Private Tax year-end review and update

Fall 2023

Building a better working world

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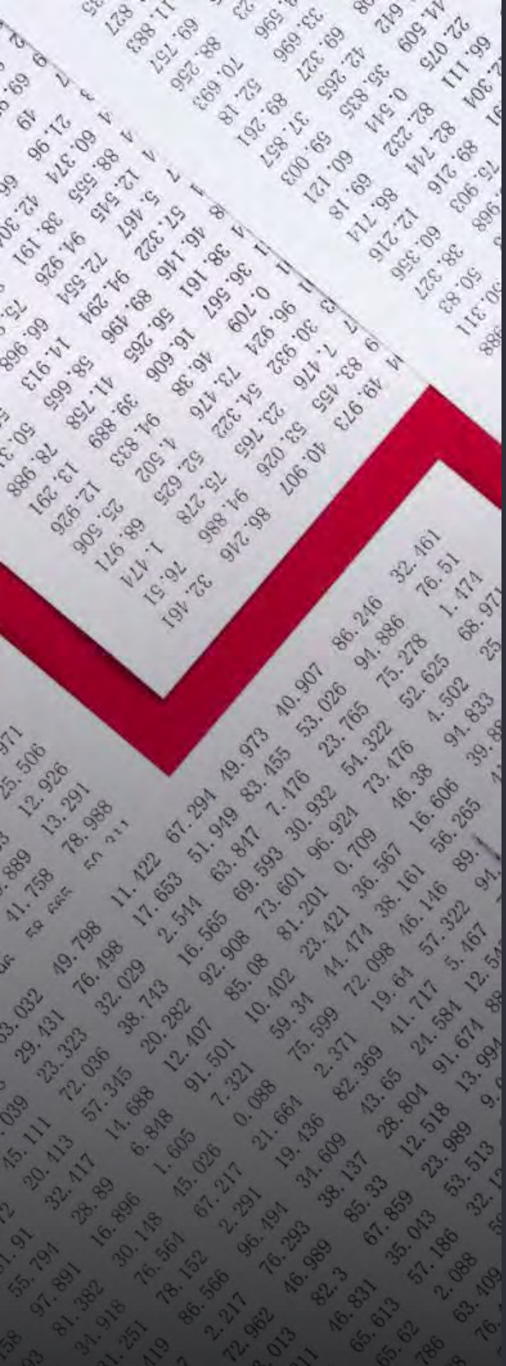
What to expect in Washington with the proposed and new tax legislation



Mapping out a 2023 tax bill

Ways & Means bill could be the GOP blueprint for a tax extenders package should the opportunity arise and a government spending or other must-pass vehicle for the package emerge.

1. Ways & Means bill, the American Families and Jobs Act, has not yet been brought to the House floor, due at least in part to GOP members demanding state and local tax (SALT) relief.

2. The bill won't be enacted as-is. The Tax Cuts and Jobs Act (TCJA) "pre-cliffs" relating to expensing of R&D costs, interest deduction limitations under Internal Revenue Code (IRC) Section 163(j), and 100% expensing remain mired in a partisan standoff over a Child Tax Credit (CTC) expansion sought by Democrats, who also are opposed to rolling back clean energy provisions from the Inflation Reduction Act (IRA) that Republicans want to use as revenue offsets.

Bipartisan support	• R&D expensing • IRC Section 163(j) interest deduction limitation • 100% expensing	• Not included in bills but priority for some members of both parties: SALT cap relief

House GOP add-ons roughly aligned with priorities of Senate GOP	Higher standard deduction, small business provisions	+	$20,000 reporting exception for commercial payments to third-party settlement organizations	+	Creditability of certain foreign taxes without regard to current foreign tax credit (FTC) regulations	?	Not marked up: Defending American Jobs and Investment Act undertaxed payments rule (UTPR) retaliatory tax

Democratic priorities	• CTC expansion toward version in effect for 2021

EY

Child Tax Credit

Version of Child Tax Credit	Eligibility	Amount	Income phaseout	Earned income threshold/phase-in	Refundability
Pre-TCJA	each qualifying child under the age of 17	$1,000	$110,000/married, $75,000 otherwise	$3,000	capped at $1,000 per child
TCJA (expires for tax years beginning after (TYBA) 12/31/25)	each qualifying child under the age of 17	$2,000	$400,000/married, $200,000 otherwise	$2,500	capped at $1,400 per child (indexed for inflation); additional $500 nonrefundable credit for other (non-child) dependents
American Rescue Plan Act (ARPA)	$3,600 for children 0–5 years old/$3,000 for children 6–17 years old		$400,000/married, $200,000 otherwise	none	fully refundable (no phase-in for low incomes); 50% of credit in monthly advance payments
2022, 2023	Same as TCJA			$2,500	capped at $1,600 in 2023
Senators Brown and Bennet, Rep. DeLauro bills	Same as ARPA				
Sen. Romney Family Security Act	$4,200 per child under 6; $3,000 per child ages 6–17		$400,000/married, $200,000 otherwise	family must have earned $10,000 in the prior year to receive full benefit; below that, proportional to earnings	
Sen. Rubio Providing for Life Act	$4,500 per child under 6; $3,500 per child 6–17		$400,000/married, $200,000 otherwise	would phase in at a rate of 15.3%, beginning with first dollar of income earned, to reflect combined employee and employer payroll tax liability	

> “What seems most sensible is a bipartisan bill that reinstates some limited part of the child tax credit, it doesn’t have to be as big.
>
> Rep. Don Beyer (D-VA), Bloomberg Daily Tax Report, August 2, 2023

Levers and dials for CTC compromise:

Refundability

Credit amount

Phase-in

TCJA pre-cliffs and select extenders

TCJA pre-cliffs
IRC Section 174 5-year amortization of R&D expenditures for TYBA 2021 (15-year for foreign R&D)
IRC Section 163(j) 30% of ATI limit calculated w/depreciation and amortization after 2021
Bonus depreciation – 100% expensing phased down in 20% increments after 2022

2021 extenders
Expanded CTC, including monthly payments
Credit for two-wheeled plug-in electric vehicles
Credit for health insurance costs (health coverage tax credit)
Credit for production of Indian coal
Indian employment credit
Mine rescue team training credit
Treatment of premiums for qualified mortgage insurance as qualified residence interest
Three-year recovery period for racehorses
Accelerated depreciation for business property on an Indian reservation
Charitable contributions deductible by non-itemizers
Temporary increase in limit on cover over of rum excise tax revenues
American Samoa economic development credit

2022 extenders
Short-line railroad track maintenance credit (expiration of 50% rate)

2025 extenders
New markets tax credit
Work opportunity credit
Seven-year recovery period for motorsports entertainment complexes
Special expensing rules for certain film, television, and live theatrical productions
Look-through treatment of payments between related controlled foreign corporations (CFCs) under the foreign personal holding company rules
Empowerment zone tax incentives

Expiring TCJA provisions — extension cost over $2.5 trillion

TCJA "pre-cliffs" (addressed in Ways & Means American Families and Jobs Act)	$ to fix through 2025[1]
IRC Section 174 — expensing over R&D 5-year expense amortization (15 for foreign R&D)	$ (25.385)b
IRC Section 163(j) — business interest deduction limit calculated as 30% of earnings before interest, taxes, depreciation and amortization (EBITDA)	$ (18.95)b
Extension of 100% expensing	$ (3.05)b
Total	$ (47.34)b

TCJA individual provisions expiring at the end of 2025		Revenue 2023–2032[2]
Income rates 10%, 12%, 22%, 24%, 32%, 35%, 37%	Congressional Budget Office (CBO) — Cost to extend changes to individual income tax provisions: lower individual income tax rates, expanded income tax base, expanded child tax credit, 20% deduction for certain business income, reduce income subject to AMT	$ (2.06)t
Higher standard deduction, alternative minimum tax (AMT) exemption		
Pass-through deduction 20%		
Child tax credit: $2,000, refundable to $1,400		
Extend higher estate (exemption doubled, currently $12,920,000) and gift tax exemptions		$ (102)b
Maintain certain business tax provisions altered by the 2017 Tax Act (i.e., preventing foreign-derived intangible income (FDII) rate decrease, global intangible low-tax income (GILTI) and base erosion and anti-abuse tax (BEAT) rate increases)		$ (125)b
Extend the 2017 Act's changes to the tax treatment of investment costs (bonus depreciation)		$ (404)b
Total		$ (2.95)t

1 – Joint Committee on Taxation, JCX-29-23
2 – CBO, The Budget and Economic Outlook: 2022 to 2032

Select post-2025 TCJA tax changes

Provision	Change under TCJA (that would be reversed after 2025)	2026 law if no action taken
Income tax rates	10%, 12%, 22%, 24%, 32%, 35%, 37%	10%, 15%, 25%, 28%, 33%, 35%, 39.6%
Child tax credit	$2,000 credit, $1,400 refundability cap, higher income phaseout	$1,000, $1,000 refundability cap
Family and Medical Leave Act (FMLA) Employer Credit	General business credit based on wages paid during family and medical leave	No credit
Individual AMT	Exemption $126,500/ married, $81,300 otherwise (inflation adjusted)	$84,500/ married, $54,300/individual
Standard deduction	$12,000/single, $24,000/married filing jointly	$6,350/single, $12,700/married
Itemized deductions	Suspension of certain itemized deductions	Itemized deductions reinstated
Housing deduction caps	Deduction cap of $750,000, home equity interest suspended	$1m, home equity interest reinstated
SALT deduction cap	$10,000	No cap
Limit on wagering losses	Applies not only to wagers, but other expenses incurred in connection	Applies only to wagers
Charitable contributions	Adjusted gross income (AGI) limitation for charitable contributions increased to 60%	50%
199A deduction	20% deduction on certain pass-through income	No deduction
Moving expenses	Suspension of deduction	Reinstated
Employer meals	50% deduction for employer de minimis food and beverage expenses	Not deductible
ABLE accounts (for people with disabilities and their families)	Contributions eligible for saver’s credit, rollovers from 529 plans permitted, contribution increase	No saver’s credit, 529 rollover, or contribution increase
Estate tax	Exemption $12.92m (inflation adjusted)	$5.49m (pre-2018 $5m inflation adjusted)

International provision	Change after 2025
GILTI	Deduction reduced from 50% to 37.5%
FDII	Deduction reduced from 37.% to 21.875%
BEAT	Rate increased from 10% or 11% for banks/dealers to 12.5% & 13.5% and base expands with modifications to regular tax (i.e., the allowance for credits that reduces regular tax expands)

Expiration/change dates of various tax provisions

Provision	2021	2022	2023	2024	2025	2026	2027	2028
Interest deduction based on EBITDA		EBIT						
R&D expensing		Five-year amortization (15-year for foreign R&D)						
Some tax extenders								
100% expensing			Phased down in 20% increments					
GILTI deduction at 50%						37.5%		
FDII deduction at 37.5%						21.875%		
BEAT rate: 10%/11% for banks/dealers						12.5%/13.5%		
TCJA individual rate cuts, other provisions								
20% pass-through deduction								
Limitations on deduction for state, local, etc., taxes								
Increase in estate and gift exemption								
Tax extenders: CFC look-through rule, Work Opportunity Tax Credit								
Expansion of the scope of IRC Section 162(m) deduction limits								
TCJA disallowance of excess business loss								

Inflation Reduction Act (IRA)

Main tax elements

Corporate Alternative Minimum Tax (CAMT) — generally 15% of financial statement (book) income

Stock repurchase tax — 1% excise tax on the value of corporate share repurchases

Internal Revenue Service (IRS) funding — $80b in additional funding (some rescinded in June 2023 debt limit deal)

Phases of energy credit implementation

Phase 1

- Focus on IRC Section 45X Advanced Manufacturing Production Tax Credit for clean energy components, which works in concert with IRC Section 48C Advanced Energy Project Credit
- Guidance before the end of this year on the clean hydrogen and sustainable aviation fuel credits

Phase 2

- About 70 guidance items were required from the IRA, and about 40 have been released
- The first phase focused on overarching provisions like prevailing wage and apprenticeship requirements, domestic content, etc.

