Steve Leimberg's Income Tax Planning
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Subject: Mary Vandenack's Notes from the 77th Annual NYU Federal Institute of Taxation, Days 4-6

The **77th Annual NYU Federal Institute of Taxation** was held October 21 to October 26 at the Grand Hyatt New York. Members should click this link to review the meeting agenda: **77th Annual NYU Federal Institute of Taxation.** The Institute provided in-depth coverage of several topics of interest to many tax planning professionals. Topics covered included current developments, executive compensation, tax controversy, real estate and partnerships, corporate tax, international tax, closely held companies, and estate taxation.

Long time **LISI** commentator **Mary E. Vandenack** attended the NYU Federal Institute of Taxation and has graciously agreed to share her notes from all 6 days with **LISI** members. In Income Tax Planning Newsletter #159 we provided members with Mary's notes from days 1-3. In this newsletter, we provide members with Mary's notes from the final three days.

Mary E. Vandenack is founding and managing member of **Vandenack Weaver** LLC in Omaha, Nebraska. Mary is a highly regarded practitioner in the areas of tax, benefits, private wealth planning, asset protection planning, executive compensation, equity fund development, business and business succession planning, tax dispute resolution, international tax, state and local tax, and tax-exempt entities. Mary's practice serves businesses and business owners, executives, real estate developers and investors, health care providers, companies in the financial industry, and tax exempt organizations. Mary is a member of the American Bar Association Real Property Trust and Estate Section where she serves as Co-Chair of the Futures Task Force, Co-Chair of the Law Practice Group and on the Planning Committee. Mary is a member of the American Bar Association Techshow Board and incoming Editor-in-Chief of Law Practice Magazine. Mary was named to ABA LTRC 2018 Distinguished Women of Legal Tech and recently appointed to ABA SCOTIS. Mary is a frequent writer and speaker on tax, benefits, asset protection planning, and estate planning topics as well as on practice management topics including improving the delivery of legal services, technology in the practice of law, building sustainable law firms.

Here is her commentary:

DAY FOUR NOTES:

PARTNERSHIPS, LLCs, AND REAL ESTATE

Tax Cuts and Job Act Changes Affecting Partnerships and Real Estate Including Latest Administrative Guidance: Blake D. Rubin, Esq., Senior Advisor, EY, Washington, DC; Andrea M. Whiteway, Esq., Principal, EY, Washington, DC; Jon G. Finkelstein, Esq., Principal, KPMG, Washington, DC; Eric B. Sloan, Esq., Partner, Gibson, Dunn & Crutcher, New York, NY; Dana L. Trier, Esq., Counsel, Davis Polk & Wardwell, New York, NY: Frank J. Fisher, Esq., Attorney, Office of the Associate Chief Counsel (Passthroughs & Special Industries), Internal Revenue Service, Washington, DC

1. 20% Deduction for Qualified Business Income Section 199A
    a. The 199A deduction has the effect of reducing highest tax rate to 29.6%.
    b. The deduction does not reduce income for application of the 3.8% net investment tax.
    c. The deduction is calculated based on entity income but applies at the level of the partner or shareholder.
    d. Section 199A also provides a 20% deduction against REIT and publicly traded partnership income.
    e. Deduction is generally limited to the lesser of:
        i. 20% of taxpayer's share of "qualified business income" OR
        ii. The greater of:
            1. 50% of taxpayer's share of W-2 wages attributable to the qualified trade or business; or

2. The sum of 25% of the W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property.

iii. If income is below certain thresholds, W-2 and unadjusted basis limitations do not apply.

iv. The deduction is calculated on a business by business basis however the deduction is limited based on total qualified business income.

v. The deduction cannot exceed taxable income less net capital gain of taxpayer for taxable year.

f. Threshold question is whether you have effectively connected income. You can have effectively connected business income that will not qualify as QBI.

g. Proposed Regulations address:

i. Computations

1. QBI includes Section 751(a) and (b) gain that is attributable to the trades or businesses conducted by the partnership.
2. Section 481 adjustments are taken into account.
3. Disallowed losses are taken into account.
4. NOLs are not taken into account.
5. QBI excludes capital gains and losses, dividends, interest, commodities and foreign exchange income, and 954(c)(1)(F) items of income, gain, deduction, loss and non-business annuity amounts.
6. QBI also excludes reasonable compensation received by a shareholder from an S corporation; guaranteed payments, and section 707(a) payments.
7. QBI must be earned with respect to qualified trade or business.

a. Whether or not rental property is a trade or business is still not addressed in the regulations; however, the regs do provide that rental that does not rise to level of section 162 trade or business is treated as trade or business for 199A is the property is rented to

        a trade or business that is commonly controlled.
    b. A “specified service trade or business” is not a qualified trade or business.
8. Determining W-2 Wages
    a. W-2 wages should be treated as paid by the business that is common law employer Prop. Reg. §1.199A-2(b)(2)(ii).
    b. W-2 wages do not include payments to independent contractors.
    c. W-2 wages are allocated among partners the same as partner’s share of wage expense.
9. Determining UBIA of Qualified Property
    a. UBIA: The unadjusted basis is determined immediately after acquisition of property.
    b. Qualified property
        i. Tangible depreciable property held by and available for use in the qualified trade or business by the end of the taxable year; used in production of qualified business income; and for which depreciable period has not ended before the end of taxable period.
        ii. Depreciable period

ii. Aggregation
1. These are not the passive loss grouping rules and are not intended to be.
2. First, we have to find whether we have trade or business.
3. Then, you look at whether you can aggregate.
4. A trade or business cannot be conducted through more than one entity.
5. Requirements:
    a. Common ownership.
    b. Common ownership period
    c. Same tax year
    d. No SSTBs

iii. Specified Service Trades or Businesses
iv. Reporting

2. Carried Interest Section 1061
    a. Holding period/recharacterization rule
        i. 1061 extends required holding period to get long-term capital gain treatment to 3 years.
        ii. Applicable partnership interest is one that was acquired in relation to substantial service.
        iii. Applicable trade or business is one engaged in an activity of raising or returning capital or developing specified assets.
        iv. Specified Assets: Securities, commodities, options, derivatives and real estate held for rental or investment.
        v. A partnership held directly or indirectly by a corporation is not an applicable partnership interest.
        vi. Applicable partnership interest does not include any interest in a partnership where the partner has a right to capital.
        vii. Transfers to related party – Definition is limited and does not include your typical related party definition. Definition includes family member and coworker.
        viii. Short term gain not ordinary income
    b. If you sell interest in partnership in less than three years, then subject to recast as ordinary income. If partnership sells its assets, then taxation will be based on nature of the assets that are sold. Rev. Rul 68-79 is still applicable.
    c. It is not yet clear whether 1231 (depreciable property) is covered by 1061. IRS is considering the issue. This issue may have to be addressed by Technical Correction.
    d. REIT Capital Gains Dividend – You would look at holding period that REIT had in the asset sold to determine whether an amount carried out to carried interest partner would be subject to capital gains or ordinary income.
3. Cost Recovery Section 168(k) Full Expensing
    a. 168(k) allows full expensing of “qualified property” including used property.

        i. Phases down 20% per year starting in 2023 (unless this gets changed).
    b. Qualified Property includes computer software and tangible property with a recovery period of 20 years or less.
    c. Related party rules apply to the cost recovery deduction. Property must be acquired from an unrelated party §179(d)(2).
        i. The section defines purchase as any acquisition of property as long as you don't acquire from a related party.
        ii. Family attribution is only spouse and linear. Property can't be acquired from a component member of a controlled group.
        iii. There is not a purchase if basis is determined in whole or in part by basis of transferor. Ex. Contribution of property from partner to partnership.
    d. Rules regarding partnerships
        i. 704(c) remedial allocations do not satisfy requirements.
        ii. 732(d) basis of distributed property determined under 732 does not satisfy requirements.
        iii. 734(b) increase in basis of depreciable property does not satisfy requirements. Sale of partnership is not an "acquisition" transaction in most instances, even though there are situations that could be characterized like an acquisition, would be too difficult to carve those out
        iv. 743(b) generally does not satisfy requirement
    e. Rev. Rul. 99-5
        i. Situation 1: A owns 100% of LLC. B purchases 50% of LLC interest from A. The 743 adjustment to C would qualify for bonus.
        ii. Situation 2: Same as 1 except that instead of purchasing from A, B contributes cash to LLC in exchange for 50%. In that situation, there is no bonus depreciation.
        iii. Situation 3: Disguised sale. B puts $10000 cash in to LLC. LLC distributes $5,000 to A. This situation is not covered by the revenue ruling. Blake Rubin indicates that the general belief of the tax community is that this is more of a Situation 2. Frank Fisher indicated that IRS had read

the comments but has not yet committed to a position at this time.

f. Open Issues under 168(k)
    i. De-linkage of 743(b) adjustments.
    ii. Should expensing be allowed for 734b adjustments?
    iii. It is unclear why 708(b)(1)(B) is included in the regulations.

