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"Final" Regs on Late GST Exemption Allocations and Late Elections

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The generation-skipping transfer (GST) tax is a dangerous mix of a complicated tax with a high single rate (currently 40%) and a non-portable exemption. The key to GST tax planning for most clients with potential GST issues involves allocating the client's and spouse's GST exemptions to those transfers that are most likely to result in an eventual generation-skipping transfer.

Unfortunately, allocations of the GST exemption are deceptively complicated and many practitioners fail to make them correctly and in a timely fashion. Similar problems exist with elections out of the automatic allocation rules and elections to treat an indirect transfer in trust as a GST trust (the "related elections").

Congress enacted section 2642(g)(1)(a) as part of the Economic Growth and Tax Relief Reconciliation Act of 2001, directing Treasury to issue regulations allowing late allocations and related elections in appropriate cases. Pub. L. 107–16, title V, §§562(a), 563(a), (b), 564(a), 115 Stat. 89–91 (June 7, 2001). Treasury responded with *Notice 2001-50*, 2001-2 C.B. 189 (transferors could obtain an extension of time to allocate GST exemption or make one of these related elections by requesting a private letter ruling), *Rev. Proc. 2004-46*, 2004-2 C.B. 142 (providing a simplified alternate method to obtain an extension of time to allocate GST exemption with respect to certain inter vivos annual exclusion trusts), and *Rev. Proc. 2004-47*, 2004 C.B. 169 (taxpayers who failed to make a reverse QTIP election on an estate tax return could request relief without a private letter ruling).

In 2008, Treasury proposed regulations allowing late allocations of GST exemption and late related elections upon request for a private letter ruling. REG-147775-06, 73 Fed. Reg. 20870 (April 17, 2008). These regulations were complex and not universally well-received.

Treasury has issued final regulations after only 16 years. *T.D. 9996*, 89 Fed. Reg. 37116 (May 6, 2024). These regulations are effective for requests for extensions that are filed on or after May 6, 2024. They apply even if the transfer in question occurs before that date. Treas. Reg. §26.2642-7(j).

Automatic Six-Month Extension

An automatic extension of six months from the due date of the gift or estate tax return is granted to file a supplemental return allocating GST exemption or making any of the related elections. This extension is available only if the transferor or executor both timely filed the gift or estate tax return and file a supplemental return within the six month period. It is not available if the original return was filed late. The same extension is also available for a taxpayer who filed a timely Form 8939, *Allocation of Increase in Basis for Property Acquired From a Decedent,* for a decedent who died in 2010 and elected out of the estate tax. The six-month extension requires neither a request for a private letter ruling nor a user fee. Treas. Reg. §26.2642-7(i)(1).

Longer Extensions

The final regulations permit an extension of more than six months when the transferor or executor proves to the IRS's satisfaction that the transferor or executor acted reasonably and in good faith, and that the extension will not prejudice the interests of the Government. Treas. Reg. §26.2642-7(d)(1). This extension requires a private letter ruling.

Good Faith and Reasonableness. The IRS will determine whether the actions of the transferor or executor were reasonable and in good faith based on all relevant facts and circumstances, including the following:

- the transferor's or executor's intent to make a timely allocation or related election, as evidenced by the trust instrument, instrument of transfer, or contemporaneous documents, such as federal gift or estate tax returns or correspondence. Treas. Reg. §26.264-7(d)(2)(I);
- intervening events beyond the control of the transferor or executor that caused the failure to allocate or elect to be late. Treas. Reg. §26.264-7(d)(2)(ii);
- the transferor's or executor's lack of awareness, despite the exercise of reasonable

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diligence, of the need to allocate GST exemption to a transfer, or to make a related election. This determination takes into account the transferor's or executor's experience and the complexity of the GST issue. Treas. Reg. §26.264-7(d)(2)(iii);

- the transferor's consistency in allocating (or not allocating) GST exemption. The preamble states that, for example, a transferor's pattern of allocating GST exemption in an amount equal to the value of a transfer in three or more years (whether or not consecutive), supports an assumption that he or she intended to do the same for the transfer in question. 89 Fed. Reg. at 37118. Lack of consistency may be less relevant if there is evidence of a change of circumstances or change of trust beneficiaries that supports a deviation from consistent allocation. The regulations add that an extension will not be denied merely because there is no pattern of consistent allocation or election. This recognizes that some taxpayers are inconsistent for perfectly innocent, even if foolish, reasons. A transferor may, for example, be quite happy to allocate GST exemption to a trust for the transferor's children and direct descendants, but unwilling to expend GST exemption for a similar trust for step-children and their descendants. Treas. Reg. §26.264-7(d)(2)(iv); and
- the transferor's or executor's reasonable reliance on the advice of a qualified tax professional retained or employed by the transferor, the executor, or both. Reliance on the advice of a qualified tax professional will not be considered reasonable if the transferor or executor knew or should have known that the professional either was not competent to render advice on the GST issue or was not aware of all of the relevant facts. Regs. § 26.2642-7(d)(2)(v).

The preamble to the final regulations states that no single factor is determinative because of the complexity of the GST exemption rules. 89 Fed. Reg. at 37118. Merely proving one of these factors may not suffice to assure the receipt of a requested extension. Practitioners applying for an extension should, therefore, include evidence of as many of the indicia of good faith and reasonableness as possible. This will, of course, make the application longer, more complicated, and more expensive, but that is part of the cost of failing to make a timely correct allocation or election.

The preamble also states that the fact that a request for an extension was made after the IRS discovers the failure to allocate or elect does not generally show a lack of good faith or reasonableness. 89 Fed. Reg. at 37118. Similarly, the fact that a request for extension or related election was made before the IRS discovered the failure does not generally show the existence of good faith and reasonableness.

Prejudice to the Government's Interests. As noted above, no extension is allowed if it will prejudice the Government's interests. The IRS will determine whether the interests of the Government may be prejudiced based on all relevant facts and circumstances, but principally based on the extent to which the requested relief is an attempt to benefit from hindsight or to deprive the IRS of the time required to challenge the claimed identity of the transferor, the value of that transferred property, or any other fact that is relevant for transfer tax purposes. Treas. Reg. § 26.2642-7(d)(3).

The regulations explain the concept of hindsight by noting that the Government's interests will be deemed prejudiced if the transferor or executor did not make a timely allocation or related election in order to determine whether making or not making the allocation or election would be the more economically beneficial. Similarly, the Government's interests would be deemed prejudiced if making a late allocation or related election gave the transferor or executor more choices (other than whether or not to make the allocation or election) that would not have been available had the allocation or election been made on a timely basis. For example, a transferor who delays allocating GST exemption to one of several trusts to learn which trust's investments produced the greatest appreciation would be deemed to have delayed the allocation in order to increase the economic benefits of hindsight. Treas. Reg. §26.2642-7(d)(3)(i).