Phase 3?

- Despite popularity even in GOP districts, could IRA provisions be subject to Congressional Review Act in 2025? (allows Congress to roll back rules)
- Another factor: Senator Joe Manchin (D-WV), who has strong ideas about implementation

Treatment of IRA energy provisions in House Republican debt limit, tax bills

Inflation Reduction Act (IRA) energy provisions per JCX-18-22	Limit, Save, Grow Act*	Build it in America Act
Extension/modification, credit for renewable electricity (45)	Modifies base amount, dates	
Extension and modification of energy credit (48)	Restores prior law	
Increase in energy credit for solar facilities in low-income communities	Repealed	
Extension and modification of credit for carbon oxide sequestration (45Q)	Restores prior law	
Zero-emission nuclear power production credit (45U)	Repealed	
Extension of incentives for biodiesel, renewable diesel, alternative fuels	Restores prior law	
Extension of second-generation biofuel incentives	Restores prior law	
Sustainable aviation fuel credit	Repealed	
Credit for production of clean hydrogen (45V)	Repealed	
Extension/increase/modification, nonbusiness energy prop. credit (25C)	Restores prior law	
Extension/modification of residential energy efficient prop. credit (25D)	Restores prior law	
Energy efficient commercial buildings deduction (179D) *permanent but expanded in IRA*	Restores prior law	
Extension/increase/modification, new energy efficient home credit (45L)	Restores prior law	
Clean vehicle credit (30D)	Reverts to pre-IRA credit	Reverts to pre-IRA credit
Credit for previously-owned clean vehicles (25E)	Repealed	Repealed
Credit for qualified commercial clean vehicles (45W)	Repealed	Repealed
Alternative fuel refueling property credit (30C)	Restores prior law	
Extension of the advanced energy project credit (48C)	Restores prior law	
Advanced manufacturing production credit (45X)	Repealed	
Clean electricity production credit (45Y)	Repealed	Repealed
Clean electricity investment credit (48E)	Repealed	Repealed
Cost recovery for facilities, property, energy storage technology	Repealed	
Clean fuel production credit (45Z)	Repealed	
Elective Payment for Energy Property and Electricity, Transfer of Credits	Repealed	
Wage and apprenticeship requirements	Repealed	

* Not to be confused with Fiscal Responsibility Act (FRA), the bipartisan bill enacted with no energy changes.

Treasury "Phase Two" forthcoming IRA energy regulations announced September 8

- Guidance before the end of the year related to the IRC Section 45X Advanced Manufacturing Production Tax Credit
- Guidance to be issued soon on the new Energy Efficient Home Credit
- Further guidance on the suite of credits for clean vehicles, including transfer of the new clean vehicle credit (up to $7,500) and previously owned clean vehicle credit (up to $4,000) to a car dealer
- Guidance on the Foreign Entity of Concern requirements in the 30D Clean Vehicle Credit
- Guidance on the underlying IRC Section 48 Investment Tax Credit
- Guidance before the end of this year on the clean hydrogen and sustainable aviation fuel credits

Main categories of IRA energy provisions

- Section 45(a) PTC for electricity produced from renewable resources
  - Wind, solar, biomass, geothermal
  - Section 45Y clean electricity technology-neutral emissions-based PTC
- Section 48 ITC
  - Solar, fuel cell, small wind, etc.
  - … Transitions to Section 45Y clean electricity technology-neutral emissions-based PTC
- Section 45Q credit for carbon oxide sequestration
- Section 45U zero-emission nuclear power production credit
- Section 45V credit for production of clean hydrogen

- Incentives for biodiesel, renewable diesel and alternative fuels
  - … Transitions to Section 45Z clean fuel production credit
- Section 40B sustainable aviation fuel credit
- Section 45V clean hydrogen credit
- Alternative fuel refueling property credit

- 48C advanced energy project credit
  - For manufacturing facility for the production or recycling of renewable energy equipment
- Section 45X advanced manufacturing production credit

Labor-related and low-income tax credits:

- Domestic content bonus
- Energy Community Bonus Credit
- Low-Income Communities Bonus Credit
- Prevailing wage and apprenticeship requirements

- Section 25C energy efficient home improvement credit
- Section 25D residential clean energy credit
- Section 45L new energy efficient home credit through 2032

Electric Vehicles

- Section 30D clean vehicle credit 200,000 per manufacturer cap lifted
  - Battery and mineral domestic content requirements
- Sec. 25E used clean vehicles credit
- Section 45W credit for qualified commercial clean vehicles

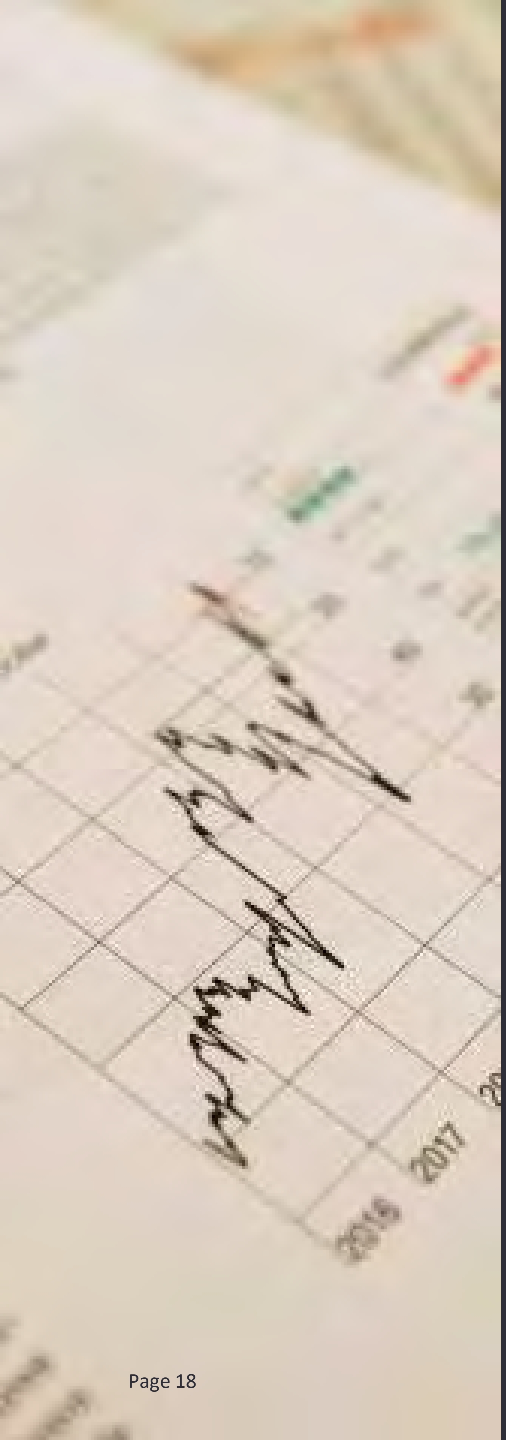
Section 48D Advanced Manufacturing Investment Credit (CHIPS ITC)

- CHIPS ITC established by the CHIPS Act of 2022
- Proposed regulations (REG-120653-22) define key terms and provide information on how to claim the credit
- Credit is generally equal to 25% of an eligible taxpayer's qualified investment in a facility with the primary purpose of manufacturing semiconductors or semiconductor manufacturing equipment
- Applies to qualified property placed in service after December 31, 2022, but only for costs incurred since enactment
- Qualified property includes any building or its structural components satisfying certain requirements unless the building or a portion of it is used for offices, administrative services, or other functions unrelated to manufacturing
- Rules don't specify the percentage of a project that qualifies as a primary purpose, so the IRS will look at each project and assess its primary purpose during audits of companies claiming the credit

Corporate Transparency Act

- On September 27, 2023, the Treasury Department and the Financial Crimes Enforcement Network (FinCEN) issued a proposed amendment to the regulations implementing the Corporate Transparency Act (CTA), also referred to as Beneficial Owner Information (BOI) reporting.
- This proposed amendment would extend that filing deadline from 30 days to 90 days for entities created or registered on or after January 1, 2024, and before January 1, 2025, to give those entities additional time to understand the new reporting obligation and collect the necessary information to complete the filing. Entities created or registered on or after January 1, 2025, would have 30 days to file their BOI reports with FinCEN, as required under the reporting rule.

FY 2024 Budget



Increase to top marginal and capital gains rates

01

- The Biden administration's budget proposes raising the top marginal rate for tax years beginning on or after 2022 to 39.6% for:
  - Heads of households with income exceeding $425,000; single individuals with income exceeding $400,000
  - Married individuals filing separately who have income exceeding $225,000
- These amounts would be indexed for inflation after 2024.
- The effective date for the proposal would be the date of enactment.

02

- The administration's budget also proposes to increase capital gains tax rates. The proposal would tax long-term capital gains and qualified dividends at ordinary income tax rates to the extent that a taxpayer's taxable income exceeds $1m ($500,000 for married individuals filing separately), with these amounts indexed for inflation after 2024.
  - The effective date for the proposal would be the date of enactment.

New minimum tax

- The Biden administration proposes imposing a minimum 25% tax on the total income (generally including unrealized capital gains) of individual taxpayers whose wealth (defined as assets minus liabilities) exceeds $100m. Taxpayers would be permitted to pay the first year's minimum tax liability in nine equal annual installments. For other years, a taxpayer could choose to pay in five equal, annual installments. Estimated tax payments would not be required.
- The proposal seeks to avoid taxing the same gain twice by allowing payments of the minimum tax (referred to as "prepayments) to be credited against subsequent taxes on realized capital gains. Any uncredited prepayments could be credited against capital gains taxes due upon a realization event, to the extent that the uncredited payments, reduced by any unpaid minimum-tax installments, exceeded 20% of unrealized gains.

New minimum tax

- Net uncredited prepayments that exceed a decedent's tax liability from gains at death would be refunded to the estate and included in the decedent's gross income. If the decedent was married when he or she died, the uncredited payments would be transferred to the surviving spouse.
- Taxpayers with wealth exceeding $100m would be required to annually report to the IRS the total basis and estimated value as of December 31 for each asset class. Nontradable assets would be valued based on the greater of the original or adjusted cost basis, the last valuation event from investment, borrowing or financial statements, or other approved methods.