4. Like Kind Exchanges Section 1031
    a. For exchanges after 12/31/2017, only real property qualifies for 1031.
    b. Availability of bonus depreciation under section 168(k) for personal property has potential mitigation effect on limiting 1031 to real property.
    c. Proposed regulations specify that UBIA of qualified replacement property is equal to basis of replacement property, not the UBIA of relinquished property. UBIA may be lost as a result.
    d. 100% bonus depreciation applies to:
        i. Basis of original use replacement property
        ii. Excess basis of used property
5. Section 163(j) Impact on Transaction Planning for Partnerships and Real Estate
    a. Business interest limitation: Taxpayer's interest income and 30% of taxpayer's adjusted taxable income.
    b. Business interest: interest paid allocable to trade or business.
    c. ATI: taxable income without regard to items not allocable to trade or business, NOL, business interest or expense, 199A deduction, depreciation, amortization, depletion.
    d. 163j applies to all taxpayers not just corporate taxpayers.
    e. Statute applies at partnership level.
    f. Disallowed interest expense can be carried forward.
    g. The 163j rules as applied to partnership seem to have the general goal of achieving parity with C corporations.
        i. 164(j)(4) – Partnership computes its own 163(j) limit.
        ii. Provisions prevent "double counting". Partnership's ATI cannot be included in partner's ATI.

        iii. Statute is unclear as to whether partner can use income against excess business interest allocated to such partner.
    h. Business interest expense shall not include investment interest. §163(j)(5).
    i. §163(j)(7) provides exceptions.
        i. One exception is partnership with exempt real estate.
        ii. A partnership that makes the election has no 163j limitation.
6. Qualified Opportunity Zones
    a. The ability to receive preferential tax treatment for investments in Opportunity Zones was added in the 2017 tax act.
    b. An Opportunity Zone is defined by the IRS as an economically-distressed community.
    c. Significant tax benefit is provided both on front end as well as back end.
    d. Regulations were proposed on October 19.
        i. Rev. Rul. 2018-19 – there are three forms of preferential tax treatment.
        ii. Deferral is limited to capital gains. Unlike 1031, only gains need to remain invested for deferral.
        iii. Capital gains rate is reduced if investor continues to hold investment.
        iv. Exclusion benefit – If you hold investment for 10 years, you recognize no gain on ultimate disposition. This would include investing in a fund that invests in Opportunity Zones.
        v. You can’t have gain triggered in sale or exchange among related persons.
        vi. Gains need to be invested within 180 days.

Crafting and Drafting Partnership Agreement Income Allocations and Other Tax Provisions: Targets, Layer Cakes, Special Allocations and More: Steven R. Schneider, Esq., Partner, Baker McKenzie,

Washington, DC; Brian J. O'Connor, Esq., Partner, Venable, Baltimore, MD

1. Plan your document before drafting.
    a. Gather background.
    b. Review term sheet.
    c. Understand the economics of the deal.
        i. What type of preferred interests will be used?
        ii. Is there equity based compensation?
        iii. What will be the structure of distributions?
    d. What is the nature of the partnership?
    e. What are the tax characteristics of each partner?
2. Distribution Detail
    a. General rights to distributions
        i. Operating and Liquidating Distributions
        ii. Liquidation Alternatives
            1. Safe Harbor Agreement.
                a. Typically, if credits are paid and the proceeds are distributed to the partners' in accordance with positive capital accounts, a safe harbor is being applied.
            2. Waterfall Liquidation.
                a. A waterfall describes the order in which distributions are made after liquidation.
    b. Capital Call
        i. Consider penalty for failure to satisfy.
        ii. Penalty options:
            1. Dilution Based
            2. Treat as loan with high interest rate
            3. Impact distribution priority
    c. Tax Distributions
        i. Tax Distributions typically receive priority over general distributions.
        ii. A typical approach is to use net income by maximum tax rate of the partners that might apply.
        iii. Tax distributions should be considered at the beginning.

iv. A significant reason for providing for tax distributions is that partners often have phantom income from partnerships because the partnership may use its profits to invest in a manner that doesn't result in immediate tax deductions. A partnership might also increase cash reserves or use the proceeds from the sale of a capital asset to invest in a replacement asset.
v. Distributions may be restricted for a variety of reasons (lender, distributions only to preferred partner). The less control there is over general distributions, the more important it is to have tax distributions to provide a cash source for taxes related to phantom income.
vi. There are some reasons that a tax provision might not be included. If partners have losses to offset the income, they may prefer to leave the cash in the investment. If most of the partners are tax exempt, the partners may not need the distributions. A carried interest partner may prefer to leave returns in the partnership in favor of a hopefully higher overall return.

d. Withholding of taxes on behalf of partner

3. Clawbacks – Introduction
    a. Generally, a partnership may have profits early on and distribute to GP. GP may be required to return a Promote Distribution
    b. Very little exists in terms of regulations regarding clawbacks.
    c. Types of clawbacks
        i. Loss allocation clawback
        ii. Priority Return Clawback
4. Tax Allocations 704(b) and 704(c)
    a. Most language refers to book allocations. 704(b)
    b. Section 704(c) covers tax allocations.
    c. Tax allocation sections should first contain a primary allocation that is consistent with the economic deal. The regulatory sections override the primary section. The regulatory section is typically designed to comply with one of the regulatory safe harbors for allocations.

   d. There are really limited reasons to liquidate based on capital accounts.
   e. Waterfall Allocation – Allocations must equal economics. For the tax allocations to be respected, the liquidation provisions must be the same as partner rights based on capital accounts. That is, capital accounts and waterfall rights must be consistent.
   f. Targeted Allocation – A formula is used to allocate book income and loss among the partners using a formula.
5. Special allocations
   a. The most common is a profits interest, which is provided for services.
   b. Carried interest layers is a modification of the service profits interest.
   c. Flip Allocation – A structure such as 99/1 is used for a tax credit. When tax credit is fully utilized, then there is a flip.
6. Profits Interest
   a. It is very common to use a profits interest.

Partnership Liability Allocation Planning Under the New Regulations: Blake D. Rubin, Esq., Senior Advisor, EY, Washington, DC; Andrea M. Whiteway, Esq., Principal, EY, Washington, DC

1. Section 752
   a. An increase in partner's share of partnership liabilities or increase in partner's individual liabilities by assumption of partnership liability is treated as deemed cash contribution.
   b. Deemed cash contribution increases outside basis
   c. Decrease in liabilities has opposite result
2. Recourse Liabilities
   a. A liability is recourse if the partner bears economic risk of loss.
   b. A constructive liquidation test is used to determine whether partner bears economic risk of loss.
   c. A partner bears economic risk of loss where partner or related person is nonrecourse lender.
   d. Anti-abuse rules exist to prevent "bad behavior".

3. Nonrecourse liabilities
    a. No partner or related person bears economic risk of loss.
    b. Three tier allocation of nonrecourse liabilities
        i. Partner share of partnership minimum gain
        ii. Sec 704(c) minimum gain
        iii. Excess nonrecourse liabilities are allocated in accordance with profits.
    c. These rules developed in the 1990s and were intended to be taxpayer favorable.
    d. The allocation of nonrecourse liabilities interacts with allocation method chosen under 704(c). 704(c) regs allow you to use one of three allocation methods: traditional; curative; remedial.
    e. Rev. Rul. 95-41: If you elect remedial allocation method, you will cause partner to be allocated more income on sale of property than under traditional method.
    f. The amount of gain that must be allocated under 704c is difference between book value and tax basis. $100 bv; $40 basis. Initial allocation will be 60. After first year of depreciation, $90 bv; $36 basis. Allocation will become $54.
4. Disregarded Entities
    a. For purposes of taxpayer being allocated liabilities under 752, particularly recourse liabilities, taxpayer can get that allocation only to the extent of net value.
    b. Disregarded entities include single owner LLC, QRS and QSUB.
    c. Net value is the fair market value less obligations other than obligation to pay partners.
5. Temporary Regulations Under Section 752
    a. Bottom dollar payment obligation will not be taken into account in determining whether partner bears economic risk of loss.
    b. Bottom dollar guaranty: T contributes $100. T determines more recourse liability might be needed. T enters into a bottom guarantee that guarantees collection, not payment – lender has to first pursue property and foreclose property. Additionally, bottom guarantor will not be required to make good on guarantee until lender had exhausted all remedies and then and only then will bottom guarantor be obligated. There is an

anti-abuse rule that states that bottom guarantees will include tiered partnerships used to achieve a bottom guarantee.

c. Vertical slice guarantee is excepted from being treated as a bottom guarantee. A vertical slice is guarantee where the guarantor guarantees one dollar of every ten or something similar. Vertical slice guarantor might guarantee 10 of every 100 of a $1000. If asset declines from $1000 to $500, half of vertical slice guarantor's guaranty is at risk.
d. Effective date was for liabilities incurred or assumed after October 5, 2016. There is a seven year transition rule that allows bottom guaranties that pre-existed the effective date to continue to be treated as recourse liabilities.
e. There is a trap if partner is an S corporation or disregarded entity. If there is a change of ownership of more than 50%, the transition period will be eliminated.
f. A significant modification of a debt would be considered new debt for purposes of the transition rule.
g. Anti-abuse Rule 1.752-2(j). The regulation lists a variety of factors that will be considered. The first couple factors look at the likelihood of payment. Is there a commercially reasonable contractual restriction? Does guarantor have the ability to get off the obligation at the time that guarantor is likely to have to pay it? Another factor is terms of the liability are substantially same as if there had been no guaranty.
h. The proposed regulations may remove 1.752-2(k) and instead create a new presumption under the anti-abuse rule in 1.752-2(j).

New Partnership Audit Rules: What you need to know and do now: Miriam L. Fisher, Esq., Global Chair of Tax Controversy, Latham & Watkins, Washington, DC; Donald B. Susswein, Esq., Principal, RSM US, Washington, DC

1. Certain partnerships can elect out of the new partnership audit rules.
    a. If a partnership elects out of the rules, there will be no partnership level tax, no control over the partners via the concept of Partnership Representative. Voluntary partnership level resolution may still be available.

b. An election out must be made annually on the filing of the return for the partnership.
c. Who May Elect Out?
    i. A partnership cannot be required to issue more than 100 K-1s.
    ii. The partnership cannot have any disregarded entities as partners.
    iii. For purposes of K-1 rule, to the extent of an S corporation partner, the number of statements that must be issued to S corporation owners are counted.

