subject of Jack's diatribe a couple of weeks ago.

And the answer is, probably. But there are other issues.

checking the boxes

Here we have joint settlors, spouses residing in a community property state, setting up a trust in a different state, whose laws are said to protect a transfer to a self-settled spendthrift trust from claims of the settlor's creditors unless the transfer was made "with an intent to defraud the specific creditor."[1]

Which sounds something like the Nevada statute.[2]

There is of course a distributions committee, here consisting of (apart from the settlors), "guardians" acting separately for each of the settlors' two children during their minority, a sibling of one of the settlors, and an acquaintance, apparently unrelated.

The class of permissible distributees during the settlors' lives includes all these folks,[3] together with more remote descendants of the settlors, who are as yet unborn. And we have the "plus two" language IRS has apparently been insisting on for awhile.[4]

So it would appear we are within the safe harbor sketched in paragraph (a) of section 3.01(93) of the rev. proc. And of course it is impossible to say whether we meet the condition of paragraph (b), that distributions not require the consent of an "adverse" party, "named or unnamed." Certainly the more remote descendants, as yet unborn, are "unnamed," but they may not be "adverse," as their "beneficial interests" may not be "substantial."[5]

who watches the watcher

But what about this business with nominal "guardians" acting for minor beneficiaries.[6] Obviously this kind of thing is commonplace in the drafting of trust instruments more generally, but here we have a rather special situation.

The committee acting unanimously, or a majority acting in concert with either of the settlors, can direct distribution of income or principal to any of the permissible distributees.[7] In the particular case, this would require the participation of at least one of the "guardians."

We are told -- and this is an express feature of pretty much every ING ruling since at least 2013 -- that the members of the distributions committee, as such, are acting in a nonfiduciary capacity.

Still, these "guardians," whoever they are, do have fiduciary responsibilities to the minors on whose behalf they are acting. But what would a breach of those responsibilities look like? and what would be the remedy?

Neither of the kids actually has an enforceable beneficial interest in the trust during the settlors' lives, and neither has more than a contingent interest in the remainder after each settlor's death, subject to defeasance by the decedent's exercise of her limited testamentary appointment power.

But any distribution made during the settlors' lives would reduce the amount available for later distribution, and it would deplete those contingent, defeasible remainders, so it kinda matters what decisions these "guardians" are making during the kids' minority.

And the situation is somewhat complicated in the particular case by the fact that, as noted in footnote [7] above, the committee could direct distribution to one or more trusts for the benefit of one or more descendants of the parents of either settlor[8] -- which as Jack observes is a larger class than the class of otherwise permissible distributees.

We already know that at least one of the settlors has at least one sibling. That sibling, or some other sibling, may have (or may yet have) descendants. A distribution to a trust for the benefit of nieces and nephews would divert assets from potential distribution to the settlors' two children and/or their descendants.

What is the responsibility of the "guardian" in that scenario? The trust instrument does not impose any standards at all on the committee's decision to distribute or not. Would the "represented" minor have a cause of action against her "guardian" for participating in directing such a distribution?[9]

It will be interesting, some years out, to watch some of the nontax fallout from the ING strategy.

substantial noncompliance

In yet another memorandum decision on cross-motions for partial summary judgment, *Oakhill Woods, LLC v. Commissioner*, T.C.Memo. 2020-24 (02/13/20), the Tax Court has again ruled that a taxpayer who fails to provide "cost or adjusted basis" on an appraisal summary accompanying form 8283 has not "substantially complied" with the reporting requirements for a noncash gift valued in excess of $5k.

Like *Belair Woods, LLC v. Commissioner*, T.C.Memo. 2018-159 (09/20/19), mentioned in our previous issue, this case involves a "syndicated" conservation easement promoted by one of the defendants in the lawsuit the Justice Department is pursuing in Georgia to shut down the operation, enjoin the principals from ever working in the industry again, and force them to disgorge every nickel they ever made on these deals.

And as in *Belair Woods*, the taxpayer here argued that it did "substantially comply" with the regulatory requirement, which does allow a taxpayer to omit to report basis if it attaches an explanation of "reasonable cause" for its "inability" to include that information.