Recapturing Section 1250

- The proposal would treat any gain on IRC Section 1250 property held for more than one year as ordinary income to the extent of the cumulative depreciation deductions taken after the proposal goes into effect. Depreciation deductions taken before the effective date would continue to be subject to the current rules and be recaptured as ordinary income only to the extent that depreciation exceeds the cumulative allowances determined under the straight-line method.
- Uncaptured IRC Section 1250 gain applies to commercial real estate and residential rental properties, and it is the portion of the capital gain that has already been depreciated. For noncorporate taxpayers, any unrecaptured depreciation gain on IRC Section 1250 property is currently taxed using a maximum tax rate of 25%.
- The proposal would apply to noncorporate taxpayers with $400,000 or more in adjusted taxable income ($200,000 for married individuals filing separate returns). Partnerships and S corporations would have to determine the character of the gains and losses at the entity level and report to entity owners the relevant amounts for ordinary income (loss), capital gain (loss) and unrecaptured IRC Section 1250 gain under both the “new law“ and the “old law.“
- The proposal would be effective for depreciation deductions taken on IRC Section 1250 property in tax years beginning after December 31, 2022, and for sales, exchanges, involuntary conversions or other IRC Section 1250 property dispositions completed in tax years after December 31, 2022.

Taxing carried interest as ordinary income

- The proposal would tax as ordinary income a partner's share of income on an "investment services partnership interest" (ISPI) in an investment partnership, regardless of the character of the income at the partnership level, if the partner's taxable income (from all sources) exceeds $400,000. Accordingly, this ISPI-related income would not be eligible for the reduced rates that apply to long-term capital gains. The gain recognized on the sale of an ISPI would generally be taxed as ordinary income, not as a capital gain, if the partner is above the income threshold. In addition, the administration's proposal would require partners in investment partnerships to pay self-employment taxes if their income exceeds $400,000.
- The proposal would repeal IRC Section 1061 for taxpayers with taxable income (from all sources) exceeding $400,000 and would be effective for tax years beginning after December 31, 2022. The Greenbook states that the proposal is not intended to adversely affect the qualification of a real estate investment trust owning a profits interest in a real estate partnership.

Limiting like-kind exchanges

- The proposal would allow the deferral of gain, up to an aggregate of $500,000 for each taxpayer ($1m for married individuals filing a joint return) each year for like-kind exchanges of real property. Taxpayers would recognize gains from like-kind exchanges exceeding $500,000 during a tax year (or $1m for married individuals filing a joint return) in the year that they transfer the real property subject to the exchange.
- The proposal would be effective for exchanges completed in tax years beginning after December 31, 2022.

Extending the child tax care credit (CTC)

- For taxable years beginning after December 31, 2022, and ending before January 1, 2026, the proposal would:
  - Increase the maximum credit per child to $3,600 for qualifying children under age 6 and to $3,000 for all other qualifying children.
  - Phase out the portion of the credit over $2,000 with income over $150,000 of modified AGI for married joint filers or surviving spouses, $112,500 for head of household filers, and $75,000 for all other filers, with a modified rule for large families.
  - Increase the maximum age to qualify for the CTC from 16 to 17.
- For taxable years beginning after December 31, 2022, the proposal would:
  - Make the CTC fully refundable, regardless of earned income.
- For taxable years beginning after December 31, 2023, the proposal would:
  - Reform the CTC to determine the eligibility and credit amount to be determined monthly rather than annually.
  - Replace the “qualifying eligibility“ standard with a new “specified child“ standard.
  - Establish a “presumptive liability“ standard to determine when a taxpayer would be eligible to claim a monthly specified child allowance or receive a monthly advance child payment.
  - Require the Secretary to establish a program for making monthly advance child payments.
  - Establish rules for the form and manner of monthly advance payments.
  - Establish an online information portal between taxpayers and the IRS.

Modifying self-employment and net investment income tax reporting

- The centralized partnership audit regime (also known as BBA) treats income tax (Chapter 1) and Self-Employed Contributions Act (SECA) tax/Net Investment Income Tax (NIIT) (Chapter 2/2A) separately for reporting, tax calculation and assessment purposes, which requires multiple tax returns and dual enforcement proceedings. Currently, the IRS assesses adjustments affecting Chapter 1 at the partnership level and assesses adjustments affecting Chapter 2/2A at the individual partner level.
- The proposal would amend the definition of a BBA Partnership-Related-Item, which currently applies to Chapter 1 taxes, to include items that affect Chapter 2/2A taxes. The highest tax rate in effect would apply for the reviewed year under IRC Section 1401 or 1411.
- The proposal would be effective after the date of enactment for all open tax years.

Increasing the net investment tax rate and the additional Medicare tax rate for high-income taxpayers

- Effective for tax years beginning after December 31, 2022, the proposal would increase the additional Medicare tax rate by 1.2 percentage points for taxpayers with more than $400,000 in earnings.
  - This would effectively bring the marginal Medicare tax rate up to 5% for those earning more than $400,000.
- The proposal would also increase the NIIT rate by 1.2 percentage points for taxpayers with more than $400,000 in income.
- For taxpayers with positive net investment income (NII), the NIIT would increase by 1.2% on the lesser of (1) NII or (2) any excess of modified AGI exceeding $400,000.
  - Both thresholds would be indexed for inflation.

Strengthen the limitation on losses for noncorporate taxpayers

- Effective for tax years beginning after December 31, 2023, the Administration proposes to make the excess business loss limitation under IRC Section 461(l) permanent and treat excess business losses carried forward as current-year business losses, rather than as net operating losses (NOLs).
- IRC Section 461(l) currently disallows noncorporate taxpayers from claiming excess business losses for tax years 2021 through 2028.
- Excess business losses are defined as the excess of current-year net business losses over a specified amount (for 2023, $578,000 for married couples filing jointly and $289,000 for other taxpayers).

Estate and gift proposals

- Treat transfers of appreciated property by gift or on death as appreciation events.
- Require a defined value formula clause to be based on a variable that does not require IRS involvement.
- Modify federal income estate, and gift tax rules for certain grantor trusts:
  - Minimum term and remainder amount for Grantor Retained Annuity Trusts (GRATs)
  - Recognition of gain on transfer to an Intentionally Defective Grantor Trust (IDGT) and payments by IDGTs
  - Payment of income tax gain on the above is a gift.
- Require consistent valuation of promissory notes.
- Improve tax administration for trusts and decedent's estates:
  - Definition of executor
  - Increase the limit on the reduction in value of special-use property
  - Ten-year period for certain estate and gift tax liens
  - Reporting estimated total value of trust assets.

Estate and gift proposals

- Simplify the exclusion from the gift tax for annual gifts
  - The proposal would eliminate the present interest requirement for gifts that qualify for the gift tax annual exclusion.
  - Instead, the proposal would define a new category of transfers (without regard to the existence of any withdrawal or put rights) and would impose an annual limit of $50,000 per donor, indexed for inflation after 2024, on the donor’s transfers of property within this new category that would qualify for the gift tax annual exclusion.
  - The new $50,000 limit would not provide an exclusion in addition to the annual per-donee exclusion; rather, it would be a further limit on amounts that otherwise would qualify for the annual per-donee exclusion.
    - Thus, a donor’s transfers in the new category in a single year that exceed a total of $50,000 would be taxable, even if the total gifts to each individual donee did not exceed $17,000.
  - This category would include transfers in trust (other than to a trust described in IRC Section 2642(c)(2)), transfers of interests in passthrough entities, transfers of interests subject to a prohibition on sale, transfers of partial interests in property, and other transfers of property that the donee cannot immediately liquidate, without regard to the donee’s rights of withdrawal, rights to put property to the donee in return for cash, or similar rights.

Estate and gift proposals

- Limit the duration of generation-skipping transfer (GST) tax exemption
- Change the GST tax characterization of certain tax-exempt organizations
  - The proposal would ignore trust interests held not only by charities described in IRC Section 501(c)(3), as under current law but also by other tax-exempt organizations for purposes of the GST tax (i.e., other organizations designated as tax-exempt in IRC Section 501(c).
- Adjust a trust's GST inclusion ratio on transactions with other trusts
  - Under the proposal, a trust's purchase of (1) assets from, or interests in, a trust that is subject to GST tax, or (2) any other property that is subject to GST tax would be treated as a change in trust principal that would require the purchasing trust's inclusion ratio to be redetermined at the time of purchase.
- Modify the tax treatment of loans from a trust
  - Loans that a trust makes to a trust beneficiary would be treated as a distribution for both income and GST tax purposes. These rules would apply to loans that trusts make, and to existing loans renegotiated or renewed, after the year of enactment.
- Modify the definition of a guaranteed annuity from a charitable lead annuity trust (CLAT)

Estate and gift proposals

- Revise the valuation of partial/fractional interests in certain assets transferred intrafamily
  - The proposal would replace IRC Section 2704(b), which disregards the effect of liquidation restrictions on FMV, and instead provide that the value of a partial interest in non-publicly traded property (real or personal, tangible or intangible) transferred to or for the benefit of the transferor's family member would equal the interest's pro-rata share of the collective FMV of all interests in that property held by the transferor and the transferor's family members, with that collective FMV being determined as if held by a sole individual.
  - Family members for this purpose would include the transferor, the transferor's ancestors and descendants, and the spouse of each described individual.
  - This valuation rule would apply only to intrafamily transfers of partial interests in property in which the family collectively has an interest of at least 25% of the whole.
- Limit the use of donor-advised funds (DAFs) to avoid private foundation (PF) payout requirement
  - This proposal would clarify that a PF's distribution to a DAF does not constitute a qualifying distribution unless two conditions are met.
    - First, the DAF funds must be expended by the end of the following tax year as a qualifying distribution that does not include a distribution to another DAF.
    - Second, the PF must maintain adequate records or other evidence showing that the DAF has made a qualifying distribution within the required time frame.
- Exclude payments to disqualified persons from counting toward the PF payout requirement

Modernize rules for digital assets

- Apply wash-sale rules to digital assets and address related-party transactions
  - Effective for tax years beginning after December 31, 2023, digital assets would be added to the list of assets subject to the wash-sale rules unless the taxpayer is a dealer in stock or securities and the loss is sustained in the ordinary course of its dealer business.
  - The wash-sale rules would also be modified as they apply to all assets with respect to transactions involving related parties, which would include members of a taxpayer’s family and tax-favored accounts such as individual retirement accounts controlled by the taxpayer and one or more family members.
- Amend the mark-to-market rules to include digital assets
  - Effective for tax years beginning after December 31, 2023, a new third category of assets — actively traded digital assets and derivatives on, or hedges of, those digital assets — would be added to those that a dealer or trader may mark to market.
  - The Green Book notes that a “digital asset would not be treated as a security or commodity for purposes of the mark-to-market rules and would therefore be eligible for mark-to-market treatment only under the rules applicable to the new third category of assets. No inference is intended as to the extent to which a digital asset may be eligible for mark-to-market treatment under current law.“

Evolution of tax proposals from the Biden administration

Proposal	FY22 Greenbook	FY23 Greenbook	FY24 Greenbook
Increase the top rate on ordinary income to 39.6%	Included	Included	Included
Increase the top rate on long-term capital gains and qualified dividends to 39.6%	Included	Included	Included
Tax the wealthiest taxpayers a 25% minimum	Omitted	Included	Included but amended
Tax IRC Section 1250 recapture at ordinary rates	Omitted	Included	Included
Tax carried interest as ordinary income	Included	Included	Included
Reduce deferral benefit of Section 1031 exchanges	Included	Included	Included
Extend the CTC	Included	Omitted	Included but amended