The IRS will presume that the Government's interests will be prejudiced if a delay was intended to deprive the IRS of sufficient time to challenge the transferor's identity, the property's value, or some other aspect of the transfer. This intent will be presumed by the effects of the delay, but may be rebutted by persuasive evidence of other reasons for or circumstances causing the delay. Treas. Reg. §26.2642-7(d)(3)(ii).

The regulations also state that the expiration of a statute of limitations on the assessment or collection of transfer taxes before an extension is requested is not a relevant factor in deciding whether or not to grant a requested extension, unless the IRS determines that there has been a gross valuation misstatement as defined in section 6662(h)(2)(C). Treas. Reg. §26.2642-7(d)(3)(iii). The proposed regulations would have viewed unfavorably any expiration of the limitations period respecting a transfer of property valued at a discount. Treasury deleted this statement in response to a comment it received, but it added the reference to a gross valuation misstatement to make it clear that an exceptional undervaluation would be relevant if the statute of limitations expired before the relief was requested.

It is not required, but it would be a good practice to include in any request for an extension the facts that indicate that neither hindsight nor an attempt to deprive the IRS of time to challenge various issues. At a minimum, one should include a statement that those were not the transferor's or executor's objectives.

Specific Instances When An Extension Will Not Be Granted. The regulations state that the IRS simply will not grant an extension to make an allocation or related election in certain situations. First, the IRS will not grant a discretionary extension that would decrease or revoke an affirmative (not automatic) allocation of GST exemption that was made on a federal gift or estate tax return, whether the transfer or allocation was made during the transferor's life or upon his or her death. Treas. Reg. § 26.2642-7(e)(2)(i).

There are, however, three exceptions to this First rule:

- No request for an extension is required when an allocation of GST exemption is void because the amount of exemption allocated to the transfer exceeds the amount needed to obtain a zero inclusion ratio. This exception does not apply to an allocation made to a charitable lead annuity trusts (CLAT) if the annuity interest is continuing or an allocation to any trust that is subject to an estate tax inclusion period (ETIP) that has not yet ended. Treas. Reg. §26.2642-7(e)(2)(ii)(A). This is reasonable because an allocation of GST exemption to a CLAT while the annuity is still being paid neither assures that the inclusion ratio will be zero nor assures that no portion of the allocation will be void as being excessive. Similarly, the allocation of exemption to a trust subject to an ETIP does not become irrevocable until the ETIP ends.
- No request for an extension is required when an allocation of GST exemption is void because the trust to which it relates, at the time of the allocation, has no GST potential with respect to the transferor. For this purpose, however, a trust has GST potential even if the possibility of a GST is so remote

as to be negligible. Treas. Reg. §26.2642-7(e)(2)(ii)(B).

- A late allocation will be deemed to be void if it was made in an effort to mitigate the tax consequences of a missed allocation that was not eligible for relief before the 2001 enactment of section 2642(g)(1). Specifically, a late allocation will be deemed void if: (1) before December 31, 2000, the transfer was made to a trust with GST potential with respect to the transferor; (2) no timely allocation of GST exemption was made; (3) before December 31, 2000, a late allocation of GST exemption was made to the trust; (4) the late allocation was disclosed as part of the request for relief or during the IRS's consideration of that request; and (5) relief under section 2642(g)(1) is granted to make a timely allocation to the transfer. Treas. Reg. §26.2642-7(e)(2)(ii)(C).

Second, no extension will be granted with regard to a lifetime transfer reported on a gift tax return, if: (1) the request for an extension is filed shortly after the expiration of the period during which an assessment of gift tax with respect to the transfer; (2) the IRS reasonably concludes that the transferor intentionally delayed filing the request in order to prevent an IRS examination of the reported value of the transferred property or the claimed identity of the transferor or of any other fact relevant for transfer tax purposes; and (3) the transferor cannot produce evidence sufficient to convince the IRS that the filing delay was attributable to some other reason or purpose. Treas. Reg. §26.2642-7(e)(3).

Third, no extension will be granted if the transferor or executor failed to make the allocation or related election after being accurately informed in all material respects by a qualified tax professional retained or employed by either (or both) of them with regard to the allocation of GST exemption or a related election, and the transferor or executor (or both) then followed that advice. Treas. Reg. §26.2642-7(e)(4). Presumably, Treasury will leave such cases to the malpractice bar to resolve.

Fourth, no relief will be granted if the IRS determines that the requested extension is an attempt to benefit from hindsight by waiting to see which of multiple transfers, made at substantially the same time but consisting of different property interests, enjoyed the greatest appreciation and thus would constitute the most effective use of the transferor's GST exemption. Treas. Reg. §26.2642-7(e)(5). This is really just a restatement of the earlier declaration that such use of hindsight would indicate a prejudice to the Government’s interests.

Extensions and the Inclusion Ratio

A granted extension is effective as of the date of the transfer, and the inclusion ratio is based on the value of the property on the date of the transfer. A granted extension of the time to make a related election is effective as of the date of, and immediately prior to, the transfer. Treas. Reg. §26.2642-7(b)(1). An allocation or related election made pursuant to a granted extension does not, however, reduce, eliminate, or void any affirmative allocation or related election made with respect to any other transfer that was made contemporaneously with or after the transfer for which the extension was granted. Treas. Reg. §26.2642-7(b)(3).

Extensions and the Statute of Limitations

If a taxable termination or distribution occurs after the transfer in question but before an extension is granted, the permitted late allocation may negate the taxability of that termination or distribution. The extension, however, does not constitute a claim for refund. Treas. Reg. §26.2642-7(g), -7(h). A separate claim for refund must be filed in such cases.

The IRS may also ask a transferor or executor to consent to an extension of the period of limitations on assessment or collection of any or all gift and GST taxes for the transfer or transfers that are the subject of the requested extension. The transferor or executor may decline to extend the statute, but that refusal may adversely impact the availability of the requested extension.

How to Request an Extension

A request for an extension of the time to make an allocation or related election, other than the automatic six-month extension, requires a private letter ruling. Treas. Reg. §26.2642-7(i)(2). The 2024 fee for such a ruling is $12,600. *Rev. Proc. 2024-1*, App. A, 2024-1 I.R.B. 1 (Jan. 2, 2024). Treasury rejected a suggestion that this fee be waived or that a ruling not be required.