In each of these two cases, an "explanation" attached to the return asserted that it was not necessary to disclose basis because basis "[was] not taken into consideration when computing the amount of the deduction." In each case the court rejected the argument that this "explanation" met the requirement of the regulation.

Judge Lauber wrote both decisions, and large portions of the text of the *Belair Woods* decision are copied and pasted into the *Oakhill Woods* decision.

In each of these cases, although the court granted in part the Commissioner's motion for a partial summary judgment, ruling that the taxpayer had not "substantially complied" with the reporting requirements of reg. section 1.170A-13(c)(4)(ii), it also denied the motion in part, saying there were material facts still in dispute on the question whether the taxpayer might nonetheless have had "reasonable cause" for its failure in this regard.[10]

Specifically, in each case the taxpayer is saying that, in omitting to report its cost or adjusted basis in the contributed easement, it had relied on an opinion letter from a lawyer for the promoter that was putting the plan together.

So the issues remaining to be decided, as framed by Judge Lauber, using almost identical language in both decisions, are these:

> whether [the promoter] was a "tax professional"; whether [it] was "a competent and independent advisor unburdened with a conflict of interest" [citing *Mortensen v. Commissioner*, 440 F.3d 375 (6th Cir. 2006), aff'g T.C.Memo. 2004-279]; whether [petitioner] could reasonably rely on legal advice relayed to it indirectly; whether petitioner's CPA was a competent tax professional who provided tax advice independent of the advice supplied by [the promoter]; and

whether [petitioner] actually relied in good faith on whatever advice it received.

Jack says that is a lot of "whethers." And the implication seems to be that most or all of them are likely to be answered in the negative. Jack suggests the court is offering the taxpayers an opportunity to settle.[11]

downward, dog

The 7520 rate for March is down forty basis points, to 1.8 pct.

This takes us back to where we were six months ago in October 2019, which in turn was the lowest 7520 rate since December 2016. In the interval, we had a peak at 3.6 pct. in November and December 2018.

Yields on mid-term Treasuries, to which the 7520 rate is keyed, are still trending down at this writing.

after words

[1]

The idea here being, though this is not discussed in the text of the rulings, to avoid triggering reg. section 1.677(a)-1(d), which treats the settlor as the income tax "owner" of a trust from which income might be distributed, without the consent of an "adverse" party, to discharge a legal obligation of the settlor or her spouse.

[2]

Setting aside conflicts of law questions, see, *In re Huber*, 493 B.R. 798 (Bankr. W.D. Wash. 2013), *i.e.*, the question whether the transfer was in fraud of creditors would be determined by reference to the law of the state of the settlors' residence, not the state that has set itself up as a haven for self-settled spendthrift trusts --

-- Jack is fascinated to read the statute in question, NRS 166.170. Entirely covered with the fingerprints of lawyers and bankers acting in their own interests.

As first enacted in 1999, the statute was simply a two-year limitation with a six-month discovery rule. An amendment in 2007 provided that discovery would be presumed if the transfer was a matter of public record.

The real action was in 2009, when the section was amended to add the language paraphrased in the letter rulings, requiring a creditor to show that the transfer was in fraud of her existing claim.

Also to allow the settlor to remove real property from a self-settled spendthrift trust for the purpose of placing a mortgage on it, and then recontribute the encumbered property, without having to restart the shortened limitations period for creditor claims.

And also to provide a not very qualifed immunity to an "adviser" to the settlor or the trustee from suit by just about anyone, for any cause. Jack is biting his tongue.

Not surprisingly, these details were only briefly mentioned in testimony before the state senate judiciary committee in March 2009 by several lawyers from the state bar probate and trust law section.

No one testified in opposition, and the committee asked no substantive questions. Your correspondent has e-mailed two of the lawyers who testified, requesting additional info, but has heard nothing yet.

There was yet more housekeeping in 2011, among other things increasing the burden of proof on a creditor from a preponderance of the evidence to "clear and convincing."

All of this may be fodder for another issue, or for another article for publication elsewhere.