Evolution of tax proposals from the Biden administration

Proposal	FY22 Greenbook	FY23 Greenbook	FY24 Greenbook
Expand the reach of the net investment income tax	Included	Omitted	Omitted
Incorporate chapters 2/2A in centralized partnership audit regime proceedings	Omitted	Included	Included
Increasing the NIIT rate and the additional Medicare tax rate for high-income taxpayers	Omitted	Omitted	Included
Strengthen the limitation on losses for noncorporate taxpayers	Included	Included	Included
Treat gifts and bequests as taxable events	Included	Included	Included
Require a defined value formula clause to be based on a variable	Omitted	Omitted	Included

Evolution of tax proposals from the Biden administration

Proposal	FY22 Greenbook	FY23 Greenbook	FY24 Greenbook
Modify the rules for certain grantor trusts	Omitted	Included	Included
Require consistent valuation of promissory notes	Omitted	Included	Included
Improve tax administration for trusts and estates	Omitted	Included	Included
Simplify the exclusion from the gift tax for annual gifts	Omitted	Omitted	Included
Limit duration of generation-skipping transfer (GST) tax exemption	Omitted	Included	Included
Change the GST tax characterization of certain tax-exempt organizations	Omitted	Omitted	Included
Modify the definition of guaranteed annuity from a charitable lead annuity trust (CLAT)	Omitted	Omitted	Included

Evolution of tax proposals from the Biden administration

Proposal	FY22 Greenbook	FY23 Greenbook	FY24 Greenbook
Revise the valuation of partial interests in certain assets transferred intrafamily	Omitted	Included	Included
Limit use of donor-advised funds (DAFs) to avoid PF payout requirement	Omitted	Included	Included
Exclude payments to disqualified persons from counting toward PF payout requirement	Omitted	Included	Included
Apply wash-sale rules for digital assets	Omitted	Omitted	Included
Amend the mark-to-market rules to include digital assets	Omitted	Included	Included

Priority Guidance Plan

Priority Guidance Plan

Project	2022–2023 Priority Guidance Plan	2023–2024 Priority Guidance Plan
Guidance under IRC Section 4941 regarding a PF’s investment in a partnership in which disqualified persons are also partners	Included	Included
Guidance regarding IRC Section 163(j)	Included	Included
Guidance on applying state and local tax deduction cap under IRC Section 164	Included	Included
Guidance under IRC Section 170 regarding charitable contributions	Included	Included
Guidance under IRC Section 170 regarding conservation easements, including façade easements	Included	Included
Regulations under IRC Section 172 regarding computation of the NOL deduction	Included	Included
Guidance on monetized installment sales under IRC Section 453	Included	Included

Priority Guidance Plan (cont.)

Project	2022–2023 Priority Guidance Plan	2023–2024 Priority Guidance Plan
Regulations under IRC Section 199A related to determination of unadjusted basis immediately after acquisition (UBIA) of qualified property, the definition of qualified business income (QBU) and other issues	Included	Included
Guidance on applying state and local tax deduction cap under IRC Section 164	Included	Included
Guidance on tax treatment of transactions involving digital transactions	Included	Included
Guidance concerning validation of digital transactions, including staking	Included	Included
Guidance under IRC Section 1202 regarding the exclusion of gain from the sale or exchange of qualified small business stock	Omitted	Included
Final regulations under IRC Sections 1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016.	Included	Included

Priority Guidance Plan (cont.)

Project	2022–2023 Priority Guidance Plan	2023–2024 Priority Guidance Plan
Guidance regarding availability of IRC Section 1014 basis adjustment at death of the owner of a grantor trust described in IRC Section 671 when the trust assets are not included in the owner's gross estate for estate tax purposes	Included	Accomplished The IRS issued Rev. Rul. 2023-2 which ruled that assets in a grantor trust that were not included in the decedent's gross estate for federal estate tax purposes could not receive a basis adjustment under IRC Section 1014
Regulations under IRC Section 645 pertaining to the duration of an election to treat certain revocable trusts as part of an estate	Omitted	Included
Regulations under IRC Section 2010 addressing whether gifts that are includible in the gross estate should be excepted from the special rule of Treas. Reg. Section 20.2010-1(c)	Included	Included

Priority Guidance Plan (cont.)

Project	2022–2023 Priority Guidance Plan	2023–2024 Priority Guidance Plan
Guidance on portability regulatory elections under IRC Section 2010(c)(5)(A)	Included	Accomplished The IRS issued Rev. Proc. 2022-32. which updates and expands the simplified method for estates to obtain an extension of time to make a portability election under IRC Section 3010(c)(5)(A)
Regulations under IRC Section 2032(a) regarding imposition of restrictions on estate assets during the six-month alternate valuation period	Included	Included
Final regulations under IRC Section 2053 regarding the deductibility of certain interest expenses and amounts paid under a personal guarantee, certain substantiation requirements, and the applicability of present value concepts in determining the amount deductible	Included	Included

Priority Guidance Plan (cont.)

Project	2022–2023 Priority Guidance Plan	2023–2024 Priority Guidance Plan
Regulations under Treas. Reg. Section 20.2056A-2 for qualified domestic trust elections on estate tax returns, updating obsolete references	Included	Included
Final regulations under IRC Section 2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption	Included	Included
Regulations under IRC Section 2632 providing guidance governing the allocation of GST exemption in the event the IRS grants relief under IRC Section 2642(g), as well as addressing the definition of a GST trust under IRC Section 2632(c), and providing ordering rules when GST exemption is allocated in excess of the transferor's remaining exemption	Included	Included
Final regulations under IRC Section 2801 regarding the tax imposed on US citizens and residents who receive gifts or bequests from certain expatriates	Included	Included

Priority Guidance Plan (cont.)

Project	2022–2023 Priority Guidance Plan	2023–2024 Priority Guidance Plan
Regulations under IRC Section 7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests	Included	Accomplished The IRS issued Treasury Decision (TD) 9974, which contains final regulations relating to the use of actuarial tables in valuing annuities, interests for life or a term of years in property, and remainder or reversionary interests in property
Regulations under IRC Section 6011 identifying a transaction involving certain uses of charitable remainder annuity trusts as a listed transaction	Omitted	Included
Final regulations regarding the application of IRC Section 163(j) to partnerships, S corporations, and their owners	Included	Included
Regulations under IRC Section 469(h)(2) concerning limited partners and material participation	Included	Included

Priority Guidance Plan (cont.)

Project	2022–2023 Priority Guidance Plan	2023–2024 Priority Guidance Plan
Regulations under subchapter S to conform with statutory changes and provide further guidance on the calculation of certain items of income, loss, and deduction under IRC Section 1361	Included	Included
Regulations under subchapter S to conform with statutory changes and provide further guidance on the calculation of certain items of income, loss, and deduction under IRC Section 1361	Included	Included
Revenue procedure under IRC Section 1362(f) regarding the validity or continuation of an S corporation election, or qualified subchapter S subsidiary election, in certain situations involving disproportionate distributions, inconsistent tax return filings, or errors or omissions on Form 2553, Election by a Small Business Corporation, or Form 8869, Qualified Subchapter S Subsidiary Election	Included	Accomplished The IRS issued Rev. Proc. 2022-19, which provides taxpayer assistance procedures, including under IRC Section 1362(f), to allow S corporations and their shareholders to resolve frequently encountered issues with certainty and without requesting a Private Letter Ruling from the IRS

Priority Guidance Plan (cont.)

Project	2022–2023 Priority Guidance Plan	2023–2024 Priority Guidance Plan
Guidance under IRC Section 7508A	Included	Included
Guidance under IRC Section 1402(a)(13)	Omitted	Included
Final regulations regarding the transfer of certain credits under IRC Section 6418. Proposed and temporary regulations were published on June 21, 2023	Omitted	Included

Developments in Private Tax and additional year-end updates

Individual income tax

Other cases and rulings
Section 162

- *Dunn v. Commissioner,* T.C. Memo. 2022-112 (November 29, 2022)
  - The Tax Court held that a couple could not deduct net losses, depreciation on the wife's vehicle, or flowthrough losses from a limited liability company (LLC) because they did not substantiate information about the vehicle, neither individual was a real estate professional, and they did not show material participation in the LLC's rental real estate activities.
- *Ayria v. Commissioner,* T.C. Memo. 2022-123 (December 19, 2022)
  - The Tax Court sustained an IRS deficiency determination against the manager of a car dealership, finding that he was not entitled to deductions he claimed on a Schedule C, "Profit or Loss from Business," that were related to his work at the car dealership.

Other developments in Private Tax
Other cases and rulings on individual income tax

- *Tillman-Kelly v. Commissioner*, T.C. Memo. 2022-111 (November 21, 2022)
  - The Tax Court held that the payment an individual received to settle his retaliation claim against a university after he was terminated for reporting the misuse of grant funds was not excludable from his gross income under IRC Section 104(a)(2), finding that the payment was for emotional distress and not for physical injury or sickness.
- *Simpson v. Commissioner*, T.C. Memo. 2023-4 (January 9, 2023)
  - The Tax Court held that deductions claimed by their S corporation were deductible to them as unreimbursed employee expenses to the extent they were substantiated, and because they failed to substantiate their basis in a limited liability company, their losses are limited.
- *Wondries v. Commissioner*, T.C. Memo. 2023-5 (January 9, 2023)
  - The Tax Court, rejecting the IRS's disallowance of loss deductions under IRC Section 183, held that a couple engaged in their cattle ranching activity for profit rather than as a hobby, but they are liable for an IRC Section 6662 negligence penalty for the underpayment of tax on an IRA distribution.
- *Patacsil v. Commissioner*, T.C. Memo. 2023-8 (January 17, 2023)
  - The Tax Court held that a couple did not show that they were insolvent in 2015, so they must recognize cancellation of indebtedness income, they are not entitled to more business expense deductions than the IRS allowed, they are not entitled to claim losses on foreclosed property, and they didn't substantiate an NOL deduction.
- *Lucas v. Commissioner*, T.C. Memo. 2023-9 (January 17, 2023).
  - The Tax Court held an individual liable for the IRC Section 72(t) 10 percent additional tax on an early retirement distribution, finding that the distribution was not excepted from the additional tax because his diabetes did not prevent him from engaging in substantial gainful activity.