2. Timeline
    a. Partnership files tax return.
        i. Upon filing, if partnership is eligible to elect out, the partnership must do so on its return.
            1. If partnership elects out, individual partners will be audited (pre-TEFRA situation).
    b. Assume return gets audited. IRS issues NAP (notice of administrative proceeding).
        i. Notice is addressed to Partnership Representative. Partnership Representative is in charge of audit.
    c. IRS issues NOPPA (notice of proposed partnership adjustment).
        i. If there is an adjustment, it is computed at highest applicable rate.
        ii. Partnership agreement needs to build in cooperation among partners.
        iii. There can be no less than 270 days from issuance of NOPPA to IRS issuing FPA (final partnership adjustment).
        iv. Partnership then has 45 days to make push-out election. (The default is that the partnership pays and tax due after audit.) A push-out election permits the partnership to cause the audit adjustments to be allocated to the partners in the year subject to audit. That is, if the partners have changed since the year for which the partnership is being audited, the partnership can push out the tax liability to the partners who were partners during the year the liability was incurred.

        1. Note that the economic burden of an adjustment falls on the partners of the adjustment year under the default rule unless there is a claw-back rule. For some partnerships, this may make sense in terms of administrative simplicity.
        2. If there is a push-out, partnership issues adjusted K-1s to reviewed year partners.

3. Partnership Representative
    a. Possible Responsibilities
        i. Initiate audit
        ii. Extend statute of limitations
        iii. Propose and agree to adjustments
        iv. Entity level vs. push-out
        v. Should partnership representative be required to seek partner level information?
        vi. What are continuing responsibilities after liquidation of partnership?
    b. In a closely held partnership, the agreement could require consent of the partners to any agreement with the IRS. At a minimum, Partnership Representative should be subject to fiduciary and reasonableness duties.
    c. The question about Partnership Representative is not so much “who” you should pick but what will control the manner in which they deal with the IRS and bind the partnership.
4. Action of Items
    a. Decide whether to elect out.
    b. Select Partnership Representative and establish procedures regarding handling of audits and choosing a successor.
    c. Establish procedures requiring partners to provide all relevant information.
    d. Decide who, if anyone, must consent before Partnership Representative can agree to an adjustment.
    e. Establish procedures for determining whether any adjustment payments should be entity level vs. push-out.
    f. Should push-out provisions be included in partnership agreement?
    g. Consider whether AAR filing should be specified in partnership agreement.

Hot Like Kind Exchange Issues: Adam M. Handler, Esq., Principal, PricewaterhouseCoopers, Los Angeles, CA; Robert D. Schachat, Esq., Consultant, EY, Washington, DC

1. 2017 legislation limits 1031 exchanges to real estate.
    a. Effective for exchanges 2018 and after.
2. Qualifying as tax-free under 1031
    a. Exchange of relinquished property for replacement property.
    b. Like kind. Real estate is generally like kind to other real estate.
        i. Exchange of Lease can qualify. Reg. 1.1031(a)-1(c); example in PLR 8453034.
        ii. Coal supply contracts were covenants running with the real property and like kind. *Peabody Natural Resources Co. v. Commissioner*
        iii. Exchange of old growth timberlands for reproduction timberlands. PLR 200541037.
        iv. Development rights for fee interest in real property. PLR 200805012
        v. Exchange of cellular tower properties for certain cable telecommunications property. PLR 201706009
    c. Not like kind
        i. Construction of new building on land already owned by taxpayer. *Bloomington Coca-Cola Bottling Co. v. Commissioner*
        ii. Fee title for 50 year water rights not of like kind. *Wiechens v. U.S.*
        iii. US and foreign real property are not of like kind. 1031(h)(1).
    d. Held for investment or use in business
        i. Held for requirement is violated if property is ordinary income or personal use property.
        ii. Requirement may be violated if there is a transfer soon after the exchange.
3. Timing Requirements
    a. Deferred Exchange: 45 days to identify replacement property; 180 day closing requirement.

   b. Reverse Exchange: new property is received before old property is transferred.
4. Taxation
   a. Gain realized is recognized to the extent of receipt of “boot”
   b. Replacement property takes a substituted basis.
   c. Loss is disallowed in a 1031.
   d. Section 1031 is not elective.
   e. *Redwing Carriers, Inc. v. Tomlinson*
   f. To avoid loss disallowance, use different taxpayers to transfer and receive properties. Do not use cross default provisions or cross references. Use separate closing dates.
5. Reverse Exchanges
   a. “True Reverse” Exchange
      i. Taxpayer receives replacement property before relinquishing property.
      ii. This might happen when the seller refuses to postpone sale or there has not been a purchaser found for property being relinquished.
      iii. Rulings are not favorable. Thus, it is generally preferable to avoid reverse exchanges.
   b. Parking Transaction as an Alternative to True Reverse Exchange.
      i. Park First: New property is acquired and parked with an accommodator. A simultaneous exchange occurs later.
      ii. Park Last: there is a simultaneous exchange first. Old property is then parked with an accommodator.
      iii. See Rev. Proc. 2000-37 modified by Rev. Proc. 2004-51.
      iv. It is difficult to structure a non-safe harbor parking arrangement, which is outlined in 2000-37. Safe Harbor Requirements:
         1. Title held by EAT
         2. Bona Fide intent for like kind exchange.
         3. Relinquished property identified within 45 days.
         4. Transfer to taxpayer or third party within 180 days.
         5. EAT cannot hold property for more than 180 days.
      v. Safe Harbors permitted:
         1. EAT may serve as QI.

        2. Taxpayer can manage parked property.
        3. Taxpayer can provide financing.
    vi. You must decide at the beginning whether parking will be within or outside the safe harbor.

ETHICS: CHALLENGES FOR THE TAX PROFESSIONAL ADVISING CLIENTS LOOKING TO PUSH THE ENVELOPE: Stephen M. Breitstone, Esq., Partner, Meltzer, Lippe, Goldstein & Breitstone, Mineola, NY and New York, NY; Roberta Mann, Esq., Mr. and Mrs. L. L. Stewart Professor of Business Law, University of Oregon School of Law, Eugene; Megan L. Brackney, Esq., Partner, Kostelanetz & Fink, New York, NY

1. Sources of Law For Attorneys
    a. ABA Model Rules of Professional Conduct
    b. State analogues
    c. Commentary on model rules
    d. ABA and State ethics opinions
    e. ABA Tax Section standards
2. Sources Of Law For Accountants
    a. AICPA Code of Professional Conduct
    b. AICPA Statements on Standards for Tax Services
    c. State Board of Accountancy
3. Circular 230
    a. Incorporates many of the ABA Model Rules and AICPA SSTS
    b. Applicability of 230 is in flux.
4. Sexton v. Hawkins
    a. Disbarred attorney was treated as a tax preparer, not regulated by Circular 230.
5. Ridgley v. Law
    a. CPA argued that Circular 230 does not apply to preparation of ordinary refund claims.
    b. Court held for CPA and allowed contingent fees for preparation of ordinary refund claims.
6. Lawyers working in an accounting firm
    a. Applicable law may depend on exactly what the lawyer is doing.
7. Circular 230

    a. Circular 230 disclosure is not required on every single email. It is required when you give an opinion. Instead of replying to an email, prepare a letter. You can always attach the letter to an email.
    b. Circular 230 contains penalties for tax preparers.
        i. IRS does not have the authority to disbar an attorney. IRS can prevent an attorney from practicing before the IRS and may refer the attorney's actions to state bar.
        ii. Attorney cannot remain a partner with someone who has been barred from practice before IRS and still practice before IRS.
    c. There was a recent case where an attorney made modifications to documents during an audit. Attorney was suspended from practice by Supreme Court in his state.
    d. Avoid losing your license for a client. Don't get involved in a client's conspiracy. Learn to say no. Never put yourself in the position of going to jail for a client.
8. ABA Model Rule 1.2 scope of Representation and Allocation of Authority Between Client and Lawyer
    a. (d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.
9. Who is a Tax Return Preparer?
    a. IRC §7701 is any person who prepares for compensation or employs one or more persons who prepare returns.
    b. If you give advice that will be used in preparing a return, you are a non-signing preparer.
    c. A planner gives advice before the transaction. A preparer gives advice after the transaction with respect to how to report the transaction.
10. Return Preparer Penalties
    a. IRC §6694 imposes penalties on tax return preparer with regard to an unreasonable position taken on a tax return if the prepare actually prepared any return or knew or should have known the return was prepared.
11. Standards with respect to Tax Returns and Documents

a. A practitioner may not willfully, recklessly, or through gross competence sign a return or claim for refund that the practitioner knows or reasonably should know contains a position that lacks a reasonable basis.

12. There must be "substantial authority" for taking a position. The weight of authority depends on its relevance and persuasiveness and the type of document providing the authority.
    a. Treas. Reg. § 1.6662-4(d)(3)(iii) lists the authorities that are considered substantial.
13. Reasonable basis for taking a position is defined in Treas. Reg. §1.6662-3(b)(3). The standard is reasonably high. The standard is not satisfied by a position that is merely arguable.
14. Adequate Disclosure Treas. Reg. §1.662-4(f) and Circular 230, §10.34(c).
    a. Charitable deduction based on giving away a valuable piece of artwork requires several forms. You don't need a separate disclosure as you have already adequately disclosed.
    b. Form 8275 or 8275-R (if you are challenging a regulation). There is a general perception that an 8275 is an audit trigger; however, one of the panelists indicated routine filing of 8275s has not triggered audits. The panelist also asked the room who had filed an 8275 and how many had triggered audits. Of those in the room that had filed 8275s, none had any knowledge of an audit being triggered relative thereto.
        i. There must be a reasonable basis relative to the disclosure. For example, it would not be reasonable to take a position not to report income.
    c. Provide the taxpayer with a return that includes the disclosure OR Advise the taxpayer of the penalty standards that apply and document the advice given.
15. Reasonable Cause and Good Faith
    a. No penalties if preparer can establish reasonable cause and good faith.
16. Tax Shelters
    a. A tax shelter is any partnership, investment, plan, or arrangement, if a significant purpose of such partnership, entity, investment, plan, or arrangement was the avoidance or evasion of tax.
    b. Avoid "the secret sauce" – that which you layer on for the sole purpose of creating a loss or deduction.

c. A tax shelter is often a deal that would look stupid but for the tax avoidance.