A transferor or executor must submit with the ruling request a detailed affidavit describing the events that caused the failure to make a timely allocation or related election, and the events that led to discovery of the error. If the transferor or executor relied on a tax professional for advice with respect to the allocation or related election, this affidavit also must include a description of the scope of the engagement, the responsibilities that the transferor or executor believed that the professional had assumed, and the extent to which the transferor or executor relied on the professional. Treas. Reg. §26.2642-7(i)(3)(i). The affidavit must also include copies of any writings and contemporaneous documents that the affiant has in his, her, or its possession or control that may be relevant to ascertaining the transferor's intent regarding the allocation or related election. Treas. Reg. §26.2642-7(i)(3)(ii). The affidavit must also be accompanied by a signed and dated declaration vouching for the accuracy of the affidavit and this declaration must be executed under the penalties of perjury. Treas. Reg. §26.2642-7(i)(3)(iii).

The transferor or executor must also submit detailed affidavits from other people involved in the transaction. Such "other people" include:

- each of the transferor's agents and legal representatives who participated in the consideration of, or the decision with regard to, the allocation of GST exemption or related election or the preparation of the return for which relief is being requested;
- the preparer of the relevant federal estate or gift tax return or returns;
- each individual (including an employee of the transferor or executor) who provided information or advice with regard to, or otherwise made a significant contribution to, the decisions concerning the allocation or related election or the preparation of the relevant federal estate and/or gift tax return or returns;
- each tax professional who advised or was consulted by the transferor or executor with regard to the allocation or related election or the preparation of the relevant federal estate or gift tax return or returns; and
- each "other individual" who has knowledge or information about the events that led to the failure to make a timely allocation or related election. Treas. Reg. §26.2642-7(i)(4)(i).

The "other individuals" mentioned in the regulations may include all individuals whose knowledge or information is not personally known by the transferor or executor. Treas. Reg. §26.2642-7(i)(4). The affidavits of these other individuals must include the following:

- a description of the scope of the engagement, the individual's responsibilities, and what advice or service the individual provided to the transferor or executor. Treas. Reg. §26.2642-7(i)(4)(ii);
- a copy of each writing and other contemporaneous documents that the affiant possesses that are relevant to the transferor's intent or to the affiant's advice regarding the application of the GST tax to the transfer.

The affiant is only required to include those documents that he, she, or it discovers after a reasonably diligent search in good faith of records in the affiant's possession, or accessible to, or subject to the affiant's control. A reasonably diligent search generally includes at least a review of the records in the possession or control of the affiant or the affiant's firm relating to the transaction or tax return at issue. Treas. Reg. §26.2642-7(i)(4)(iii);

- such additional affidavits and documents as the IRS determines to be required or helpful in deciding whether or not to grant an extension. Treas. Reg. §26.2642-7(i)(4)(iv);
- a signed and dated declaration vouching for the accuracy of the affidavit and executed under the penalties of perjury. Treas. Reg. §26.2642-7(i)(4)(v).

The transferor or executor must include a statement stating which individuals who would be required to provide an affidavit are unwilling or unable to do so. This statement must include a description of:

- the relationship between that individual and the transferor or executor;
- the information or knowledge that the transferor or executor believes that individual had about the events that led to the failure to make the allocation or related election or to the discovery of that failure; and
- except where the individual has died, a detailed description of the efforts made to obtain the affidavit from the individual. Treas. Reg. §26.2642-7(i)(4)(vi).

An individual is "unwilling" to provide an affidavit if he or she is able to do so but refuses or simply fails to do so, "despite the best efforts, made in good faith" of the transferor or executor. *Id.* An individual is "unable" to provide an affidavit if he or she has a permanent or potentially long-term condition, such as physical or mental incapacity, that prevents him or her from so doing. A temporary or short-term inability, such as travel or a confidentiality agreement, does not make an individual "unable" under this regulation. *Id.*

The regulations appear to recognize that some other persons can be unwilling or unable to provide an affidavit, but they also state that the lack of such affidavits "may be considered by the IRS in determining whether to grant the requested relief." *Id.* This should cause the practitioner to use all possible efforts to obtain these affidavits.

Conclusions and Suggestions

The final regulations are significantly less complex than the proposed regulations, but they still make requesting an extension of the time to allocate GST exemption or to make a related election a significant project. It is likely that the time and cost of this effort will limit such requests to situations where failure to do so will leave the lawyer or accountant personally responsible for significant damages, or when the likelihood of an otherwise avoidable GST tax is very high.

The regulations do not address several problem areas, and they include no examples. A Treasury official has stated that examples and further guidance will appear in additional proposed regulations. The preamble states that the issues to be addressed in the forthcoming regulations will include how and if one may obtain relief from an automatic allocation (89 Fed. Reg. at 37117) and the effect an extension has on a timely allocation of the same transferor's GST exemption to a transfer made after the transfer to which the extension relates (89 Fed. Reg. at 37120). Practitioners must gather what guidance they can from these new final regulations, until the next set of proposals is available.

Probate Report

- **Validity of Witness Signature: Location, Location, Location**

In *Estate of Abrahamson*, not reported in N.W. Rptr. (Minn. App. 2024), the testator named two charities as devisees of his three-page will. The third page contained the signature of the testator, a notary, and an undetermined witness because of an indecipherable signature. The third page contained the statement that "Under no circumstance can my [sole surviving child and] daughter break this will." Nevertheless, the daughter tried to "break the will." She contended that the will was not properly executed. She and one of the charities settled, but the other fought the daughter over the estate, which was worth approximately $450,000. The daughter presented a handwriting expert, who could not determine whether the indecipherable marking was intended to be a signature. Although the trial court determined that the will did not qualify as self-proved, it ruled that the charity met its prima facie burden of proving that the will was properly executed.

The appellate court cited the state probate code requirements for valid execution: a writing signed by the testator that is attested by at least two witnesses who observed the testator either signing the will, acknowledging the signature, or acknowledging the will. A self-proved will creates a conclusive presumption of due execution.

Although the daughter assigned as one error the trial court's supposed reliance on the self-proving presumption, the appellate court noted that the trial court expressly provided that the will was not self-proved.

Consequently, the appellate court addressed the daughter's second argument: that the trial court probated the will without extrinsic evidence about the second witness. The appellate court cited with approval the trial court's reliance on the location of the second mark as proof that it was the signature of a second witness. "[B]ased on the location of the signature 'under the word "Witness" and to the left of a date, the visual evidence strongly suggested 'that the individual who made the mark on the third page intended to make a signature.'" Moreover, the trial court observed that the testator sought out the notary, who worked in an office supply store and had notarized prior documents for the testator: "[t]he inferences drawn from the document suggest that [the testator] understood he needed a second signature and obtained a second signature the following day."