Other developments in Private Tax

Other cases and rulings on individual income tax

- *Haghnazarzadeh v. Commissioner*, Docket No. 21-71390 (9th Cir. February 2, 2023) (per curium)
  - The Ninth Circuit affirmed a Tax Court decision that sustained IRS deficiency determinations against a couple based on a bank deposits analysis and affirmed the exclusion of their accountant's testimony at trial and the denial of a motion for reconsideration, finding no error or abuse of discretion by the Tax Court.
- *Patrinicola v. Commissioner,* T.C. Memo. 2023-16 (February 14, 2023)
  - The Tax Court held that a couple underreported taxable pension distributions on their return, finding no code section or other statute that excludes pension distributions of less than $1,990 a month as they had argued.
- *Nath v. Commissioner,* T.C. Memo. 2023-22 (February 27, 2023)
  - The Tax Court upheld an IRS determination based on a bank deposits analysis that advances on future earnings paid by a family business to one of its owners were taxable income when received rather than loans because there was no indication that he intended to repay them.
- *Cheam v. Commissioner,* T.C. Memo. 2023-23 (February 27, 2023)
  - The Tax Court held that a couple had unreported gross receipts from their grocery business based on a bank deposits analysis but found that they provided enough evidence to estimate their costs of goods sold. The court held that they failed to substantiate their expense deductions beyond those allowed by the IRS.
- Rev. Rul. 2023-8 (April 12, 2023)
  - The IRS obsoleted Revenue Ruling 58-74, 1958-1 C.B. 148, which allowed taxpayers to amend prior returns to correct missed deductions for research and experimental expenses under IRC Section 174. The new revenue ruling explained that "[t]he rational … for obsoleting Revenue Ruling 58-74 is independent of the removal of the expense method by the [Tax Cuts and Jobs Act] amendments to former [IRC Section] 174."

Other cases and rulings

Other cases and rulings on individual income tax

- *Betz v. Commissioner*, T.C. Memo 2023-84 (July 6, 2023)
  - The Tax Court denied taxpayers' research credit claim for activities conducted by an S corporation that designs and supplies air pollution control systems under contracts with its customers. After reviewing the 19 projects on which the taxpayers' 2014 research credit claim was based, the Tax Court found that the taxpayers did not establish that the products were pilot models under IRC Section 174 or that their employees' wages were incurred in the performance of qualified services. For five of the taxpayers' company's projects, the Tax Court found that the research was not qualified research because it was funded (taxpayers did not retain substantial rights in the research).
- *Mylan v. Commissioner*, No. 21-1194, 2023 WL 4778284 (3d Cir. July 27, 2023)
  - The US Court of Appeals for the Third Circuit (Appeals Court) affirmed a Tax Court ruling that patent infringement litigation expenses resulting from ANDA (Abbreviated New Drug Application) filings are ordinary and necessary business expenses that may be deducted under IRC Section 162(a).

Renewable energy credits

Other developments in Private Tax

Final and proposed regulations: REG 101610-23

- The Inflation Reduction Act (IRA) added IRC Section 6418, which allows an eligible taxpayer to transfer all or a portion of an eligible credit to an unrelated transferee taxpayer for cash. The provisions were effective January 1, 2023. The IRA allows certain credits to be transferred. Under new IRC Section 6418, an eligible taxpayer can elect to transfer all (or any portion specified in the election) of an eligible credit to an unrelated transferee taxpayer. The transfer, however, must be purchased with cash, not be included in the seller’s income and not be deductible by the transferee buying the credit. Further, the transfer must be a one-time transfer (i.e., the transferee cannot subsequently elect to further transfer any portion of the transferred credit). The taxpayer must elect to transfer the credits no later than the due date (including extensions) of the tax return for the tax year for which the credit is determined. Any election, once made, is irrevocable.
- The IRS has released proposed rules (REG-101610-23) on transferring renewable energy credits.
- At the same time, the IRS released proposed rules (REG-101607-23) on the direct-pay election of applicable energy credits under IRC Section 6417 (see Tax Alert 2023-1102), FAQs on the two options and temporary regulations (TD 9975) on the pre-filing requirements. Taxpayers electing direct pay of the credits under IRC Section 6417 cannot transfer the credits under IRC Section 6418.
- The proposed rules would apply to tax years on or after the date the final rules are published in the Federal Register. Taxpayers may rely on the proposed rules for tax years beginning after December 31, 2022, if they follow the proposed rules in their entirety and in a consistent manner.

Other developments in Private Tax
Final and proposed regulations: REG 101610-23

- As part of the IRA, the transfer election is available for the following tax credits:
  - The IRC Section 30C alternative fuel vehicle refueling property credit.
  - The IRC Section 45 production tax credit (PTC).
  - The IRC Section 45Q carbon capture use and sequestration (CCUS) credit.
  - The new IRC Section 45U zero-emission nuclear power production credit.
  - The new IRC Section 45V clean hydrogen production credit.
  - The new IRC Section 45X advanced manufacturing production credit.
  - The technology-neutral PTC (new IRC Section 45Y) and investment tax credit (ITC) (new IRC Section 48E).
  - The new IRC Section 45Z clean fuel production credit.
  - The IRC Section 48C qualifying advanced energy project credit.
  - The IRC Section 48 ITC.
- The elections related to the IRC Section 45 PTC or the credits under IRC Sections 45Q, 45V or 45Y must be made separately for each applicable facility and for each tax year during the 10-year period beginning on the date the facility was placed in service (or, for IRC Section 45Q CCUS purposes, for each year during the 12-year period beginning on the date the carbon capture equipment was originally placed in service at that facility).
- The IRA does not allow applicable entities, as defined for direct-pay purposes, to elect to transfer credits.
  - Applicable entities are defined for direct-pay purposes as tax-exempt entities, any state or local governments, the Tennessee Valley Authority, Indian tribal governments or Alaska Native Corporations. An additional 20% penalty can apply to "excessive credit transfers." For eligible credits resulting from property held by a partnership or S Corporation, any election to transfer a credit must be made at the partnership or S corporation level.

Other developments in Private Tax
Final and proposed regulations: REG 101610-23

- Pre-filing registration requirements
  - The proposed rules describe the requirements for electronic pre-filing registration for eligible taxpayers who want to transfer credits. The IRS also released temporary regulations (TD 9975) that list the requirements and state that the IRS anticipates opening the electronic portal for pre-filing registration in Fall 2023.
  - Under the pre-filing requirements, taxpayers who want to transfer credits must obtain a registration number for each eligible facility, and then give the registration number to the transferee taxpayer, who must use it to complete a transfer election statement. The transferor must also give the IRS the supporting documentation relating to the construction or acquisition of the eligible credit property (e.g., permits, leases) and provide documentation to validate the existence of the eligible credit property, any bonus credits and the evidence of credit qualification. The transfer election statement, also described in the proposed rules, must be attached to the tax returns of both parties.
  - The proposed rules clarify that taxpayers can transfer the eligible credit to multiple parties. If the credit is being transferred to multiple parties, the same registration number will be provided to all parties, but separate registration numbers are required for each facility where there are multiple facilities.
  - Implications
    - The pre-filing registration requirements are more substantive than many people anticipated in that supporting documentation needs to be transferred to both the IRS and the transferee. It remains to be seen whether the IRS will use the additional support to apply enhanced audits for transferred tax credits.
    - Additionally, the need to undertake a pre-filing registration on a facility-by-facility basis begs for additional guidance. While Revenue Ruling 94-31 defines an onshore wind facility as a pad, pole and turbine, there is no similar guidance for solar and other technologies, which rely on general tax principles instead. It is also interesting that the IRS did not grant the ability to look at a project as a single facility as it did with other issues like "begun construction." It is unclear if this is intentional or an oversight.

Other developments in Private Tax

Final and proposed regulations: REG 101610-23

- Transfer elections
  - The proposed rules describe the requirements for making a transfer election, including whether the transfer election is allowed, how and when the election must be made, limitations on the transfer election, determining the eligible credit, the transfer election statement that must be attached to the tax returns and how to treat the payments for all or a portion of the credits.
  - Under the proposed rules, taxpayers could transfer part of the tax credit from an eligible facility. In addition, the tax credit (all or part) from an eligible facility could be transferred to multiple taxpayers, provided that the total tax credits transferred do not exceed the total credits for which the project is eligible.
  - No transfer would be allowed if the taxpayer did not own the eligible property, and the tax credit would be claimed from an election by another taxpayer. This situation crops up in IRC Section 45Q projects and more prevalently for solar credits (IRC Section 48) where a common tax equity structure is the lease passthrough under IRC Section 50(d)(5) whereby the owner of the asset elects to pass the tax credit to a qualified lessee. In that case, the lessee could not transfer the tax credits.
  - The proposed rules clarify that taxpayers may transfer a portion of an eligible credit, but the portion must be a "vertical slice" of the tax credits and cannot relate solely to a bonus credit, such as the domestic content bonus. Thus, a taxpayer cannot single out the bonus credit for purposes of the transfer.
  - In addition, transferees can reduce their estimated tax credits before buying the credits.
- Implications
  - Many tax-equity transactions were closed before guidance on the bonus credit was released, which resulted in an agreement whereby the tax equity investor would get the base tax credits, and the bonus credits would be transferred. The proposed rules would prohibit this while allowing a portion of the tax credits to be transferred, creating the same economic result but likely with a different sharing of tax risk around the qualification for the bonus credits.
  - The inability of a taxpayer who receives an investment tax credit through a passthrough election to then transfer the tax credit is a bit surprising and likely eliminates many of the tax approaches discussed before the guidance.

Other developments in Private Tax

Final and proposed regulations: REG 101610-23

- Recapture rules
  - If an eligible project becomes ineligible after the credits are transferred, the proposed rules confirm that the transferee is liable for any recaptured tax credits. The credits' seller must tell the buyer, in a "timely" manner, if the project is no longer eligible.
  - Departing from the general rule that transferring the tax credit property would create recapture, the proposed rules set forth that the "recapture tax liability resulting from the reduction of an S corporation shareholder's interest or a partner's interest in general profits should continue to result in recapture to the applicable disposing shareholder or partner." Thus, there is no recapture liability on the transferee.
  - The proposed rules also clarified that IRC Section 6418 does not prohibit an eligible taxpayer and a transferee from contracting between themselves to indemnify the transferee against a recapture event.
- Implications
  - While many taxpayers had hoped that recapture would be the transferor's responsibility as opposed to the transferee, the guidance offers some leniency for partnerships and S corporations but largely leaves transferees with a risk that is out of their control. The explicit allowance for guarantees is helpful, and all tax credit transfers could be expected to have a guarantee covering any losses due to recapture. It is likely that non-creditworthy counterparties will need insurance to transact competitively.

Other developments in Private Tax

Final and proposed regulations: REG 101610-23

- Partnerships and S corporations
  - The proposed rules clarify that a partnership or S corporation may qualify as an eligible buyer or seller of the credits, and property can be owned by a disregarded entity. Income from the transfer would be treated as arising from an investment activity, not from the conduct of a trade or business.
  - The proposed rules address the rule that an eligible credit may only be transferred once in the partnership context by requiring partnerships to treat a transferred specified credit portion purchased by a transferee partnership as an "extraordinary item" under Treas. Reg. Section 1.706-4(e).
    - By making the transferred credit an extraordinary item, a credit transferred to a partnership would be allocated to partners based on the sharing ratios in place on the date of the transfer.
    - If the transferee partnership and transferor have the same tax years, this extraordinary item is deemed to occur on the date the transferee partnership first makes a cash payment to an eligible taxpayer for any transferred specified credit portion. According to the Preamble, this was done to prevent taxpayers from circumventing the "one transfer rule" by having partners come in and out of a partnership.
    - The proposed rules provide detailed instructions on how to deal with parties that have different tax years.
  - The proposed rules create the new concept of a "partner's eligible credit amount." This concept allows partners to take different approaches to how they want to utilize the tax credits.
    - Under the proposed rules, the partnership would first have to determine each partner's distributive share of the otherwise eligible credits.
    - The transferor partnership could then determine, in any manner described in the partnership agreement, or as the partners may agree, the portion of each partner's eligible credit amount to be transferred, retained and allocated.
    - The partnership could then allocate to each partner its agreed-upon share of eligible credits, tax-exempt income resulting from credit portions, or both.