17. Relying on Information From Clients
    a. Preparers do not have to audit the client.
    b. Information provided should pass the smell test.
18. Likelihood of Audit
    a. Written Advice: Practitioner must not, in evaluating a federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raise on audit. Circular 230, §10.37(a)(2).
    b. Oral Advice: Audit risk should not be considered. Regulations Governing Practice Before the Internal Revenue Service.
    c. There is not a duty to file an amendment when an error is discovered.
19. Fifth Amendment Returns
    a. United States v. Sullivan; United States v. Josephberg
    b. A preparer can assist with a Fifth Amendment return.
20. Reportable Transactions
    a. The new tax act will likely result in a plethora of new tax schemes that will be sold to taxpayers.
    b. Reportable transactions are listed in various places on the IRS website. Website listing is not complete as there have been rulings since the list on the website was updated in 2009.
21. Why Prepare a Written Opinion?
    a. Penalty protection
    b. Circular 230 treats almost anything as advice.
    c. Opinion must be based on reasonable factual and legal assumptions.
    d. Opinion must reasonably consider all relevant facts that the practitioner knows or should know using reasonable efforts to identify and ascertain the relevant facts.

DAY FIVE NOTES:

SUBCHAPTER S AFTER THE TAX CUTS AND JOBS ACT – THE GOOD, THE BAD, AND THE UGLY: Larry J. Brant, Esq., Shareholder, Garvey Schubert Barer, Portland, OR

1. The Tax Cuts and Jobs Act Provisions Directly Impacting Subchapter S
    a. There are four provisions that directly impact Subchapter S.
        i. Changes to beneficiary eligibility requirements for ESBT
        ii. Changes to the manner in which deductions for charitable contributions made by an ESBT are claimed
        iii. Adoption of an additional limitation on an S corporation shareholder’s ability to use losses passing through from S corporation
        iv. Additional rules relating to the impact of termination
2. ESBT Eligibility Requirements
    a. All beneficiaries, current, contingent, and remainder, of an ESBT have to be individuals, estates or charitable organizations described in Code
    b. No interest in ESBT can be acquired by purchase
    c. An ESBT may not be a foreign trust
    d. An ESBT cannot be a Qualified Subchapter S Trust
3. An ESBT cannot be a tax exempt trust under subtitle A of Code
    a. An ESBT cannot be a charitable remainder trust.
    b. An ESBT must affirmatively elect to be treated as an ESBT.
4. ESBT Election Statement
    a. Must contain 6 items:
        i. Name address and taxpayer identification number of the ESBT, each of the potential income beneficiaries and the S corporation in which the trust currently holds stock;
        ii. If trustee has power to make distributions from trust to tax exempt organizations, a statement to that effect;
        iii. A clear statement to identify the document as an ESBT election;
        iv. The first date upon with the ESBT owned stock in an S corporation;
        v. The date upon which election is to be effective;
        vi. And a representation of trustee that trust and all potential current beneficiaries of ESBT meet the applicable requirements under subchapter S.
    b. Aspects of ESBT Elections

        i. If ESBT has more than one trustee, the trustee with legal authority to bind trust must sign election.
        ii. If any one of trustees can bind trust, only one trustee must sign.
        iii. Only one election is made for ESBT.
        iv. There are specific rules about where to file the election.
        v. A trust is not allowed to make a protective ESBT election.
        vi. Relief is likely available for a late election.
    c. Taxation of ESBTs – five special rules
        i. The highest individual tax rate is applied.
        ii. The exemption amount from Code §55(d) is zero.
        iii. Capital losses allowed only to extent of capital gains.
        iv. Items of income, gain, loss, deduction or credit taken into account are those items required to be taken into account under 1366, any gain or loss from the disposition of the S corporation stock and state/local taxes and administrative expenses.
        v. If trust terminates, loss carryovers or excess deductions are applied to entire trust.
5. TCJA makes nonresident alien a permissible beneficiary of an ESBT.
    a. S corporations that want nonresident alien to benefit from ownership could make such NRA beneficiary of ESBT. (NRA's cannot own S corporation stock.)
    b. Trust must be designed to avoid distribution of stock to NRA directly or indirectly as corporation's S election would be terminated on date of distributions.
6. Charitable Contributions
    a. This is a favorable change for taxpayers.
    b. Prior to TCJA, treatment of charitable contribution by trust and individual were handled differently. Trust does not get carryover of excess deductions.
    c. Deduction for charitable contributions for ESBT's is now the same as individuals. Carryover of excess contributions can be carried over for 5 years.
7. Excess Business Losses
    a. This is not a favorable change.

b. The aggregate amount of losses taken into account by an S corporation shareholder cannot exceed: the shareholder's adjusted basis; plus the shareholder's adjusted basis of any indebtedness owed by corporation to shareholder; and
c. The losses being passed through to S corporation shareholder must be tested under the at risk and then passive activity loss rules before the losses may be used by the shareholder in determining his/her/its taxable income. Losses that are disallowed are generally suspended and carried forward indefinitely until the shareholder has sufficient amounts of the type of income needed or until shares of S corporation are disposed.

8. S Terminations – Ability of shareholder to use losses
    a. Method of Accounting
        i. Gross receipts test is increased from $5m to $25m.
        ii. The test is applied looking back at the prior three year period.
        iii. If you are an eligible terminated S corp, you can take income into account ratably over 6 years. Eligible terminated S corp: S corp before effective date of TCJA; revokes S election within two years; no changes in shareholder. The statute speaks in terms of a revocation not a termination.
        iv. Review Rev. Proc. 2018-31 and Rev. Proc 2018-44.
    b. Post-Termination Distributions
        i. TCJA changes "post-termination period" distributions for eligible terminated S corporations.
        ii. New law provides that "post-termination period" distributions will be chargeable to AAA account in same ratio that AAA account bears to amount of accumulated E & P. this applies only to eligible terminated S corporations.
9. Five Provisions of TCJA that impact S corporations and shareholders indirectly
    a. Individual Tax Rates
    b. AMT
    c. 199A

    d. Elimination of Corporate AMT
    e. Corporate Tax Rate of 21%

10. Continuing Shortcomings of Subchapter S
    a. Timely and Proper Election Filed
    b. Domestic Corporation
    c. Corporation cannot be bank or insurance company
    d. S corp can't be a Disc or former Disc
    e. Shareholders must meet eligibility requirements for S Corporation shareholders.
    f. NRA cannot be shareholder
    g. One class of stock limitation
    h. No basis for Corporation's debt.

11. The Ugly
    a. If you revoke election, you must wait five years to re-elect.
    b. Built-in Gains Tax
    c. LIFO Recapture Tax
    d. Passive Investment Tax – If you have C corporations and profits and go S and have passive investment tax, you can lose S election.

SECTION 199A AND ITS APPLICATION TO PASS-THROUGH ENTITIES: Ronald A. Levitt, Esq., Shareholder, Sirote & Permutt, PC, Birmingham, AL; Stephen R. Looney, Esq., Shareholder, Dean Mead, Orlando, FL

1. Tax changes
    a. Tax Rates – Rates are lower
    b. New Thresholds – top marginal rates $500,000; $600,000
    c. C corporation rate at 21% - this is one of the few permanent changes.
    d. Earnings on distributions to shareholder.
2. Impact on choice of entity
    a. Owners will net less in C corporation currently if all income is distributed.
    b. C corporations may be useful where earnings are not distributed annually or in the entirety.

    c. 199A sunsets while C corporation tax rate is permanent. There may be more conversions as we get close to 199A sunset.
3. 199A
    a. Taxpayers may deduct 20% of QBI of an S corporation, partnership, or sole proprietorship allocable to such shareholder, partner, member or sole proprietor.
    b. Taxpayer receiving full benefit will have a top marginal tax rate on QBI of 29.6%.
    c. Taxpayers who will not be eligible (SSTBs) should be considering how they can reduce their income. For example, consider a defined benefit pension plan.
    d. Calculated based on entity income but individual deduction that reduces taxable income.
    e. Carryover of Loss will reduce QBI in subsequent years.
4. Proposed Regulations under 199A
    a. Wages and UBIA of Qualified Property – Prop. Reg. §1.199A-2. Notice 2018-64.
    b. QBI, Qualified Real Estate Investment Trust Dividends and Qualified Publicly Traded Partnership Income Prop. Reg. §1.199A-3
    c. Aggregation Rules – Prop. Reg. §1.199A
    d. Specified Trades or Businesses (SSTBs) Prop. Reg. §1.199A-5
    e. Relevant pass through entity (RPE) is one of new acronyms under new rule
    f. Proposed regs are generally taxpayer friendly but there are anti-abuse rules.
5. Example: Sole Proprietor in a Qualified Trade or Business with Income less than threshold amount: Assume A is sole owner of QTB through a single member disregarded LLC. Business has no employees and no substantial assets. QBI from business is \$200,000. A’s wife has \$100,000. Combined taxable income = \$300,000. Taxable income is less than \$315,000 threshold for married individuals. A’s deduction is \$40,000. If A were single, A’s income would exceed the threshold for single taxpayers and would be subject to limitations as a result.
6. Calculation of 199A for individuals with taxable income above the threshold amount.