Finding no clear evidence to overturn the trial court, the appellate court upheld the lower court decision.

Editors' Comment: One could argue that the courts based a lot of presumptions on the location of the second mark and the notion that one who seeks a notary to witness a will successfully fulfilled the intent to find a second signing witness. To avoid such disputes, careful probate practitioners include sufficient information on the will to clearly show the names of the witnesses, such as printing their names and identifying the city and state where they are located. Commonly, the proponent of a will has the prima facie burden of showing due execution, after which the burden to prove the will is invalid falls on the contestant. Clear designation of the witnesses should be a significant aid in satisfying the prima facie burden, even if the will is not self-proved.

- **Parents Not Listed Survivors for Wrongful Death Because Deceased Child Was an Adult**

In *Estate of Golden,* __ P.3d __ (N.M. App. 2024) (2024 Westlaw 1153672), the deceased priest died at the age of 35 in an automobile accident. The decedent's parents challenged the appointment of a reverend as personal representative for the wrongful death act claim. The trial court determined that the parents were the statutory beneficiaries under the wrongful death act and thus entitled to appointment as personal representative.

The appellate court focused on the issue of whether the parents were listed in the statutory hierarchy of those entitled to appointment as personal representative under the wrongful death act. Proceeding down the list of persons entitled to serve under the statute, the appellate court concluded that the statute gave priority to parents only if the deceased was a minor. Thus, the parents were not listed statutory beneficiaries, and the trial court erred in determining that they were, and consequently entitled to appointment as personal representative. Last in the wrongful death act hierarchy of statutory beneficiaries, if no one qualified under the preceding categories in the statutory list, were those who were "authorized by law [to take] the personal property of deceased persons." The appellate court remanded to determine who would take the personal property of the decedent by law and, therefore, who would also thereby qualify as the personal representative.

Editors' Comment: Although the opinion did not focus on the issue, the decedent's property would pass to his parents if he died intestate but presumably to the Dominican Order as a devisee if he had a valid will. If the parents would take his property by intestacy, then they should also qualify as personal representatives. Although wrongful death claims are prosecuted by a personal representative, the proceeds of any recovery are nonprobate and pass to the named statutory beneficiaries in any particular jurisdiction. Those statutory beneficiaries might differ from the probate estate beneficiaries, particularly if the deceased died testate.

- **Fiduciary Accounting Prevents Fund to Pay Commission**

In *Estate of Duell*, 207 N.Y.S.3d 75 (App. Div 2024), the personal representative of his mother's estate contested his brother's objections to his accounting. The central dispute involved the treatment of an accounting item titled "Due from Duell LLC," which the accounting treated as principal. The brother's expert questioned the decrease of that asset without explanation. The personal representative produced an affidavit from a CPA, who served as the LLC's accountant since 2011, asserting that the treatment of the item was a "carryover from the way the prior management company" treated the asset, which was not a true receivable. The court noted that the brother's expert did not examine the underlying books and records to determine the asset's origin. At stake was the brother's commission as co-trustee of the subtrust that owned the asset. State statutory fiduciary accounting rules allowed commissions payable from income in any given trust year to be made only actual income from that trust year. Based on the treatment of the LLC asset in dispute, the trust had no income to pay any trustee commissions.

Editors' Comment: The court seemed to wryly observe that the brother was in charge of the predecessor management company's treatment of the LLC asset. Fiduciary accounting issues impact many probate and trust issues, although they seem to garner relatively little attention in reported cases.

- **Expert Witness Fees Assessed**

In *Echeverria v. Trombino*, 382 So.3d 755 (Fla. App. 2024), a beneficiary sued a trustee for breach of fiduciary duties for mismanagement of assets. The trial court granted the beneficiary's motion to withhold proceeds from a sale pending the resolution of the case, but the appellate court reversed and remanded to the trial court to determine if "the equities favored the imposition of fees for the trustee." On remand, the trial court awarded attorneys' fees to the trustee and also imposed the cost of the trustee's expert witness fees on the beneficiary.

On this trip to the appellate court, the beneficiary argued that the award of fees was premature pending the resolution of the underlying lawsuit and that the trial court lacked sufficient competent evidence to render its decision. The appellate court rejected both of these arguments without further explication.

However, the appellate court chose to address the question of taxing an expert witness's fee for preparing for and testifying that the trustee's appellate attorneys' fees were reasonable. According to the majority, state case law precedent considered the assessing of fees of expert witnesses was within the discretion of the trial court, which could include the expert witness fees as part of a taxing of costs against a party. Because the appellate court considered the trial court to be in a better position to determine whether to charge the beneficiary with the expert witness fees, it deferred to the ruling of the trial court.

Editors' Comment: A special concurrence reasoned that a state statute requires an expert witness's fee to be taxed as a cost. The concurrence also observed that an expert is necessary about the reasonableness of attorneys' fees when fees are sought against another party. "[I]t is unfair to expect uncompensated testimony as a matter of 'professional courtesy'" because the days of handing an attorney a file in the courthouse and expecting essentially impromptu testimony about the reasonableness of attorneys' fees is no longer appropriate, given the complexity of fee issues in today's practice.

- **Putative Heirs Fail to Clear Burden of Proof**

In *Dallas v. Hicks*, __ So.3d __ (Ala. 2024) (2024 Westlaw 1223807), the decedent died intestate survived by one legitimate child. However, five individuals claimed to be his biological children — three from one mother and two from another, neither of whom was married to the decedent. The trial court considered oral testimony, photographs, and child support documents. The putative mothers and the children testified about the relationships that they and their mothers had with the decedent, although all had relatively fuzzy recollections given the passage of considerable time. They produced a photograph with the decedent taken shortly before his death. The mother of three of the children produced evidence that she had sought and obtained court-ordered child support in 2000, with the monthly amount of $240 being paid only once by the decedent.

The applicable state intestacy statute required an adjudication of paternity commenced after the decedent's death to be established by clear and convincing evidence. The trial court ruled that the putative children had not satisfied that strict burden: the testimony was uncertain; the award of child support did not establish that the decedent admitted the children were his, not to mention the question raised by his paying only once; and the lack of other photographs was problematic.

The appellate court did not find sufficient evidence to overturn the trial court, under the applicable standard of review. Moreover, the appellate court questioned the lack of other evidence, such as DNA tests and birth certificates.

Editors' Comment: The state intestacy statute regarding illegitimate children is similar to an earlier version of Uniform Probate Code section 2-109, requiring either an adjudication of paternity before the putative father's death or a determination brought after death, which requires the higher clear and convincing burden of proof. Of course, the higher post-mortem burden of proof is because the decedent cannot refute the evidence.