Other developments in Private Tax
Final and proposed regulations: REG 101610-23

- Partnerships and S corporations (cont.)
  - Implications
    - The concept of “partner’s eligible credit amount“ should be welcomed by taxpayers as it gives partnerships significant flexibility and allows partners to choose what they want to do based on their tax profile. In a simple example, a partnership may have one partner that wants to keep its share of the tax credit while the other wants to sell its share. Without this rule, the unsold credits might have been allocated 50/50 in accordance with the partnership agreement. Further, this will allow developers/sponsors to monetize their 1% of the tax credits, which they get allocated in typical tax-equity transactions.
- Partnerships and S corporations subject to IRC Section 49 at-risk rules
  - The proposed rules address the situation where the IRC Section 49 at-risk rule might affect the amount of the eligible credits (which concerns the project’s financing requirements).
    - If this rule applies, the amount of an eligible investment credit held directly by a transferor partnership or transferor S corporation must be determined by taking into account the IRC Section 49 at-risk rules at the partner or shareholder level.
    - Under the credit at-risk rules in IRC Section 49, if a credit-generating project is encumbered with too much debt and the owners are not personally liable, the partnership or S corporation’s base for calculating the credit is reduced to the amount of capital that is at risk. If the amount of capital at risk increases in later years, some or all of any suspended credit can get “released.“ If the capital at risk decreases, there is a recapture of previously allowed credits.
  - Implications
    - The regulations make it clear that the IRC Section 49 at-risk regime applies to these transferable credits. Thus, if a project that could have generated $100 of credits is limited by IRC Section 49 to only $70 credits, the most the S corporation or partnership can transfer to another party is only $70. Overall, it is a relatively logical conclusion.

Other developments in Private Tax

Final and proposed regulations: REG 101610-23

- Buyers of credits subject to IRC Section 469
  - The proposed regulations would essentially permit only individuals, estates and trusts (including exempt organizations that have unrelated business taxable income (UBTI) and are organized as trusts), closely-held C corporations and personal service corporations to use a purchased credit to offset tax exclusively from passive business income generated by businesses they own directly, or indirectly, through partnerships and S corporations.
  - It then follows that these taxpayers cannot use the credits to offset wages, active business income from their businesses (i.e., self-employment income), or investment income and retirement income. Large corporations, in contrast, do not have a similar limitation.
  - Implications
    - The proposed regulations would permit the transferee to use the credit only against tax imposed on net passive income (within the meaning of IRC Section 469). This treatment of transferees is one of the more unusual, and unexpected, portions of the proposed regulations in that it would exclude a large portion of the tax-paying public from this transferable credit regime.
- Utilities
  - The proposed rules do not address whether the normalization rules under former IRC Section 46(f), which affect depreciation, would continue to apply to the transferor because the transferee is deemed the taxpayer for purpose of the credit.
  - Implications
    - To gain much needed clarity, companies should submit comments by the due date or possibly engage with the IRS by requesting a private letter ruling.

Other developments in Private Tax
Final and proposed regulations: REG 101610-23

- Excessive transfers
  - Under the proposed rules, the 20% penalty for an excessive transfer credit would not apply if the taxpayer receiving the credit shows that the transfer resulted from reasonable cause, which would be based on the relevant facts and circumstances of the transaction. In the preamble, the IRS lists the factors that it would list in the proposed regulations that a taxpayer could demonstrate to show reasonable cause:
    - The extent of the transferee’s efforts to determine that the amount of the credit portion transferred to the transferee is not more than the allowed amount and was not transferred to any other taxpayer (this is the most important factor).
    - Review of the eligible taxpayer’s records (including documentation evidencing eligibility for bonus credit amounts).
    - Reasonable reliance on third-party expert reports.
    - Reasonable reliance on the transferor taxpayer’s representations.
    - Review of audited financial statements provided to the Securities and Exchange Commission (SEC) (and underlying information), if applicable.
  - Implications
    - When IRC Section 6418 was first enacted, many people wondered how excessive transfers would be defined and how it would be handled in situations where the IRS may, upon audit, determine that the eligible tax credit is lower than the transferred tax credit.
    - The list of factors helps transaction participants understand where the risk lies.

Other developments in Private Tax
Final and proposed regulations: REG 101610-23

- Real estate investment trusts (REITs)
  - The proposed rules do not definitively say that eligible credits have not yet been transferred are treated as a real estate asset, cash or cash items, and therefore would not cause a REIT to fail the asset test under IRC Section 856(c)(4).
    - In the Preamble, however, the IRS noted that “the Treasury Department and the IRS believe that the proposed regulations, particularly with respect to the paid in cash and timing of sale requirements, will assist REITs in managing issues with the REIT asset test.“ It also asked for comments on whether this was enough guidance.
  - The Preamble also stated that the Treasury Department and IRS do not believe that the transfer of eligible tax credits results in a prohibited transaction.
    - This statement responds to a comment about whether transferring an eligible credit under IRC Section 6418 would be considered a dealer sale under the REIT prohibited transactions rules of IRC Section 857(b)(6).
    - “Since cash received by an eligible REIT as consideration for the transfer of an eligible tax credit would not be includible in any calculation of the eligible taxpayer’s gross income, the transaction cannot result in any net income and, consequently, there is no prohibited transaction tax issue regarding the transfer of an eligible credit,“ according to the Preamble.
  - Implications
    - REITs went one for two on the issues for which they were awaiting guidance. The fact that the transfer does not result in a prohibited transaction is very helpful. The failure to explicitly say that credits that have yet to be transferred are good assets was disappointing, but the fact that the IRS said that the proposed regulations will assist in managing the issue is at least a head nod. REITs may wish to request more specific guidance.

Cryptocurrency

Cryptocurrency
Notice 2023-34

- Notice 2023-34 updated prior guidance (Notice 2014-21) providing that cryptocurrency was not legal tender in “any jurisdiction.“
  - Under Notice 2014-21, cryptocurrency is generally considered “virtual currency“ and treated as property. Thus, tax principles for property transactions, rather than currency transactions, apply to transactions involving cryptocurrency.
- The modification in Notice 2023-34 does not change the IRS’s view that “convertible virtual currency“ is not a currency and cannot generate foreign currency gain or loss for US federal tax purposes.
  - The modified sentence reads: “In certain contexts, virtual currency may serve one or more of the functions of “real“ currency — i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance — but the use of virtual currency to perform "real" currency functions is limited." Following the change, the virtual currency addressed in Notice 2014-21 is no longer described as not having “legal tender status in any jurisdiction.“
- The IRS explained that the change to Notice 2014-21 does not affect the answers to the frequently asked questions (FAQs) in Section 4 of the Notice, specifically noting Q&A-2, which concludes that convertible virtual currency is not treated as currency that could generate foreign currency gain or loss for US federal tax purposes.

Cryptocurrency
Notice 2023-34 (cont.)

- Implications
  - Taxpayers may have inferred from Notice 2014-21 that a digital currency would be treated as currency for US tax purposes if it became accepted as legal tender in another jurisdiction. The modification clarifies that another jurisdiction's adoption of a digital currency as legal tender for a "limited purpose" does not render that digital currency a "currency" for US federal income tax purposes.
  - While adopting legal tender for a limited purpose is not sufficient, it is unclear how extensively a digital currency would need to be used in a particular jurisdiction to be "currency" for US federal income tax purposes. In particular, it is not clear whether the IRS would ever accept as a "currency" a digital currency that was not used as a unit of account (i.e., used to set prices for goods and services), even if that digital currency were widely used as a medium of exchange in a particular jurisdiction.
  - This issue will likely continue to be debated; hopefully, additional guidance will address the nuances among virtual currency assets.

Cryptocurrency
CCA 2023-16-008

- In CCA 2023-16-008, the IRS concluded that a cryptocurrency owner did not have taxable income when the native blockchain of that cryptocurrency underwent a protocol upgrade with no change to the owner's cryptocurrency.
- The IRS addressed the situation where a taxpayer purchased 10 cryptocurrency units and stored them in an unhosted wallet. The cryptocurrency was native to a blockchain that underwent a protocol upgrade, changing how transactions are validated (from proof-of-work to proof-of-stake). The protocol upgrade affected the consensus mechanism by which future transactions are validated, and blocks are added to the blockchain but did not affect the transaction history of the cryptocurrency units. The upgrade also did not change any terms or aspects of the cryptocurrency units themselves, and the taxpayer held the same 10 units following the upgrade. The taxpayer did not receive cash, services, or property due to the protocol upgrade.
- The IRS concluded that the taxpayer did not realize a gain or loss under IRC Section 1001 and did not have an item of gross income under IRC Section 61(a). For purposes of IRC Section 1001, the upgrade did not alter past transactions or previously-validated transactions or blocks. Thus, the taxpayer's cryptocurrency remained unchanged, so there was no gain or loss. For purposes of IRC Section 61(a), the taxpayer did not derive any economic benefits (e.g., cash, services or other cryptocurrencies) from the upgrade, so there was no income inclusion.

Cryptocurrency

CCA 2023-16-008 (cont.)

- Implications
  - CCA 2023-16-008 does not label the cryptocurrency being discussed; given that Ethereum had recently completed the "Merge," a highly publicized transition to the proof-of-stake consensus mechanism, in September 2022, the CCA may be addressing a taxpayer who held Ethereum tokens during the Merge.
  - CCA 2023-16-008 is helpful in providing guidance on the factors that a taxpayer should consider when determining whether a particular event involving a blockchain protocol results in a realization event. The IRS's statement that the upgrade did not "change any terms" of the cryptocurrency is interesting, given that proof-of-stake protocols, but not proof-of-work protocols, enable owners of tokens to earn staking rewards. That is, the Merge gave the owner the ability to earn staking rewards on the cryptocurrency, which the owner could not do before the merge. Apparently, however, the IRS did not consider this change to the cryptocurrency significant in analyzing whether IRC Section 1001 applied to the transition.

Cryptocurrency
Rev. Rul. 2023-14

- Rev. Rul. 2023-14 (July 31, 2023).
  - The IRS ruled that taxpayers using the cash method of accounting must include the rewards from cryptocurrency staking in gross income in the year they gain control of the rewards.
  - The IRS stated that cryptocurrency is treated as property for federal income tax purposes. A taxpayer's receipt of property constitutes gross income equal to the property's fair market value when its possession is undisputed. Taxpayers using the cash method of accounting must include gains in property in their gross income in the tax year they gain "dominion and control of those amounts."
  - Applying this analysis to cryptocurrency staking, the IRS said cash-method taxpayers that stake cryptocurrency native to a proof-of-stake blockchain, either personally or through a cryptocurrency exchange, and receive rewards of additional units of cryptocurrency must include the fair market value of the rewards in their gross income in the tax year in which they gain dominion and control over those rewards. Dominion and control are gained when the taxpayer can sell, exchange or otherwise dispose of the cryptocurrency.
  - This Revenue Ruling is broadly consistent with the IRS's position in Notice 2014-21 that those earning cryptocurrency as payment for goods or services (e.g., mining) must include the fair market value of the cryptocurrency as of the date that the virtual currency was received when computing gross income.