    a. Applicable percentage of QBI, W-2 wages and UBIA of Qualified Property is taken into account. (An individual with taxable income in excess of phase-out whose income is from SSTB will have no deduction.)
    b. If taxpayer chooses to aggregate, ABI, W-2 wages, and UBIA of qualified property must be combined before calculation.
7. Qualified Trade or Business
    a. Domestic Earnings.
    b. Any business other than an SSTB or business of being an employee.
    c. Flow through entity.
    d. Must have right flavor of income – can't be foreign income or investment income.
    e. Proposed Regulations adopt a Section 162(a) definition of trade or business. Solely for purposes of 199A, the proposed regulations extend the definition of trade or business to entities with 50% or more commonly owned trade or business. This may be favorable to many taxpayers but not to owners of SSTBs. For example, if the partners of a law firm also own an entity that owns a building of which the law firm is the sole tenant, the rental entity will be an SSTB if the law firm is one.
    f. A triple net lease to a non commonly controlled entity is not usually treated as a separate trade or business.
    g. Aggregation Rules
        i. Grouping rules of 469 were not adopted.
        ii. Aggregation is permitted but not required.
        iii. To aggregate, you have to show each business is a trade or business and the same person or group of persons, directly or indirectly own a majority interest in each business to be aggregated for the majority of the taxable year. Family attribution rules apply but these are different than typical attribution rules in that they include spouse, parents, grandparents, and children and grandchildren but not siblings.
8. Qualified Business Income – If net QBI is below zero, you have no deduction.

    a. Investment income is not included. (Interest, dividend, short term capital gain or loss).
    b. Reasonable compensation and guaranteed payments are excluded from QBI.
9. Section 199A Issues
    a. W-2 wages definition.
        i. Common law employer takes into account W-2 wages.
    b. Independent contractors.
    c. Management Fees
    d. What is Qualified Property? Prop. Reg. 1.199A-2(c)(1)(i)
        i. Tangible property of a character subject to depreciation that is held by, and available for use in, the qualified trade or business at the close of the taxable year, which is used in the production of QBI sometime during the taxable year.
        ii. Property acquired under 1031. Qualified property that is acquired in a like kind exchange, or in an involuntary conversion is treated as replacement MACRS property whose depreciable period generally is determined as of the date the relinquished property was first placed in service.
10. SSTBs
    a. Any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.
    b. Deduction is allowed for SSTBs if taxpayer taxable income is less than the threshold. Deduction is phased out for SSTBs if taxpayer income is between the bottom and top of the phase-out thresholds.
    c. Proposed Regulations 1.199A-5 provides definitions for the professions identified as SSTBs.
    d. Anti abuse rules exist to prevent companies from separating out business functions to claim 199A.

e. IRS De minimis rule – If you have a trade or business with gross receipts of $25m or less for a taxable year, a trade or business is not an SSTB if less than 5% of the gross receipts of the trade or business is attributable to the performance of services in an SSTB. If gross receipts are over $25m, then a 10% rule applies. Interestingly, if you have 11% of gross receipts from consulting, all of the income is tainted and business becomes SSTB.

11. Open Issues
    a. It is unclear whether 199A applies to banking, insurance, leasing; farming business; business involving extraction of products; business of operating hotel, motel, restaurant.
    b. Further clarification is needed on whether particular businesses are SSTBs. For example, in the field of health, care ambulatory surgery centers, dialysis centers operated in a separate entity included?
    c. Further guidance is necessary on QBI. For example, should interest on working capital be QBI? Should guaranteed payments for the use of capital be QBI?
    d. Does it make sense to allocate UBIA consistent with tax depreciation?
    e. Aggregation
        i. Can trades or businesses be aggregated through tiered entities?
        ii. Trust aggregation rules in the proposed regulations are inconsistent with the examples provided and should be clarified.

DRAFTING FOR PARTNERSHIP AUDITS: Terence Floyd Cuff, Esq., Of Counsel, Loeb & Loeb, Los Angeles, CA

1. Consider whether partnership should make election out of audit rules.
    a. The election must be made annually.
    b. Consider including audit provisions in the partnership agreement to cover the situation where an election out is not made or an election is made and fails.

2. Significant concerns in drafting a tax audit provision
    a. How do things work upon an audit?
    b. Power to name a Partnership Representative.
    c. Does agreement provide sufficient authority to undertake an audit under the new rules?
    d. Does current agreement provide sufficient power to make audit strategy decisions?
    e. Does current agreement provide a source of funding for future audits?
    f. Does current agreement provide sufficient indemnification to Partnership Representative?
    g. Does agreement provide sufficient controls over Partnership Representative?
3. Appointing Partnership Representative
    a. Appointing a partnership representative is required annually on tax return for such year.
    b. An entity can act as partnership representative only if an individual who would otherwise be eligible to serve as partnership representative is designated as the sole individual through whom the partnership will act. This appointment is referred to as designated individual.
    c. If agreement does not designate a Partnership Representative, the IRS will notify partnership. If a PR is not designated within 30 days after such notice, IRS can designate a PR.
4. Power of Partnership Representative
    a. The partnership agreement should restrict the power of the Partnership Representative. While the agreement does not bind the IRS, the agreement will bind the PR.
    b. Consider requiring that the PR receive prior approval of the partnership for the following:
        i. Meetings with IRS.
        ii. Submitting writings to IRS.
        iii. Making any partnership election.
        iv. Electing out of audit rules.
        v. Designating a successor PR.
        vi. Employing experts.
        vii. Spending partnership funds.

viii. Incurring debt.
ix. Agreeing to extend statute of limitations.
x. Agreeing to any closing agreement.
xi. Agreeing to waive limitations on assessment.
xii. Settlement agreement
xiii. Agreeing to pay any imputed underpayment.
xiv. Filing a Tax Court petition or any other petition on behalf of partnership.
xv. Submitting or responding to interrogatories on behalf of partnership.
xvi. Depositions, court appearances.
xvii. Responding to 30 day letter on behalf of partnership.

5. Basic Mechanical Provisions to Include in Partnership Agreement
    a. Who makes decision as to whether to elect out of audit rules? How?
    b. Delineate who can be chosen to act as PR.
    c. Should partnership restriction provisions be designed to restrain transfers so that ability to elect out remains?
    d. Should partnership agreement provide a limitation on number of K-1s?
    e. Provisions regarding preserving partner confidentiality in a partnership audit.
    f. Provisions specifying how to resolve partner disputes with respect to how audit should be resolved.
    g. Notice provisions: To what notices is partnership entitled? Partners?
    h. Funding of an audit after a partnership liquidation.
    i. Funding of an audit after a partnership bankruptcy.
    j. Partnership funding of imputed payment.
    k. Allocation of economic burden of imputed underpayment.
    l. Powers of PR
    m. Limitations on power of PR
    n. Specify who makes determinations on issues such as election out, payment of imputed underpayment at the partnership level, push out, pull in?
    o. PR indemnification, compensation, supervision, engagement.
    p. Selection, removal, replacement of PR.

6. Additional Drafting Considerations
    a. Should S corporations be allowed as partners?
    b. Should partnerships, trusts, estates be allowed as partners?
    c. Will there be partners that are pass-through entities?
    d. Provisions related to electing out of audit rules.
    e. Adjusting partnership economics to take into account partnership payments of imputed underpayments and audit expenses.
    f. Standard of conduct of PR.
    g. Dealing with state audit.
    h. Does partnership or PR engage legal counsel and accountants?

ACQUISITIONS AND DISPOSITIONS OF INTERESTS IN PARTNERSHIPS: Robert W. Phillpott, Esq., Partner, Baker Botts, Houston, TX Stephen A. Kuntz, Esq., Partner, Norton Rose Fulbright US, Houston, TX

1. Focus of Presentation
    a. There has been a significant increase in the number of M&A transactions involving partnerships
    b. Need to know whether the aggregate or entity theory applies when structuring the transaction.
    c. When entity theory applies, different structures can have very different tax results.
    d. Analogies to consequences of corporate transactions do not work well with partnership transactions.
2. Simplifying Conventions
    a. 20% Corporate Tax Rate
    b. 40% Ordinary Income Tax Rate
    c. 20% Long Term Capital Gain Rate
    d. No Check the box elections have been made
    e. All partners of partnerships are individuals unless otherwise specified.
3. Example 1
    a. Hero is sole member of PipeCo LLC

b. PipeCo completed construction of a pipeline.
c. PipeCo incurred $900 of capital expenditures. Pipeline now has fmv of $1,000.
d. Villain wants to acquire 50% interest.
e. Can transaction be structured in a way that minimizes tax to Hero's partners?
    i. Proposed Transaction: Initial proposed transaction – Hero would sell 50% to Villain for $500. Admission of Villain will result in entity being partnership vs. disregarded entity.
    ii. Under Rev. Rul. 99-5, 1999-1 CB 434) – such transaction treated as if Hero sold 50% interest in pipeline and immediately thereafter, Hero and Villain contributed their respective interests in the pipeline to newly formed partnership. Deemed sale to Villain would result in $10 of federal income tax to Hero's partners. Amount Realized: $500 less Allocable basis of $450 Long term gain of $50 multiplied by 20% capital gain rate = tax $10.
    iii. Transaction restructured to avoid taxation: Villain contributes $500 to PipeCo in exchange for 50% interest. Pipeco distributes $500 to Hero. Under Rev. Rul. 99-5, Hero should be treated as contributing the pipeline in exchange for a 50% interest in PipeCo and distribution of $500.

4. Villain wants to buy Hero's 50% PipeCo interest in exchange for Villain's $1000 note that pays interest currently and a balloon payment in 5 years.
    a. Proposed Transaction: Villain purchases hero's 50% interest for $1000 note. PipeCo will be reclassified as disregarded entity. Under Rev. Rul. 99-6, Villain's purchase will be treated as if Villain purchased from Hero 50% interest in pipeline and Hero is treated as if it sold its interest in PipeCo to Villain. Hero's $1000 gain is subject to ordinary income treatment because all such gain will be attributable to depreciation recapture. Gain will have to be recognized in year of sale even though the $1000 isn't received until five years later.
    b. Revised Transaction: PipeCo issues $1000 note in redemption of Hero's 50% interest in PipeCo. PipeCo's promissory note

should be treated as liquidating distribution when paid. Hero should be treated as partner until final payment of note and Hero will only recognize gain when cash distribution exceeds outside basis.