[3]

Jack wonders whether it is realistic to suppose that distributions would ever actually be made to the unrelated acquaintance. She and the sibling are each in for ten pct. of the remainder at the death of each settlor -- if she survives, and if the decedent settlor has not exercised her reserved limited testamentary power to appoint the remainder to others.

But as Jack has been arguing, this may not be a "substantial beneficial interest," sufficient to constitute the acquaintance as an "adverse" party for purposes of section 672(a).

The figure ten pct. does appear to be a recurring theme in these letter rulings, which may suggest that there is an informal agreement between the promoters and the folks in the Chief Counsel's office that this will in fact be treated as sufficient.

[4]

In an interesting wrinkle, the trust includes a mechanism for trying to assure that there are always at least three permissible distributees on the committee, apart from the settlors. By unanimous action, the committee, here including the settlors, may appoint more remote descendants to the committee, if necessary designating "guardians" to represent them.

But the mechanism is not mandatory, and of course there are as yet no more remote descendants. So if both the sibling and the acquaintance predeceased the surviving settlor before further appointments were made, the committee could still fail.

In which event, the trust instrument would permit the trustee to distribute income and/or principal to any of the permissible distributees, including either settlor. This would implicate section 677(a), and because the trustee's discretion is not limited by an ascertainable standard, we would also not have the protection of section 674(b)(5).

[5]

And as Jack argued in our previous issue, the unenforceable "interests" of the current class of permissible distributees may also not be "substantial."

[6]

Who are these folks, anyway? If they did not nominally represent parties whose interests are supposed to be "adverse" to the committee's exercise of its power to distribute, would they be considered "related or subordinate" to either settlor per section 672(c)?

[7]

Or to a trust for the benefit of one or more members of either settlor's "family," defined to include descendants of each settlor's parents and "all charities." This is a broader class than the class of otherwise permissible distributees.

[8]

And/or for "charities," presumably meaning exempt orgs to which distributions might qualify for income tax charitable deductions, cf. PLR 201908008, which we discussed in Jack Straw volume two, number four. Possibly a split-interest trust is contemplated.

In any event, a deduction per section 642(c)(1) would not be limited to a percentage of "adjusted" gross income, nor to reduction for unrealized short-term gains or depreciation recapture.

[9]

Or what if, as seems at least as likely, the settlors later divorce and one spouse wants her half back? She would have to persuade at least a majority of the distributions committee other than herself and her former spouse, and again this would require at least one of the kids or their "guardians" to participate.

One imagines there are informal understandings in place to cover these kinds of scenarios, probably something as simple as "whatever dad says," which of course would implicate section 674(a).

And this is why IRS should be declining to rule on any of the "grantor" trust issues, not just on whether the settlor has reserved "administrative" powers that would trigger section 675(4).

[10]

The phrase "reasonable cause" is used in two different contexts here.

The regulatory requirement to report basis has a "reasonable cause" exception where the taxpayer is "unable" to provide its cost or adjusted basis, or the date it acquired the property. In these two cases, the court ruled that the taxpayer had not met this exception.

But section 170(f)(11) also includes a "reasonable cause" exception to the denial of a deduction for failure to attach a qualified appraisal to a return claiming a deduction in excess of $500k for a noncash contribution. To meet this exception the taxpayer would typically show that it relied reasonably on advice from a qualified tax professional, etc.

[11]

On February 05, the taxpayer in *Belair Woods* filed a motion to certify for interlocutory appeal another, more recent partial summary judgment order, 154 T.C. No. 1 (01/06/20), having to do with whether the examiner timely sought supervisory approval for the assessment of valuation misstatement penalties -- an issue that has occupied quite a bit of the court's attention in recent years, but which thus far we have been treating as outside the scope of this newsletter.

Several judges did dissent from the ruling in question, so it is possible the taxpayer may actually get some traction here. The Commissioner's response is due March 13.

It will be awhile before either of these cases goes to the appeals court on the merits of the "substantial compliance" or "reasonable cause" questions. Assuming the parties do not settle.

Jack says, this amusement never ends.