The trial court took the clear and convincing standard seriously. Although the opinion did not focus on the issue, perhaps the decision was the result of a concern that the best proof of paternity today — DNA testing — was not offered into evidence. The opinion made no mention of why DNA testing was absent, although obtaining a decedent's DNA for matching can be problematic, particularly if a putative child needs a court to approve an exhumation of the decedent's body.

The opinion also noted the absence of birth certificates, although naming a person as the father on a birth certificate is not necessarily proof of paternity.

Perhaps the greatest quibble with the trial court's decision involves the other path to prove paternity under the intestacy statute: a court determination before the putative father's death. One can argue that the trial court's dismissal of the court order for child support was rather cavalier: it is certainly possible that a father ordered to pay child support might disagree with the ruling, but that does not render the court order, as a determination of paternity, invalid.

- **POA Agent Does Not Have to Account**

In *Williams v. Boggess for Ward*, 899 S.E.2d 636 (Va. App. 2024), the principal created a durable power of attorney. A niece suspected that the agent under the power was mismanaging the principal's finances and petitioned under the state's version of the Uniform Power of Attorney Act to require an accounting. The agent countered that the niece was not entitled to require an accounting and that the principal was a "very private person." The principal died during the pendency of the dispute, but the niece continued to pursue an accounting. She asserted that she had an interest in the outcome because she was entitled to the "'relief' and 'satisfaction' of knowing her aunt had been properly cared for." The trial court ruled that the niece had standing under the UPAA but that it had discretion to decide whether to require an accounting, and it denied the niece's petition.

The agent had handled the principal's financial affairs for more than a decade. The niece contended that, over time, he had mishandled her funds, causing her to lose more than $100,000 and to be transferred from a private nursing facility to a Medicaid bed.

The appellate court confirmed that the niece had standing under the statute. However, it listed the three reasons an appeals court can reverse a lower court for abuse of discretion:

> The three principal ways a court abuses its discretion are "when a relevant factor that should have been given significant weight is not considered; when an irrelevant or improper factor is considered and given significant weight; and when all proper factors, and no improper ones, are considered, but the court, in weighing those factors, commits a clear error of judgment."

The appellate court reasoned that it was not improper for the trial court to consider the agent's position that the principal was very private, even though the trial court may have been a little overzealous in describing the niece's petition as a "fishing expedition." The applicable statute required a court to consider "the interest of the principal and his estate," but otherwise did not define this criterion. The appellate court determined that a principal's "general disposition as to financial matters and to whom the principal entrusted financial information appear to be fairly encompassed by this factor." Consequently, the appellate court held that the consideration of the principal's desire for privacy was a fair issue for the trial court to weigh in exercising its discretion.

Editors' Comment: The opinion cited an earlier decision in which the principal expressly provided that the agent did not have to account. Of course, the danger of such an expression is that it opens the door for mismanagement without oversight. When the client is a "very private person," the probate practitioner should discuss the pros and cons about the inclusion of a specific prohibition for an accounting in the document.

The *Williams* appellate court also considered the niece's argument that the agent was also the personal representative and unlikely to investigate his own actions as agent on behalf of the estate. However, the appellate court observed that others, such as interested persons in certain cases, had mechanisms to ask a court to explore such claims even if the personal representative is unlikely to do so. The "personal representative of the estate is not the exclusive representative of all individuals with a financial stake."

A common method for asking the court to pursue an exploration of the personal representative's actions during the decedent's lifetime is through the appointment of a special administrator.

A special administrator can be appointed for many reasons, but may be particularly appropriate when a person interested in the estate suspects that the person serving as personal representative mishandled or improperly obtained property while the decedent was alive, whether that personal representative was acting in a fiduciary capacity or was involved in a non-fiduciary capacity in undue influence, fraud, or tortious interference with an inheritance. Of course, a probate court could take such allegations into account when determining whether to even appoint that individual as personal representative, but even if that individual is appointed, those interested in the estate are not left without a mechanism to explore such claims.

Tax Report

- **Proposed Regulations Explain Reporting Requirements and Tax Consequences of Foreign Trust Loans and Large Foreign Gifts Made to United States Persons**

In *Proposed Regulation sections 1.673(i)-1 through 1.673(i)-5, 1.6039F-1, 1.6048-1 through 1.6048-7, and 1.6677-1* (issued May 7, 2024), Treasury offers guidelines for reporting transactions with foreign trusts and receipts of large foreign gifts. The proposed regulations also explain rules regarding loans from foreign trusts and the use of property held by foreign trusts. In large part, these regulations codify prior guidance issued in the form of a Notice.

Background on Relevant Statutes

Throughout the 1980s and 1990s, United States persons would transfer substantial assets offshore through foreign trusts based in jurisdictions with bank secrecy laws. This made it difficult, if not impossible, for the IRS to know whether and to what extent United States persons were paying federal income tax on the income realized by these trusts. As part of the Small Business Job Protection Act of 1996, Congress made changes to the information reporting rules to curb what it perceived as "rampant tax avoidance" through the use of foreign trusts.

Specifically, section 6048(a) requires the United States grantor of a foreign trust (or, where applicable, a "United States transferor" or the executor of a United States decedent) to report the creation of any foreign trust, the transfer of any money or property to a foreign trust that is not a sale for fair market value, and the death of any United States person treated as the owner of any portion of a foreign trust (or whose gross estate includes any portion of a foreign trust). This is done on Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts.* In addition, section 6677 imposes a penalty for failing to report the information required under section 6048 absent reasonable cause. The penalty amount is equal to the greater of $10,000 or 35 percent of the gross amount reportable. If, after the IRS mails notification of the failure to report, the failure continues for more than 90 days, an additional $10,000 penalty is imposed, and successive $10,000 penalties continue every 30 days (or portion thereof) thereafter.

Furthermore, section 643(i) generally provides that when a foreign trust loans cash or marketable securities to any nonexempt United States grantor or beneficiary of a foreign trust (or to any person related to such grantor or beneficiary), the amount of the loan is treated as a distribution to the grantor or beneficiary. It also treats any uncompensated use of foreign trust property by a United States grantor or beneficiary (or any person related to such grantor or beneficiary) as a distribution. The statute authorizes regulations identifying exceptions to this rule. Loans and use of trust property are likewise reported on Form 3520. And finally, section 6039F requires United States persons who receive large gifts or bequests from foreign persons to report those receipts. The purpose of this requirement is to give the IRS a chance to determine whether the receipt is, in fact, a gift. Failure to report a foreign gift triggers a penalty of five percent of the amount of the gift for each month the failure to report continues, up to a maximum penalty of 25 percent of the amount of the gift.