5. Guarantees: Hero is sole member of RefineCo LLC. Sole asset is a refinery with tax basis of $300 and FMV $1000. Villain wants to acquire 50% interest in RefineCo by contributing $500, which will be used for expansion. To equalize value, RefineCo LLC will borrow $500 that it will distribute to Hero. The issue is whether transaction can be structured to minimize tax to Hero as a result of receiving $500 of debt proceeds.
    a. Proposed Transaction: Distribution to Hero should be treated as though Hero borrowed the money and that the loan was secured by RefineCo LLC's assets. Villain would then contribute $500 to RefineCo for 50% interest. Rev. Rul. 99-5 – Villain and Hero would be treated as though they formed a partnership with Villain contributing $500 in exchange for 50% and Hero contributing all the assets of RefineCo, subject to liability, to newly formed partnership. The $500 liability is a non-qualified asset and non-recourse. Hero's share of liability is equal to share of profits. Hero would be deemed to receive $250 in a disguised sale. Hero would recognized $175 gain.
    b. Revised Transaction: Hero guarantees $500 liability. As a result of guaranty, Hero's share of liability should be $500. Because liability deemed assumed by partnership does not exceed Hero's Section 752 share of liability, Hero should not be deemed to receive any distribution that could be part of a disguised sale. As a result, Hero should not recognize any gain.
6. Partnership Merger: Same as previous. RefineCo has repaid $500 liability and RefineCo basis in refinery is zero. Hero contributed additional capital in exchange for an additional 1%. BigDog LLC wants to acquire all the LLC interest in RefineCo and has offered to pay $2,000 and issue BigDog units valued at $2,100, which represents 20% interest in BigDog. Villain wants the $2000 and Hero wants the BigDog units.
    a. Issue is whether gain recognized resulting from receipt of $2,000 can be allocated to Villain.

b. Proposed Transaction: Treat as merger under 708 merger regulations. Under assets over form, RefineCo is treated as contributing its assets, the refinery, to BigDog in exchange for $2000 and the 20% interest in BigDog and then liquidating by distributing $2000 and 20% to Villain and Hero respectively. RefineCo will be treated as selling part of refinery to BigDog LLC in a disguised sale. Gain is recognized by RefineCo and allocated 49% to Villain and 51% to BigDog.

c. Revised Transaction: Treasury regulations provide that sale of a partner's interest in terminated partnership to the resulting partnership that occurs as part of a merger will be respected as a sale if the merger agreement specifies that resulting partnership is purchasing interest from particular partner and the consideration transferred for each interest sold and selling partner consents to treat transaction as a sale. BigDog LLC is treated as purchasing Villain's 49% interest in PipeCo for $2000 with BigDog LLC becoming the partner with respect to such interest. Refineco then contributes 51% of the refinery to BigDog LLC in exchange for 20% interest in BigDog LLC. Immediately thereafter, RefineCo liquidates by distributing the 20% interest in BigDog to Hero and 49% of refinery to BigDog LLC. RefineCo does not receive any money so there is no disguised sale and RefineCo does not recognize any gain that is allocated to Hero.

ACQUISITIONS AND DISPOSITIONS OF INTERESTS IN CLOSELY HELD CORPORATIONS: Jerald David August, Esq., Shareholder, Chamberlain, Hrdlicka, White, Williams & Aughtry, PC, Philadelphia, PA; C. Wells Hall, III, Esq., Partner, Nelson Mullins Riley & Scarborough, Charlotte, NC

1. Tax Free Reorganizations
    a. Seller treatment: nontaxable.
    b. Can structure as A, B, (a)(2)(D), (a)(2)(E), or C
    c. Type A are the most flexible.

    d. B is stock for stock.
    e. Buyer treatment: carryover of asset basis – no step up; carryover of tax attributes but may be limited; buyer inherits old tax history.
2. Mergers Involving Disregarded Entities
    a. Final regulations were issued in 2003.
    b. Under a Type A reorganization under the Final Regulations, the following events occur simultaneously at the effective time of the transaction:
        i. All of the assets and liabilities of each member of one or more combining units become the assets and liabilities of one or more members of one other combining unit; and
        ii. The combining entity of each transferor unit ceases its separate legal existence for all purposes.
3. Basic Structures
    a. Taxable Asset Acquisitions and Stock Purchases and Dispositions Treated as Asset Acquisitions – Section 338(h)(10) and Section 336(e).
        i. Taxable Asset Sale: S corporation seller
            1. Seller Treatment: No double tax, potential for character differences, installment sales treatment
            2. Buyer Treatment: Step-up in basis of assets for buyer; Can exclude unwanted assets and excluded or undisclosed liabilities.
        ii. Taxable Asset Sale – C Corp Seller
            1. This might be used where C corp target has significant goodwill attributable to shareholders without non-compete agreements.
            2. Absence of non-compete is important in establishing that significant value should be attributable to personal goodwill. See *Martin Ice Cream Co. v. Commissioner.*
        iii. Under new tax law, an asset purchase may be attractive to purchaser where value of tangible assets is significant as compared to goodwill component.

            1. Section 168(k) allows for 100% expensing for purchases of new and used qualified property from unrelated parties.
            2. Other considerations: Potential for triggering recapture of depreciation and ordinary income to Seller; buyer may expense portion of purchase price allocable to qualified property and amortize portion of purchase price allocable to goodwill.

b. Taxable Stock Acquisition – No 338(h)(10)
    i. Seller Treatment: Generally capital gain/loss; no double tax; possible installment sale treatment.
    ii. Buyer Treatment: Carryover of asset basis – no step-up; carryover of tax attributes, but may be limited; buyer inherits tax history.

c. Taxable Acquisition of Stock Treated as Purchase of Assets – 338(h)(10)
    i. Requirements:
        1. Target is S corporation
        2. Need a purchasing corporation
        3. QSP: 805 of vote and value within 12 months; Treas. Reg. 1.338(h)(10)-1(c)(2)
        4. Joint Election regarding treatment
    ii. Transaction is treated as deemed asset sale/liquidation
    iii. For buyer, treated like an asset purchase.
    iv. For seller, treated like a deemed asset sale.
    v. Post Closing Matters:
        1. Purchase Agreement should require that records be retained for any tax examination.
        2. Section 338(h)(10): Form 8883 needs to be prepared.
        3. Asset Sale: Form 8594 Asset Acquisition Statement
    vi. Purchase Price Adjustments
        1. A seller will typically have a greater tax burden for an asset sale vs. a stock sale even though the overall tax burden of the transaction is likely to be less.

        2. Structure can make Seller whole for extra tax costs of asset sale.
4. QSP and Installment Sale Sections 453(h) and 453B(h)
    a. Section 453B(h) – S gain is not triggered on distribution of installment note to Seller shareholders. See Reg 1.453-11.
    b. Reg. 1.338(h)(10)-1(d)(8) and -1(e)Ex. 10
5. Regulations provide that step transaction doctrine will not apply if a corporation engages in a qualified stock purchase and makes a valid 338(h)(10) election.
6. Corporate Acquisitions and Dispositions – Basic Structures – Private Equity Recapitalizations
    a. Equity Recapitalization of S corporation by issuing minority interest in operating business to private equity group.
    b. Equity recapitalization through leveraged purchase of 80 percent of operating business.
    c. Use of Section 351 to structure rollover of minority shareholders into acquiring corporation
    d. Use of Section 351 to structure rollover into acquiring corporation.
    e. Capital Gain Deferral – rollover to qualified opportunity funds.
    f. Rollover of Gain Through Reinvestment in Qualified Opportunity Zone Fund.

DAY SIX NOTES:

CURRENT DEVELOPMENTS IN TRANSFER TAXATION: Sanford J. Schlesinger, Esq., Founding Partner, Schlesinger Lazetera & Auchincloss, New York, NY

1. Roll Call of the States
    a. Connecticut $2.6m
    b. Massachusetts $1m exemption
    c. Iowa – Inheritance Tax
    d. Nebraska – Inheritance Tax (county level)
    e. District of Columbia – Pick up tax
    f. New York – pick up only $5.25m
    g. New Jersey – pick up tax; inheritance tax
    h. Hawaii – modified pick up tax

i. Illinois – modified pick up tax
j. Kentucky – Inheritance tax
k. Maine – pick up only
l. Maryland – pick up tax; inheritance tax
m. Minnesota pick up only $2.4m
n. Oregon – separate estate tax $1m
o. Pennsylvania – inheritance tax
p. Rhode Island – pickup only $1.537m
q. Vermont – Modified pick up $2.75m
r. Washington – separate estate tax $2.193m
s. None: Alabama; Alaska; Arizona; Arkansas; California; Colorado; Delaware; Florida; Georgia; Idaho; Indiana; Kansas; Louisiana; Michigan; Mississippi; Missouri; Montana; Nevada; New Hampshire; North Carolina; North Dakota; Ohio; Oklahoma; South Carolina; South Dakota; Tennessee; Texas; Utah; Virginia

2. New York
    a. 3 year rule only effective for gifts made by decedents who die before 1/1/2019.
    b. Real estate and tangible personal property outside the state is not subject to New York estate tax.
3. Federal Transfer Tax Issues
    a. 2017 – Estate tax returns filed: 12711 returns; a little over 5,000 reflected tax due.
        i. Most of the returns filed were from Florida, California, New York
        ii. Alaska – one return
    b. Gift Tax Returns – 2016: 242,585 returns filed; Taxable – slightly over 2,000.
        i. Gift tax returns are being filed because you can give away $22m.
    c. 168 GST returns filed.
    d. Should you give away $22m? What do you need to live on?
        i. Most people really don't want to give away 22m. Most people can't afford to give away 22m but even those that can don't necessarily want to.

    ii. The way tax legislation is working, no one knows what the law will be by the end of the day… so of course, you should consider using the 22m exemption while it exists.
    iii. If gifts are made, use high basis property! If you make a gift of low basis property, you are making a gift with a built in liability for capital gains taxes. That can get really expensive for those in places like NYC.

e. None of the bases of claimed tax reform occurred: AMT repeal; Estate Tax Repeal
f. No transferee liability for clawback re gift tax. Thus, the concern about the clawback is likely misplaced.
g. Basic exclusion amount is now 10m indexed for inflation since 2010. After 2025, the amount reverts to pre-2017 Tax Act amount of $5m, indexed for inflation since 2010.
    i. There are current proposals to reduce the exemption.

h. GST Exemption is also $10m indexed for inflation since 2010.
i. No changes to:
    i. 40% tax rate for gift, estate and GST taxes.
    ii. Portability of unused exclusion at death between spouses.
    iii. Stepped up basis rules.

j. 2017 Tax Act provides that non-resident aliens may be included as a potential beneficiary of an ESBT (although they are still not permitted to be an S corporation shareholder).
k. Charitable Contributions By ESBT's: ESBT charitable contributions are subject to same rules that apply to charitable contributions made by individuals.
l. Annual Gift Tax Exclusion remains at $15,000.
m. 2017 Tax Act provides in part that the exceptions to the transfer for value rules do not apply in the case of a transfer of a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale.