Cryptocurrency

Other cases and rulings on cryptocurrency

- CCA 2023-02-012 (January 10, 2023).
  - The Office of Chief Counsel of the IRS concluded that a qualified appraisal is required for charitable contributions of cryptocurrency over $5,000 to qualify for an IRC Section 170(a) deduction, and a taxpayer may not rely instead on the value reported on a cryptocurrency exchange.
- CCA 2023-02-011 (January 13, 2023).
  - The Office of Chief Counsel of the IRS concluded that taxpayers cannot claim a deduction under IRC Section 165 for cryptocurrency losses that have, absent a sale or other taxable disposition, substantially declined in value if such cryptocurrency continues to trade on at least one cryptocurrency exchange and has a value that is greater than zero.

Estate, gift and trust

Other developments in Private Tax
Rev. Rul. 2023-2

- Facts
  - The decedent had established an irrevocable trust funded with assets that were a completed gift for gift tax purposes.
  - The decedent retained a power over the trust that caused him to be treated as the owner of the trust for income tax purposes under the grantor trust provisions of IRC Sections 671-679 but did not cause the trust to be included in his gross estate for estate tax purposes.
  - At the time of the decedent's death, the fair market value (FMV) of the trust assets had appreciated.
  - The trust's liabilities did not exceed the basis of its assets, and neither the trust nor the individual held a note on which the other was the obligor.
- Law and analysis
  - IRC Section 1041(a)(1) generally considers the basis of property that was acquired from or passed from a decedent to a person, if not sold, exchanged, or otherwise disposed of before the decedent's death by that person, to be the FMV of the property at the date of the decedent's death.
  - Under IRC Section 1014(b), seven types of property are considered to have been acquired from or to have passed from the decedent for purposes of IRC Section 1014(a), including: (1) property acquired by bequest, devise or inheritance, or by the decedent's estate from the decedent; (2) property where a decedent had, while alive, the power to (a) revoke or (b) amend the trust or hold a power to appoint the assets; (3) property transferred under a testamentary general power of appointment; (4) community property; (5) property that is included in a decedent's gross estate under the provisions of Chapter 11; and (6) property included in a surviving spouse's estate due to a marital deduction allowed in the first-to-die spouse's estate.

Other developments in Private Tax
Rev. Rul. 2023-2 (cont.)

- Law and analysis (cont.)
  - The IRS first found that the assets were not “bequeathed,“ “devised“ or “inherited“ within the meaning of IRC Section 1014(b)(1) when the decedent died. The IRS based its analysis on previous case law and legislative history and found that the property transferred in trust before the decedent’s death was not bequeathed or inherited because it did not pass either by will or intestacy.
  - The IRS then found that the assets did not fall within any of the remaining types of property listed in IRC Section 1014(b).
  - The IRS concluded that the assets in the grantor trust could not receive a basis adjustment because: (1) property must be acquired or passed from a decedent under IRC Section 1014(a) to receive a basis adjustment; (2) the property must fall within one of the seven types listed in IRC Section 1014(b) for IRC Section 1014(a) to apply; and (3) the assets did not fall within any of the seven types of property listed in IRC Section 1014(b). As a result, IRC Section 1014(a) does not apply, and the basis of the assets immediately after the decedent’s death is the same as the basis of assets immediately preceding the decedent’s death.

Other developments in Private Tax
Rev. Rul. 2023-2 (cont.)

- Implications
  - This matter has been on the IRS priority guidance plan since 2015. Many practitioners believe that IRC Section 1014(b) applies to preclude a basis adjustment for property that is includible in a decedent's estate for estate tax purposes. However, a few practitioners take the position that assets in a "defective grantor trust" (i.e., a trust that is not includible in a decedent's estate) receive a basis step-up under IRS Section 1014(b)(9)(C). The argument likely stems from Priv. Ltr. Rul. 201245006, which was issued by the IRS in 2012 and addressed the application of IRC Section 1014 to foreign grantor trusts.
  - Because the taxpayer held the power to appoint the trust property via will or deed at death, the IRS concluded in the PLR that the property was received by taxpayer's heirs via bequest, devise or inheritance under IRC Section 1014(b)(1). As such, the IRC Section 1014(b)(9(C) exception was met, and the property would receive a basis step-up even though it was not includible in the decedent's US taxable estate.
  - Considering this Priv. Ltr. Rul., a few practitioners have argued that assets received on account of a decedent's death, even if not included in the decedent's gross estate, are eligible for an IRC Section 1014(a) basis adjustment. For a defective grantor trust, the argument is that, if the assets passing under the inter vivos trust are deemed to constitute a bequest, as they appear to have been in the PLR, then the basis in any irrevocable grantor trust should be adjusted under IRC Section 1014(a). Revenue Ruling 2023-2 closes the door on this argument by clarifying that assets in a defective grantor trust are generally not assets eligible for an IRC Section 1014(a) basis adjustment because they are not acquired or passed from a decedent within the meaning of IRC Section 1014(b).

Other developments in Private Tax

Cecil v. Commissioner, T.C. Memo 2023-24 (February 28, 2023)

- Facts
  - Taxpayer inherited the family's home, the Biltmore House, and its surrounding estate. Biltmore House was held inside an S corporation, TBC, which, at the time, was owned by Taxpayer and his wife (collectively Taxpayers) and their children. TBC operates primarily in the travel and tourism/historic hospitality industry.
  - On two consecutive days in November 2010, the Taxpayer's wife transferred her Class A voting shares to her two children in undivided equal shares. The next day, the Taxpayer transferred his 9,337 Class B shares to his five grandchildren equally along family lines. All gifts were subject to the obligation of the donee to pay any obligation to pay any tax associated with the gifts (a net-gift).
  - On their 2010 gift tax returns, Taxpayers reported a value of $3,308 per share for the Class A stock and $2,236 per share for the Class B stock. Taxpayers chose to split their gifts, and each reported total gifts of $10,438,766.
  - The IRS audited Taxpayers' gift tax returns and issued notices of deficiencies, determining that the valuation method used by Taxpayers understated the value of the shares of the TBC stock. In 2014, the IRS issued a $26 million deficiency in their federal gift tax return, and the taxpayers petitioned the Tax Court to redetermine the deficiency.
  - The evidence showed that over many years, the Taxpayers, their children, and their grandchildren crafted a culture of keeping the company in the family through regular business meetings to teach each generation and with shareholder agreements.

Other developments in Private Tax

Cecil v. Commissioner, T.C. Memo 2023-24 (February 28, 2023) (cont.)

- Facts (cont.)
  - Valuations
    - For purposes of filing their return, Taxpayers obtained an appraisal from Dixon Hughes. In determining the value of the TBC shares, Dixon Hughes used a weighted average using an asset approach and an income approach.
    - At trial, Taxpayers presented two experts:
      - One expert from Adams Capital appraised the TBC stock on the income approach using the discounted cash flow (DCF) method and a market approach using the comparable transactions method. The valuation included tax affecting to take into consideration future tax burdens on pretax cash flows. The expert rejected using the net asset value (NAV) method for valuing the assets of TCB because the number of shares was too small to force a liquidation and he was told by TBC's owners and management that TBC would not be liquidated in the foreseeable future (within the next 30 years).
      - The other expert from Bannister Financial valued the TBC stock on the income approach using the net cash flow method (NCF) and the guideline public company (GPC) method. This method included tax affecting the net cash flows using the S Corporation Economic Adjustment Model (SEAM). This expert also did not use the NAV method because the interest being valued was a minority interest with no power to force a liquidation.
    - The IRS also presented experts that both applied the NAV method. One expert with the IRS appraised the artwork in the Biltmore House. The other expert with Morrison Valuation and Forensic Services valued the TBC shares, taking into consideration the valuation of the artwork as part of the valuation. This expert also valued the TBC stock using the income approach's discounted future benefits (DFB) method. The expert's valuation also took into consideration tax affecting to take into consideration future tax burdens on pretax cash flows.

Other developments in Private Tax

Cecil v. Commissioner, T.C. Memo 2023-24 (February 28, 2023) (cont.)

- Reasoning and holding
  - Tax affecting
    - The Tax Court first addressed the use of tax affecting the valuation of TBC stock, noting that all three experts had used this method in rendering their valuations. The court noted its long-standing position that tax affecting is generally not a consideration in the valuation of S corporation stock except in exceptional cases. However, in the case before it, the court noted that all three experts agreed that tax affecting should be considered in the valuation of the TBC stock and, therefore, the court was satisfied with its use. The court then sided with the IRS's expert that the tax affecting rate should be 17.6%.
  - Review of valuations
    - The Tax Court next addressed the valuations of the three experts. The court rejected the IRS's valuation using the NAV approach because TBC was an operating company whose continuing existence was not in jeopardy. Thus, it determined that TBC's earnings, rather than its assets, are the best measure of TBC's stock value. Although the court agreed with Taxpayers' experts that the GPC method was the appropriate method to value TBC's stock, it found flaws in each of the valuations. Although the court found flaws in the valuation by Adams Capital, the court determined that the flaws were not fatal to the overall valuation, finding the valuation with an adjustment of the 17.6% tax affecting rate was the truest reflection of the value of the stock's pre-discount FMV.
  - Discounts
    - The Tax Court accepted Adams Capital's 20% discount for lack of control. It declined to apply a discount for lack of voting rights. It accepted the IRS's discount rates of 19% for the Class A stock, 22% for the smaller block of Class B stock that went to Dini's children and 27% for the larger block of Class B stock that went to Bill's children for lack of marketability.
    - In conclusion, the Tax Court determined that value of the TBC should be tax affected at a rate of 17.6% and that the gifted stock was subject to a 20% discount for lack of control and 19%, 22% or 27% lack of marketability discount depending on the size and class of the TBC stock.

Other developments in Private Tax

Estate of Spizzirri v. Commissioner, T.C. Memo. 2023-25 (February 28, 2023)

- Facts
  - The decedent had been married four times. His first marriage gave the decedent four children. He had three stepchildren as the result of his fourth marriage. Regarding his fourth marriage, the decedent and his wife entered into a prenuptial agreement, which was modified on various occasions during their marriage. Among other provisions, the prenuptial agreement provided that the decedent’s will would include a bequest of $1 million to each of his stepchildren of his fourth marriage.
  - Although the decedent’s fourth marriage was never dissolved before his death, he and his wife were estranged for several years before his death. During this estrangement, the decedent had various relationships with other women that resulted in the decedent fathering two more children. The decedent made large payments to many of these women, as well as various other family members, which he never reported as gifts or issued Form 1099-MISC, Miscellaneous Income, to the recipients.
  - The decedent’s will that was probated had been executed prior to his entering into his fourth marriage and did not contain the provisions agreed to by him in the prenuptial agreement regarding payments to his surviving spouse and her children. The will generally provided that the decedent’s estate would go to his children from his first marriage. There were three codicils to this will, three of which specified the rights of his two sons born out of wedlock and one which provided for the payment of the mortgage and transfer of his interest in a condominium he purchased with one of his romantic relationships.

Other developments in Private Tax

Estate of Spizzirri v. Commissioner, T.C. Memo. 2023-25 (February 28, 2023) (cont.)