In *Notice 97-34*, 1997-1 C.B. 422, the IRS issued preliminary guidance on the application of these Code provisions. The proposed regulations now attempt to reaffirm much of what was set forth in that earlier guidance, and also reflect changes to the statutes made after 1997.

Loans from Foreign Trusts and Use of Foreign Trust Property by United States Persons

Proposed Regulation section 1.643(i)-1 explains the requirements of section 643(i) and sets forth procedural rules for implementing the statute. Unless an exception applies, the proposed regulation treats any loan of cash or marketable securities from a foreign trust, whether from corpus or income, made directly or indirectly to a United States grantor or beneficiary as a distribution as of the date on which the loan is made. An anti-abuse rule in the proposed regulation provides that a nonresident alien grantor or beneficiary who receives a loan from a foreign trust and then becomes a United States person within two years will be deemed to receive a distribution of the outstanding loan amount as of the date the grantor or beneficiary becomes a United States person. With respect to the use of foreign trust property, the proposed regulation clarifies that use by an agent or nominee of the grantor or beneficiary is treated as use by the grantor or beneficiary.

Proposed Regulation section 1.643(i)-2 then lists four exceptions to the deemed distribution rule in Proposed Regulation section 1.643(i)-1. First, there is no deemed distribution in the case of any loan made in exchange for a “qualified obligation,” defined generally as a written debt instrument with a term of not more than five years requiring all payments to be made in United States dollars and with interest payable at a fixed rate. Further, all stated interest on the obligation must be “qualified stated interest” as defined in the rules related to original issue discount, and the yield to maturity on the obligation must not be less than the applicable federal rate of interest in effect on the day the debt instrument is issued, nor more than 130 percent of such applicable federal rate of interest. Second, there is no deemed distribution from a foreign corporation to a United States beneficiary where the total amount of all loans made to the beneficiary does not exceed the foreign corporation’s undistributed earnings and profits that are or have been included in the beneficiary's gross income under subpart F.

Third, in the case of a use of foreign trust property, there is no deemed distribution when the foreign trust receives fair rental value for such use within a reasonable period. Fourth, no deemed distribution results from a *de minimis* use of trust property, defined as use by all United States grantors and beneficiaries totaling not more than 14 days during the taxable year.

Proposed Regulation section 1.643(i)-3 provides rules for determining the amount of the deemed distribution, how the deemed distribution amount is allocated when the trust has multiple United States grantors and beneficiaries, and how to determine the tax consequences to the foreign trust of a deemed distribution. Proposed Regulation section 1.643(i)-4 contains examples explaining the foregoing rules, and

Proposed Regulation section 1.643(i)-5 states that the proposed rules would become effective when finalized.

Reporting Rules for United States Recipients of Large Foreign Gifts

Proposed Regulation section 1.6039F-1 generally requires a United States person to report an amount received from a foreign person as a foreign gift during the taxable year on Form 3520 by April 15 of the following year, though the deadline is extended in certain cases. The proposed regulation defines a "foreign gift" as any gift received from a foreign person except for qualified transfers under section 2503(e)(2) (transfers directly to providers for education and medical expenses of the donee). The proposed regulation contains several exceptions to this reporting requirement, including exceptions for gifts to charities, gifts of not more than $100,000 received from any one foreign individual or estate (or persons related to the foreign individual or estate), and gifts of not more than $10,000 from a foreign corporation or partnership. For purposes of these rules, the value of a gift is to be determined using normal gift tax valuation rules, specifically including the special valuation rules in sections 2701 through 2704.

Rules for Reporting Transactions with Foreign Trusts and Related Penalties

Proposed Regulation section 1.6048-2 requires a "responsible party" (grantor, transferor, or executor, as appropriate) to provide notice of a "reportable event" (foreign trust creation, transfer to a foreign trust, or death of a United States owner of a foreign trust) that occurs during the taxable year with respect to a foreign trust on Form 3520. For responsible parties using the calendar year, the deadline for filing Form 3520 is generally April 15 of the following year. Proposed Regulation section 1.6048-3 then provides rules to ensure a foreign trust provides certain information about the trust's activities and operations for the year both to the IRS and to any United States person treated as an owner of the trust or who receives a distribution from the trust. Further, Proposed Regulation §1.6048-4 provides rules for reporting the receipt of a distribution from a foreign trust.

Proposed Regulation section 1.6048-5 provides exceptions to the reporting rules, including exceptions for transfers for fair market value, transfers to certain compensatory foreign trusts, and transfers to foreign charities. Proposed Regulation section 1.6048-6 contains special rules related to dual resident taxpayers and dual status taxpayers who compute their United States income tax liability as nonresident aliens for at least a portion of the taxable year. Section 1.6048-7 generally provides that the proposed regulations under section 6048 would be effective when finalized.

Proposed Regulation section 1.6677-1 explains the application of civil penalties applicable for failing to comply with the rules of Proposed Regulations sections 1.6048-2 through 1.6048-4. Notably, this proposed regulation takes the position that the section 6677 penalty applies separately to each of the section 6048 reporting requirements (the requirements to report transactions under Proposed Regulation section 1.6048-2, to report certain trust activities and operations under Proposed Regulation section 1.6048-3, and to report distributions from foreign trusts in accordance with Proposed Regulation section 1.6048-4). In explaining the reasonable cause exception to the section 6677 penalty, the proposed regulation states that the determination of whether a failure to file a complete Form 3520 is due to reasonable cause and not due to willful neglect will be made "on a case-by-case basis, taking into account all pertinent facts and circumstances." According to the proposed regulation, the fact that a foreign jurisdiction would impose a civil or criminal penalty for disclosing the required information is not reasonable cause, nor is a foreign trustee's refusal to provide information.

- **Tiered Partnerships and Opinion Letters Couldn't Disguise This Disguised Sale**

In *PICCIRC, LLC v. Commissioner*, T.C. Memo. 2024-50 (April 22, 2024), the Tax Court held that an alleged contribution to a limited liability company of distressed receivables followed within about six months by a cash distribution to the contributing partner constituted a disguised sale, resulting in a disallowed loss deduction of over $27 million and a gross valuation misstatement penalty. The transactions in this scheme involved multiple tiered entities, an investment management firm operating through several aliases, and an individual who looked to be shopping for some tax deductions on the cheap.