4. Estate Planning Opportunities After 2017 Tax Act
    a. Additional Gifts for those who have used their lifetime exclusion.
    b. Leverage the use of the increased basic exclusion amount by creating an intentionally defective grantor trust, make a 10%

    seed gift, and then have trust purchase taxpayer assets that can be discounted.
    c. Provide a beneficiary a narrow general testamentary power of appointment (if beneficiary's estate will be less than basic exclusion amount), in order to obtain a stepped up basis in trust's assets for income tax purposes at beneficiary's death.
    d. Certain irrevocable trusts authorize the trustee to grant a trust beneficiary a general power of appointment. Trustee should consider doing so to obtain a stepped up basis in trust's assets at beneficiary's death.
    e. Use of Promissory Notes: If this is a reasonable strategy, get it done as rates are going up.
5. Pitfalls
    a. Use of formula clauses may cause an unintentional shift in beneficial interests under estate planning documents and should be revisited.
    b. Consider the non-tax reasons for use of "credit shelter" trust as compared to portability.

TAX ISSUES FOR ART COLLECTORS: Paul N. Frimmer, Esq. Partner, Loeb & Loeb, Los Angeles, CA

1. When you sell art, the two primary considerations are income tax and sales tax.
2. Income Tax
    a. Art held more than for one year – long term capital gain.
        i. Capital gain rate for sale of art is 28% plus 3.8% medicare surtax state (and any state income tax).
    b. 1031 exchanges of art were eliminated by 2017 Tax Act.
3. Sales Tax
    a. Absent an exemption, sales tax applies.
    b. Seller is ultimately liable for sales tax.
    c. States have various exemptions. For example, NY has an out of state exemption.
4. California Resale Royalty Act
    a. Act has been held unconstitutional.

   b. The intent was to benefit the original artist upon appreciation of artwork by paying a royalty upon resale. European countries do have rules paying royalties to original artists.

5. Selling through auction house or dealer
   a. Standard agreement is “auction house” friendly:
      i. If you are a seller, there is usually a seller commission. Auction house will try to charge you for all expenses. You should not let clients pay a seller commission
      ii. Buyer premium – 25% on first million; 12.5% on everything over $1m.
         1. As seller, you can often get a share of the buyer premium. The more desirable the art is, the more that can be negotiated by the seller.
      iii. Price Guarantees on Auction
         1. It is possible to get a guarantee from the auction house.
         2. Can you get a guarantee? Do you want a guarantee? What will a guarantee cost?
         3. Most high end owners don’t need a guarantee.
      iv. Auction house request a lot of reps and warranties. Seek to limit to the extent possibility. To the extent made, limit reps and warranties to “Actual knowledge; no duty to investigate”. Client selling art is often a fiduciary. Fiduciary is not often in a position to make reps requested.
      v. Auction Reserve: Set reserve to lowest amount that seller is willing to take.
      vi. Negotiate where art is located in auction catalog.
      vii. If working with a dealer, the biggest issue is transparency.
         1. Obligate dealer to disclose selling price, dealer commission, commissions paid or received from anyone else. Include audit rights.
         2. Seller should obtain a security interest in the work while it is in possession of dealer. Dealers go bankrupt all the time. File UCC1 so there is a security interest in the work and in the proceeds.
         3. Dealers are sometimes slow in sending the money.

4. Limit time and number of people to whom work can be shown. There is a concept called “burning the work”. If a work has been shown around extensively, there is a group that knows the work might have issues and that information gets readily shared.

6. Use Tax Applies to Artwork
   a. California is very aggressive in tracking purchases of art to determine whether a use tax is payable.
   b. It is possible to avoid all sales and use tax if transaction is properly structured.
   c. There are three states with no sales or use tax: Oregon, Delaware, New Hampshire.
      i. If a work is purchased in New York by a California resident and shipped to Portland for display in Portland for 90 days, there is no New York sales or use tax obligation.
      ii. There is a presumption that if a work is first used outside of California for at least 90 days, the work was not purchased for use within California.
   d. Delaware has a “freeport”. Delaware has increased a “tax free” zone to store art without being subject to sales and use taxes. Freeport is most commonly used by foreigners.
7. Non-Charitable Gifts of Art
   a. For high tax states, there is a negative arbitrage between income tax and estate tax rates.
   b. Legacy Art – Art that children will keep. Children are often unable to keep art as it will cost them 40 cents per dollar of value. Most children will sell art. To the extent there are pieces of art that children/beneficiary are likely to keep, then a lifetime transfer may be useful.
   c. For the grantor who wants to give the art now but continue to have it hanging on his wall, use the intentionally defective grantor trust. Sell the art to the trust and rent it back.
      i. Issues:
         1. Do you get a discount? Probably no but we don’t know for sure. There are two cases. In one, a five

percent discount was allowed. In Elkins case, appellate court gave a 65% discount on a minority interest but in the case, the government put on no evidence.

2. What should be the rental price?

d. Using a GRAT isn't practical.

8. Charitable Remainder Trusts
    a. It takes 20 to 25 years to break even if you have a very low basis asset with a 5% pay-out. Thus, you can use a CRT but it may not make sense if the goal is to "make money".
    b. When do you get deduction?
        i. When non-charitable interest terminates.
        ii. This is because the taxpayer has retained an income interest in tangible personal property.
        iii. Amount of deduction depends on whether the work of art is long term or short term capital gain property or ordinary income property.
9. Recent Development
    a. When you make a loan of art to a museum, there is an exception.
    b. Is there a gift tax when you make a promise of a gift of artwork to charity?
    c. PLR 201825003: Taxpayer and his spouse deeded works of art to museums but reserved a life estate. Taxpayer and spouse were prohibited from selling during lifetime. There were additional restrictions. IRS took the position that the transfer was a taxable gift because donors gave up dominion and control and none of the circumstances that would permit gift to fail were in control of taxpayers.
        i. Work is still subject to creditors. Creditor can sell work and attach the value of the life estate.

PRIVATE FOUNDATION PRIMER FROM THE TAX REFORM ACT OF 1969 TO THE 2017 ACT: Christopher D. Petermann, CPA, Partner; Co-Partner-in-Charge for the Private Foundation Practice New York, NY; Thomas Blaney, CPA, CFE, Partner; Director of the Private Foundation Practice, PKF O'Connor Davies, New York, NY

1. 1969 Act
    a. First Statutory Definition of Private Foundation
        i. First statutory definition of private foundation
        ii. 4% excise tax on investment income
        iii. Required minimum distribution of 6%
        iv. Self Dealing Regulations
    b. Types of Private Foundations
        i. Family
        ii. Independent
        iii. Corporate
        iv. Community
        v. Operating
    c. Formation
        i. Form entity: corporate or trust
2. Foundation Excise Tax
    a. The original purpose was an audit fee
    b. 2% NII (1979)
    c. Original 4% from 1969
    d. Possible reduction to 1% - 1986
    e. Definition of Net Investment Income
3. Distribution Requirement
    a. 5%
    b. Based on FMV
        i. Securities are calculated monthly.
        ii. Real estate has to be valued every five years.
            1. Charitable use real estate (building used to operate charity) is not included.
            2. You might want to do a real estate appraisal more often.
        iii. Art can be an investment asset or a charitable use asset.
    c. Penalties apply if this is missed.
    d. It is important to manage the 5%.
    e. What counts toward the 5%?
        i. Qualifying distributions include grants and grant related expenses. (Many miss that the grant related expenses count as qualifying distribution.)
            1. 501(c)(3) charities

2. Individuals
3. Private Entities
4. Other Private Foundation
    a. Expenditure responsibility must be taken.
5. Foreign Entities
    a. Grantee is recognized by IRS.
    b. Expenditure responsibility
    c. Equivalency Determination
    d. Foreign transactions are an IRS audit target. To the extent of grants to foreign entities, exercise care that there are no terrorist relationships or international prohibitions.
6. Program Related Investments.
    a. Investments made by foundations to support charitable activities that involve the return of capital within a certain amount of time.
    b. Purpose is to accomplish foundation primary exempt purpose.
    c. No significant purpose of the investment is for the production of income or the appreciation of property.
    d. Investment can't be used for lobbying.

f. Responsibilities regarding grants:
    i. Pre-grant due diligence.
    ii. Written agreement.
    iii. Reporting
    iv. 990-PF Disclosure
    v. Separation of Funds
    vi. Penalties

4. Self Dealing and Disqualified Persons
    a. A "disqualified" person is one who is in a position to exercise a substantial influence over the affairs of a tax exempt organization.
    b. Self Dealing
        i. Payment of compensation – Any trustee/CEO can be paid as long as compensation is reasonable and necessary. The best approach is to have a study done.

        ii. Even if the IRS is not focusing on foundations, some state Attorney Generals are paying close attention to foundations.
        iii. Tickets to Fundraisers
        iv. Office Rent
            1. No substantial contributor can charge rent but you can let foundation use space for free.
        v. Avoid having a foundation credit card.
            1. Using credit card to make grants to obtain points that are used for personal use is likely self dealing.