It all started with a Brazilian corporation that had a ton of accrued receivables owed from a customer on the cusp of bankruptcy. As one would expect, the receivables had a high basis but a very low fair market value. Enter Gramercy Advisors, LLC, a United States investment firm. Gramercy and the Brazilian corporation formed a Delaware LLC called XBOXT. (How apt that the firm's name resembles that of a *gaming* platform). The Brazilian company contributed the distressed receivables to XBOXT for a 99-percent member interest, while Gramercy made a cash investment for its one-percent stake. On the same day, XBOXT then dumped the receivables into PIMLICO, LLC, another new Delaware entity, in exchange for a 99-percent interest in that entity. The other one percent interest in PIMLICO was held by Tall Ships, LLC, an entity that—you guessed it—is affiliated with Gramercy.

Four months later, the next player, an individual named John Howard, joined the party. Howard acquired an 89-percent interest in PIMLICO from XBOXT in exchange for about $300,000 cash. Howard was introduced to the structure through BDO Seidman, to whom Howard paid a fee of $865,000 for an opinion letter that everything you're reading about would not result in the imposition of any penalties. Howard paid another $100,000 to a law firm for a separate opinion letter that all of the transactions involved in this scheme had economic substance and business purposes.

On the same day Howard acquired his interest in PIMLICO, PIMLICO contributed the receivables to yet another new Delaware entity, PICCIRC, LLC, for a 99-percent interest. (The other one-percent interest was held by Tall Ships.) Two weeks later, PICCIRC sold the receivables to Gramercy Financial Services LLC, another Gramercy affiliate, for about $360,000. PICCIRC claimed a loss of about $22.7 million from the sale, and ultimately 89 percent of this loss (some $20.4 million) flowed through to Howard. This gave him a substantial deduction for use on his individual tax return, a great return on his investment of about $300,000. Meanwhile, about a month after the sale, XBOXT distributed about $300,000 cash to the Brazilian corporation in redemption of its 99-percent member interest. Weird that the amount paid to the Brazilian corporation was about the same as the amount invested by Howard, huh?

If the law firm that gave Howard the opinion letter was correct, PICCIRC's loss from the sale was real and XBOXT's redemption of the Brazilian corporation's membership interest was without tax consequence since it was a cash distribution that did not exceed the Brazilian corporation's basis in its XBOXT membership interest. But the IRS determined that all of these transactions were, in substance, a disguised sale between the Brazilian corporation and Gramercy. That led the IRS to disallow PICCIRC's claimed deduction, which would, in turn, result in no deduction to Howard.

The Tax Court held that the taxpayers did not meet their burden to prove that the IRS's determination was erroneous. The court observed that while contributions to (and distributions from) partnerships are generally without tax consequence, section 707 provides that nonrecognition does not apply when contributions and distributions are, in reality, a disguised sale of property. The court explained the framework for its analysis as follows:

> A disguised sale occurs where a partner contributes property to a partnership and receives a related distribution that is, in effect, consideration for the contributed property. See §707(a)(2)(B); *Canal Corp. & Subs. v. Commissioner*, 135 T.C. 199, 210-11 (2010); Treas. Reg. §1.707-3. A transaction may be deemed a disguised sale if, on the basis of all the facts and circumstances, (1) the partnership's transfer of money or other consideration to the partner would not have been made but for the partner's transfer of property and (2) if the transfers were not made simultaneously, the subsequent transfer was not dependent on the entrepreneurial risks of partnership operations. Treas. Reg. §1.707-3(b)(1); see also *Route 231, LLC v. Commissioner*, 810 F.3d 247, 253 (4th Cir. 2016), *aff'g* T.C. Memo. 2014-30. The regulations provide that transfers between a partnership and a partner within a two-year period are presumed to be a sale of property to the partnership unless the facts and circumstances "clearly establish" otherwise. Treas. Reg. §1.707-3(c)(1); see *Superior Trading, LLC v. Commissioner*, 728 F.3d 676, 681 (7th Cir. 2013) (finding the presumption triggered where the partner received a substantial distribution 10 months after contributing distressed receivables), *aff'g* 137 T.C. 70 (2011).

Here, the time between the Brazilian corporation's contribution of the receivables to XBOXT and its receipt of a $300,000 cash distribution was less than six months. Moreover, the court found it not coincidental that the amount paid by Howard to acquire his interest more or less matched the amount ultimately paid to the Brazilian corporation. "The purpose of the redemption," observed the court, "was to trigger the section 704(c) loss allocation rule for the benefit of Mr. Howard. The dates and account activity of the partnerships match to such an extent that it becomes clear that XBOXT was formed solely as a conduit to execute a disguised sale of the … receivables."

The Tax Court went on to hold that, because there was no evidence corroborating the basis of the receivables except for a spreadsheet prepared by Gramercy, no loss could be sustained. Further, the court found the various LLCs were shams that could be disregarded under the anti-abuse rules in Regulation section 1.701-2. Finally, the court upheld the imposition of a 40-percent gross valuation misstatement penalty, concluding that PICCIRC's basis in the receivables was, at most, the $300,000 paid by Howard, making the claimed basis of $23 million well-deserving of the penalty.

Editors' Comment. The case is a helpful reminder of the disguised sale rules. While the transactions here look like they may have been designed to obfuscate the purchase of a tax deduction, the disguised sale rules can apply even where taxpayers do not have a tax avoidance motive. Planners should hesitate anytime they see a partner receiving cash or property from a partnership within two years of contributing some other property to the partnership. Likewise, planners should hesitate when they see multiple tiers of partnerships with similar ownership structures that don't seem to have any business function or purpose apart from generating very large deductions.

- **Tax Court Upholds Only Ten Percent of Taxpayer's Claimed Conservation Easement Deduction**

In *Buckelew Farm, LLC v. Commissioner*, T.C. Memo. 2024-52 (April 25, 2024), the Tax Court held that, while the taxpayer was entitled to a deduction for the donation of a conservation easement, the correct amount of the deduction was far less than the amount claimed on the taxpayer's return. It thus upheld the application of a substantial valuation misstatement penalty, though it rejected the IRS's attempt to impose an additional civil fraud penalty.

Regular readers of the REPORTER are very familiar with conservation easement donations and the almost inevitable litigation between taxpayers and the IRS that ensues. Still, a quick recap of the general rules can't hurt. While section 170(f)(3)(A) generally disallows a charitable contribution deduction for the donation of "an interest in property which consists of less than the taxpayer's entire interest in such property," section 170(f)(3)(B) allows a deduction for certain partial-interest transfers, including the donation of a "qualified conservation contribution." The rules for qualified conservation contributions, found in section 170(h), require a taxpayer to donate a "qualified real property interest" to a charity exclusively for conservation purposes. To be a "qualified real property interest," the donated interest must include a perpetual restriction on the use of the real property. See IRC §170(h)(2)(C).