5. Other Issues:
    a. Unrelated Business Income Issues
    b. Use of blocker corporations to avoid unrelated business income issues.
        i. 926
        ii. 8865
        iii. 5471
6. TCJA
    a. Qualified Transportation Fringe Eliminated
    b. QTF benefit costs treated as unrelated business income – unclear but note.
    c. Lower Tax Rates for Foundations that are corporations and trusts
    d. Notice 2018-67
    e. 21% excise tax on 5 highest paid employees over $1 million.

TRUSTS AND DIVORCE: Yoshimi O. Smith, Esq. Co-Founding Partner, Beller Smith, PL, Boca Raton, FL

1. Property Division
    a. Community Property States: Louisiana, Arizona, California, Texas, Washington, Idaho, Nevada, New Mexico, and Wisconsin.
    b. Parties have undivided one half interest in everything
2. Equitable Distribution – bulk of the states

    a. Court looks at separate and marital assets and seeks to make a "fair distribution".
3. All Property Approach –
    a. Connecticut, Massachusetts, Oregon
    b. States look at all of the assets and divide them between the spouses.
4. Treatment of Third Party Trusts Upon Divorce
    a. A trust can come under scrutiny upon divorce.
    b. The degree of scrutiny varies by state, judge, etc.
    c. Courts are finding ways to include third party trusts in divorces.
5. Third Party Trust as a Marital Asset
    a. Historically, inherited assets have been excluded from marital estate in a divorce. Courts have increasingly been finding ways to include inherited assets as a marital asset.
    b. Kitchen sink trusts will almost always look at the trust as a third party asset.
    c. A spendthrift clause doesn't prevent this trend.
    d. Court Theories
        i. Income was distributed from trust for living expenses during marriage so income was marital income.
        ii. Trust was used to support standard of living during marriage and spouse should continue to have right to same standard following marriage.
        iii. The nonmarital trust has been commingled with marital property.
        iv. Spouse made contribution to increase in value of trust assets.
6. Strategies to Protect Third Party Trust
    a. Give Trust Protector power to modify Trust.
    b. Use Decanting.
    c. Provide directions to trustee as to actions to take in the event of a pending divorce. Direct trustee to play aggressive role in opposition to non-beneficiary spouse.
    d. Use sprinkle trust with multiple beneficiaries.
    e. Give beneficiary spouse income interest only.
    f. Have a nuptial agreement where the non-beneficiary spouse waives all rights under the trust.

g. Make distributions contingent on beneficiary entering into a prenuptial agreement with non-beneficiary spouse. Be concerned with whether provision violates public policy.
h. Use independent trustee.
i. Don't have a pattern of distributions.

7. Support Trusts
   a. Set up to be used in lieu of alimony.
   b. Types of support trusts include: inter-vivos QTIP trust; Term Trust; Reversionary Trust.
   c. Trust has to meet very strict requirements.
      i. You can't make a significantly large payment shortly after divorce.
      ii. Support payments must terminate after death of spouse.
   d. New tax law has changed deductibility of alimony. Prior to 2017 Act, alimony was deductible to payee and taxable to recipient. 2017 Act eliminated the deduction and taxability for decrees entered into after 1/1/2018.
      i. New York is not following the federal change to treatment of alimony.
   e. Notice 2018-37. Trusts created before 12/31/2017 – 682 continues to apply.
8. Trusts Seen In Divorce
   a. Purely Discretionary Trust
      i. Beneficiary is one of several beneficiaries and trustee has absolute discretion for distribution purposes.
      ii. Purely discretionary trusts usually escape being treated as marital property.
   b. Future Interest
      i. Cases are problematic. In a New Hampshire case, the spouse was remainder beneficiary of a trust created by his parents. He had to survive parents to receive the remainder interest. Court deemed property vested and declared trust was subject to property division. *Flaherty v. Flaherty*
   c. Some courts have not allowed a contingent remainder interest to be considered marital property. *Loeb v. Loeb; Rubin v. Rubin*

d. When remainder interest of the beneficiary spouse is contingent on power of appointment held by another, courts are hesitant to treat the trust as marital property.
e. Grantor Trusts (SLATs)
    i. 677a – Grantor Trust – income may be distributed to grantor spouse.
    ii. Settlor could be in position of paying tax on income awarded to a former spouse.

WHAT EVERY ESTATE PLANNER NEEDS TO KNOW ABOUT SUBCHAPTER K: Andrea C. Chomokos, Esq., Partner, McGuireWoods, Charlotte, NC

1. Estate Plan Recommendation
    a. Form and fund an LLC for the consolidation and protection of family assets.
        i. The LLC would own the second home of Ozzie and Harriet in Charleston SC; Brokerage Account; Life Insurance Policy.
        ii. Consider:
            1. Jack and Jill each receive an interest on formation.
            2. Jack and Jill may each make a capital contribution. (Investment Company Rules Section 721).
                a. Taxable gain will typically not be recognized on contribution
                b. IRC Section 721: provides that gain will be recognized on contribution of appreciated property, if partnership would be characterized as an investment company.
            3. Investment Company Rules
                a. Are more than 80% of assets in stocks and securities?
                b. Is diversification received?
                    i. Greater than 25% invested in single issuer?
                    ii. 50% in 5 or fewer issuers?

2. Considerations
    a. Capital Contributions
    b. Ownership Interests
    c. Rights
    d. Management and Control
    e. Business Purpose
    f. Estate Tax Inclusion and viability of valuation discounts.
3. 704c built in gain property
    a. Stock sold for $650,000. Book value $600,000. Tax basis $300,000.
        i. Tax gain on sale is $350,000.
        ii. 704c gain is first allocated to contributing member. Balance of gain is allocated to members pro rata.
    b. Section 754 – Step up in Basis
        i. Decedent has 75% interest in LLC with tax capital account/outside basis of $2,360,000. Valuation indicates that FMV of 75% is $3,175,000
        ii. Manager of LLC makes 754 election.
        iii. Step up in basis is allocated pursuant to 743b.
        iv. Amount of step up is $815,000.
    c. Treas. Reg. Section 1.662(a)-2(f)(1) – Satisfaction of a pecuniary bequest by a distribution of assets is treated as a deemed sale of assets for fair market value.
        i. As a result, when property is transferred from estate to a trust in satisfaction of a pecuniary bequest, there will be a taxable gain to the extent that the FMV exceeds adjusted tax basis.
        ii. If asset used to fund pecuniary bequest has 754 election in place, then entity will be required to adjust tax basis of assets related to distribution.
    d. Possible downward adjustment to basis in property.
        i. Trust owns LLC which owns house.
        ii. Conclusion is made that house should be distributed from LLC.
        iii. Trust basis in LLC is $1m.
        iv. LLC adjusted tax basis in house is $1,320,088.

v. After liquidating distribution, Marital Trust adjusted tax basis in house is $1m (downward adjustment). IRS 732b.
vi. If LLC has a 754 election in place, downward basis adjustment in house will result in corresponding basis adjustment to LLC assets and capital accounts of remaining members.

FAMILY LIMITED PARTNERSHIPS: THE CONTINUING SAGA: John W. Porter, Esq. Partner, Baker & Botts, Houston, TX; Sanford J. Schlesinger, Esq., Founding Partner, Schlesinger Lazetera & Auchincloss, New York, NY; Andrea C. Chomakos, Esq., Partner, McGuire Woods, Charlotte NC.

1. Dealing with 2036
    a. Have a transfer with bona fide sale for adequate and full consideration.
    b. Senior family member can be a manager but must have fiduciary obligations.
    c. Estate of Powell v. Commissioner
        i. Son created partnership under power of attorney.
        ii. Son received 1% GP interest and decedent 99% LP interest.
        iii. Decedent's interest was contributed to a Charitable Lead annuity trust.
        iv. IRS claimed assets contributed to partnership were includible in decedent's estate.
        v. Majority and concurring opinions opine that 2036(a)(2) applied because decedent, in conjunction with other partners could dissolve the partnership, and (2) decedent, through her son as the GP and as her agent could control timing and amount of distributions.
        vi. There is a potential double inclusion issue in this case.
    d. This is a bad facts case but raises an issue regarding senior partner ability to vote on dissolution.
2. Installment sales

a. Gift/Sale to IDGT
b. Put time between date of gift and date of sale.
c. Gift Tax Issues
    i. FMV of interest sold
        1. Step transaction – *Pierre* case
    ii. FMV of consideration received
        1. Valuation of Note
        2. 2702
d. Estate Tax Issues
    i. 2036/2038
        1. *Pierre* case issue
        2. Payment of note
    ii. *Woelbing/Whittingham* cases
e. To prevent issues
    i. Bona fide sale for full and adequate consideration
    ii. Seed money so there is cash to pay the note.
    iii. Consider using a formula clause.

3. Gift From a Merger
    a. *Cavallero v. Commissioner*
    b. This case raises the issue of donee liability
    c. Start the statute of limitations.
4. Valuation Decisions:
    a. *Giustina* 2016 – 25% LOM
    b. *Richmond 2*014 46.5% (37% LOC/LOM &15% BIG)
    c. *Koons* 2013
    d. Understanding the nature of the property transferred is crucial.
5. Formula Transfers
    a. Defined Value as finally determined for federal estate tax purposes.. *Wandry*
    b. Defined Value Clause (*McCord, Hendrix*)
    c. Price Adjustment Clause (*King*)
    d. Reversion clauses don’t work (*Procter*)

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Mary Vandenack

CITE AS:

LISI Income Tax Planning Newsletter #160 (November 5, 2018) at http://www.leimbergservices.com.