Most qualified conservation contributions take the form of "conservation easements" in connection with large parcels of land. A conservation easement is, in essence, a covenant that typically restricts the use of the subject real property to its current use in perpetuity. The amount of the deduction for the donation of a conservation easement is measured as the difference between the value of the land at its highest and best use and the value of the land now that its use is forever limited to its existing use. That difference in value is often quite large; in fact, in many cases the tax savings from the deduction proves to be more than the cost to acquire the subject property. As a result, taxpayers seeking large deductions have found conservation easements quite attractive.

At first, the IRS limited its policing of conservation easement transactions to questions of valuation. Instead of disallowing deductions altogether, the IRS would question the appraisals used to determine the amount of the deduction, often concluding that the donation amounts were quite smaller than those claimed by taxpayers. But over the past several years, the IRS found an Achilles heel in several conservation easement deeds that, according to the IRS, caused the donations to flunk the perpetuity requirement explained above. The IRS's position was based on Regulation section 1.170A-14(g)(6)(ii), known on the streets as the "proceeds regulation." In short, the proceeds regulation provides that, upon a judicial extinguishment of a conservation easement that has become impossible to fulfill and subsequent sale of the property, the perpetuity requirement will be met only if the charity is entitled to a certain share of the sale proceeds. Early conservation easement deeds provided that the charity would receive a share of the *net* sale proceeds (after reimbursing the donor for the costs of any improvements made to the property after the easement's donation), but the IRS successfully argued the proceeds regulation required that the charity had to receive a share of the *gross* sale proceeds.

Until 2021, the IRS was overwhelmingly successful in attacking conservation easement deductions based on this argument. But then, in *Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 2021), the Eleventh Circuit held that the proceeds regulation is invalid because the IRS did not comply with the Administrative Procedure Act in promulgating the regulation. If the regulation is invalid, then the IRS cannot disallow a conservation easement contribution deduction on the basis that it violates the regulation. In 2022, the Sixth Circuit concluded the regulation was valid. *Oakbrook Land Holdings, LLC v. Commissioner*, 28 F.4th 700 (6th Cir. 2022). Maddeningly, the Supreme Court refused to resolve the split among the federal circuit courts of appeal.

This case involved property located in the Eleventh Circuit, where the proceeds regulation is invalid under *Hewitt.* In 2013, the taxpayer granted a conservation easement on about 1,500 acres of land in Jones County, Georgia, to the Southeast Regional Land Conservancy. On its federal income tax return, the taxpayer claimed a charitable contribution deduction of about $47.5 million based on a reporting position that, while the value of the land at its highest and best use would be about $50.5 million, the value of the land is now only about $3 million because of the conservation easement's restriction on development. The IRS disallowed the deduction and asserted both an accuracy-related penalty and a civil fraud penalty against the taxpayer in connection with the claimed deduction.

Before the Tax Court, the IRS argued that the deduction should be disallowed under the proceeds regulation, but the court quickly rejected the argument given the controlling decision in *Hewitt* that the regulation is invalid. The IRS then argued that the taxpayer lacked donative intent because the contribution was made only to generate a large income tax deduction and that the deal was structured to assure the taxpayer's investors would receive tax savings far exceeding their investments. Consistent with its decisions in other cases, the court rejected this argument too, finding it sufficient that the easement was donated to a charitable organization. In this case, in particular, the taxpayer's investors voted in favor of a conservation easement over other options that included developing the property or holding it for long-term investment. The court also rejected arguments from the IRS that the taxpayer's appraisal was deficient and that the taxpayer's appraiser was not qualified.

But the court bought the IRS's argument that the value of the conservation easement was much less than the value claimed on the taxpayer's return. While the taxpayer's expert determined the highest and best use of the subject land was for development into a "hunting and conservation oriented residential community," the IRS's expert claimed the highest and best use for the land was for timber production and for recreational purposes like hunting and fishing. The evidence showed that the zoning variance that would be required to develop the property into a residential community likely would not be granted. In addition, the court found the 12 comparable property sales used by the IRS's expert to be more relevant than the five comparable property sales used by the taxpayer's expert, only two of which were in the same state as the subject land. Ultimately, the court agreed with the IRS's expert that the value of the land at its highest and best use was about $7.4 million, an amount much less than the $50.5 million claimed by the taxpayer on its return. And since both experts seemed to accept that the value of the land was now $2.8 million, the resulting deduction amount was about $4.6 million.

Given the correct deduction amount ($4.6 million) was less than one-tenth the amount claimed by the taxpayer ($47.5 million), it is no surprise the court upheld the IRS's determination of a 40-percent accuracy-related penalty under section 6662 in light of the gross valuation misstatement. The IRS also wanted a civil fraud penalty under section 6663, but the Tax Court declined to impose it. Had the IRS prevailed on that issue, the taxpayer would have faced a penalty of about $32 million (gulp!). But the Code requires that the IRS prove fraud by clear and convincing evidence, and this burden the IRS could not meet. As the court noted:

> This is not a case in which the donor intentionally deprived the Commissioner of an essential tool needed for the "efficient identification of overvalued property." In fact, the Partnership complied with the reporting requirements of section 170(f)(11) when it timely filed its 2013 Form 1065 and attached Form 8283, which expressly disclosed the Partnership's relatively low adjusted basis ($3,521,827) in the Subject Property and, by comparison, its substantially higher amount claimed as a charitable contribution deduction ($47,750,000, which is an approximately 1,300% increase in value over the Partnership's original adjusted basis in the Subject Property). Moreover, section 170(f)(11) functioned as Congress intended with respondent being alerted to the Partnership's basis in the Subject Property and the value of the claimed charitable contribution, which resulted in the Partnership's return being examined and an FPAA being issued. We find the Partnership's compliance with its reporting obligations to stand in stark

contrast to an intentional act, on its part, to conceal the underlying transaction from respondent.

Editors' Comment. We can expect more decisions like this from the Tax Court in future conservation easement cases, when the dispute centers more around valuation instead of the application of the proceeds regulation. For one thing, the Tax Court recently announced that it would no longer follow its prior holding that the proceeds regulation is valid, citing *Hewitt* with approval. *Valley Park Ranch LLC v. Commissioner,* 162 T.C. No. 6 (2024). For another, the IRS issued sample deed language that complies with the proceeds regulation. *Notice 2023-30*, 2023-17 I.R.B. 766. Newer conservation easement deeds should use this sample language, even for property located in the Eleventh Circuit (where the proceeds regulation is invalid) because a later court could change its mind.

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Tax Index

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