- Facts (cont.)
  - During probate, the decedent's surviving spouse filed claims seeking enforcement of the prenuptial agreement, which was ultimately settled. The surviving spouse's children also filed claims seeking to enforce the prenuptial agreement regarding the $1 million bequest to each of them. The estate ultimately paid these bequests and sent the IRS Forms 1099-MISC reporting these payments.
  - After settlement of the claims of the surviving spouse and her children, the estate filed an estate tax return. Among other reported items, the return reported no adjusted taxable gifts, even though the decedent had made various payments to various persons in excess of the gift tax annual exclusion. The return also reported the payments to the surviving spouse's children as claims against the estate, which otherwise reduced the decedent's taxable estate. Additionally, the estate claimed as administrative expenses repairs to property of the estate.
  - The IRS issued a notice of deficiency and assessed additional tax adjusting the following items: (1) increased adjusted taxable gifts from $0 to approximately $200,000; (2) disallowed the deductions for the payments to the surviving spouse's children; and (3) disallowed administrative expenses for repairs to one of the estate's properties.

Other developments in Private Tax

Estate of Spizzirri v. Commissioner, T.C. Memo. 2023-25 (February 28, 2023) (cont.)

- Holding
  - The Tax Court held that payments a decedent made to relatives and friends were taxable gifts, that payments his estate was required to make to his stepchildren under a prenuptial agreement were not deductible claims against the estate under IRC Section 2053, and expenses the estate paid for property repairs were not deductible.

Other developments in Private Tax

Estate of Kalikow v. Commissioner, T.C. Memo. 2023-21 (February 28, 2023)

- Facts
  - Decedent resided in New York when she passed away on January 4, 2006. Decedent's husband predeceased her in 1990.
  - Decedent's husband's will create a qualified terminable interest property (QTIP) trust which was funded with the residue of his estate. Decedent's husband's will instruct the trustees to pay the QTIP trust's net income to Decedent at least quarterly during her lifetime and authorized the trustees to make discretionary principal distributions to her. Upon Decedent's death, the trust assets were to be paid over to trusts for the benefit of their two children, respectively, and their issue. The property that passed to the QTIP trust on Decedent's husband's death consisted primarily of interests in ten income-producing apartment buildings in New York City. In 1997 the then trustees of the QTIP trust entered into a limited partnership agreement creating a family limited partnership (FLP). The QTIP trust transferred the interests in the apartment buildings to the FLP in exchange for a 98.5% limited partnership interest. At the time of Decedent's death, the FLP interest, along with $835,000 of cash and marketable securities, constituted the principal property held in the QTIP trust.
  - Under the Decedent's will, the QTIP trust is responsible for its share of the estate tax arising from the inclusion of the QTIP trust property in Decedent's estate. After the payment of certain bequests and administration expenses, the residue of Decedent's estate was bequeathed to a charity Decedent had created during her life.
  - In November 2009, one of Decedent's grandchildren petitioned a court to compel one of the trustees of the QTIP trust to render an account of his proceedings as cotrustee of the QTIP trust. During these proceedings the trustee of the QTIP trust alleged that the FLP had failed to distribute to the QTIP trust all of the income properly due the QTIP trust. The parties litigated the matter for about 10 years and in March 2019, the parties settled and agreed that the QTIP trust would pay the estate $9,200,000, $6,572,310 of which was due to Decedent's estate as undistributed income earned by the QTIP trust during Decedent's lifetime.

Other developments in Private Tax

Estate of Kalikow v. Commissioner, T.C. Memo. 2023-21 (February 28, 2023) (cont.)

- Facts (cont.)
  - Pursuant to a decree dated September 18, 2007, the Surrogate's Court awarded the trustees of the QTIP trust permanent limited letters of administration for the purposes of filing, supplementing and defending any audit and/or any judicial tax proceeding relating to that portion of Decedent's estate tax return concerning the QTIP trust. The decree ordered the trustees and the executors of Decedent's estate to exchange copies of executed estate tax returns. The executors filed the estate's estate tax return with a statement that the return was made in respect of all assets of the estate other than Decedent's interest in the QTIP trust. On Schedule F, the executors listed total "other miscellaneous property" of $31,869,441, including undistributed income due from the QTIP trust of $4,632,489.
  - The limited administrators (i.e., the trustees of the QTIP trust) prepared on the estate's behalf a separate estate tax return which incorporated the estate's assets and deductions as included on the executors' estate tax return and also included the QTIP trust assets. More particularly, Schedule F incorporated the $31,869,441 of assets (including the $4,632,489 claim for undistributed income from the QTIP trust) as reported on the executors' estate tax return and also reported $43,300,000 of QTIP trust assets, made up of a 98.5% limited FLP interest, with a reported value of $42,465,000, and cash and marketable securities of $835,000. In a statement attached to the estate tax return, however, the limited administrators noted that they disputed any claim by the executors for amounts due from the QTIP trust as having no merit.
  - In the notice of deficiency, the IRS determined, among other things, that the value of the QTIP trust's 98.5% limited partnership interest in the FLP was $105,664,857 instead of $42,465,000 as reported on the limited administrators' estate tax return. The IRS also reduced the estate's Schedule F assets by the $4,632,489 value of the estate's pending claim against the QTIP trust, as originally reported on the executors' Schedule F and as incorporated in the estate's assets reported on the limited administrators' Schedule F.

Other developments in Private Tax

Estate of Kalikow v. Commissioner, T.C. Memo. 2023-21 (February 28, 2023) (cont.)

- Holding
  - The Tax Court determined the value of Decedent's estate's claim for undistributed income did not reduce the value of the FLP interest included in the decedent's estate because the liability for the agreed upon settlement was not a liability of the FLP?
- Reasoning
  - IRC Section 2044
    - In general, IRC Section 2044 includes in a decedent's estate assets of a QTIP trust created for the benefit of a surviving spouse. Pursuant to section 2044, Decedent's gross estate included the QTIP trust assets of $55,327,712 ($54,492,712 limited partnership interest and $835,000 of cash and marketable securities). However, the limited administrators argued that the value of the FLP interest should be reduced by the claim the of Decedent's estate for undistributed income ($6,572,310).
    - The limited administrators asserted that the inclusion of the undistributed amount in Decedent's estate will result in an equivalent increased charitable contribution deduction to the estate and the failure to reduce the value of the QTIP trust's assets by the same amount would result in double taxation effectively imposing estate tax on the bequest to the charity. The Tax Court found the argument without merit determining that the inclusion of the QTIP assets in Decedent's gross estate will give rise to neither double taxation nor estate tax on any charitable bequest but rather will merely give effect to the provisions of IRC Section 2044.

Other developments in Private Tax

Estate of Kalikow v. Commissioner, T.C. Memo. 2023-21 (February 28, 2023) (cont.)

- Reasoning (cont.)
  - IRC Section 2053
    - As an alternative to the double taxation argument, the limited administrators argued that the settlement payment relating to the undistributed income claim is an administrative expense deductible under IRC Section 2053 as well as the other components of the settlement agreement. The Tax Court began its discussion by noting that the parties devoted much of their arguments to the question of whether the various components of the agreed-upon settlement payment meet the limitations on deductibility as set forth in the regulations under IRC Section 2053. The court then noted that these arguments were misdirected determining that the limitations on deductibility in the regulations do not apply with respect to claims in favor of the estate the are includible in the decedent's gross estate under IRC Section 2031. The obligation of the QTIP trust to make the settlement payment to the estate does not give rise to any deduction by the estate. Rather, the estate's claim against the QTIP trust is itself, property to be included in the gross estate. The court determined that even if it were to assume that the estate actually incurred the fees and commissions specified as components of the agreed-upon settlement payment, reimbursement of these expenses under the settlement agreement would preclude any deduction by the estate.

Other developments in Private Tax

Estate of Block v. Commissioner, T.C. Memo 2023-30 (March 13, 2023)

- Facts
  - Prior to her death on October 21, 2015, the decedent created a revocable trust and executed a will in which she left her remaining estate to her revocable trust. One of the provisions of the revocable trust created a subtrust that was intended to meet the requirements of a charitable remainder annuity trust (CRAT), as such trust is defined in IRC Section 664.
  - Under the provisions of the subtrust, it was to be created upon the decedent's death, with the annuity to be paid to the decedent's sister and then to the sister's husband if he should survive her. Upon the death of the later of the sister or the sister's husband, the remainder of the subtrust was to be paid to a public charity eligible for the estate tax charitable deduction pursuant to IRC Section 2055. The provisions of the subtrust stated that the decedent's sister was to be paid an annual amount equal to the greater of: (a) all net income or (b) the sum of $50,000. The subtrust provisions further stated that the trust was irrevocable but that the trustees could amend it for the sole purpose of making sure the subtrust met the requirements of IRC Section 664. However, the trustees could not change the annuity period, the annuity amount, or the charity.
  - The estate timely filed its federal estate tax return on July 21, 2016, taking an estate tax charitable deduction for the remainder interest in the subtrust going to the charity.
  - The IRS initiated an examination of the decedent's estate tax return in August 2017 and issued a notice of deficiency disallowing the charitable deduction, determining that the subtrust did not satisfy the requirements of a CRAT under IRC Section 664 because the annuity amount was not a specified amount but the greater of: (a) all net income or (b) $50,000.
  - After issuance of the notice of deficiency, the trustees of the subtrust amended its provisions to provide that the annuity amount was fixed at $50,000 (excluding any reference to the income of the subtrust), making the amendment effective as of the date of the decedent's death. The IRS continued to disallow the deduction.

Other developments in Private Tax

Estate of Block v. Commissioner, T.C. Memo 2023-30 (March 13, 2023)

- Issue
  - Whether the terms of a CRAT preclude an estate's claim for a deduction under IRC Section 2055(a)?
- Holding
  - Tax Court held that an estate was not entitled to a charitable deduction under IRC Section 2055 from the value of the gross estate for the transfer of a remainder interest in a trust, finding that the trust did not qualify as a CRAT and the trustees did not effect a qualified judicial reformation of the trust.
- Reasoning
  - The Tax Court noted that the initial subtrust provisions did not meet the requirements of a CRAT because the annuity amount was not limited to a specific dollar amount. The court further determined that the judicial reformation provisions in IRC Section 2055 also did not apply because: (a) the amendment to the subtrust was executed sometime after August 17 – beyond the 90-day qualified reformation window, and (b) the amendment was not the result of a judicial proceeding.
- Implications
  - A CRAT annuity must be a certain sum.
  - Such glaring errors may only be fixed through a judicial proceeding.

Other developments in Private Tax

Connelly v. United States, 70 F.4th 412 (8th Cir. June 2, 2023)

- Facts
  - Michael and Thomas Connelly were brothers and the only shareholders in Crown C Corporation (Crown C), with Michael owning 385.90 shares (77.18%) and Thomas owning 114.10 shares (22.82%) of the outstanding shares of Crown C. To provide for a smooth transition of ownership of Crown C, the brothers and Crown C signed a stock purchase agreement (SPA). The SPA noted that, upon one brother's death, the surviving brother had the right to buy the decedent's shares, and, if the surviving brother did not purchase the decedent's share, Crown C was required to redeem or buy the shares. The brothers always intended that Crown C would redeem the deceased brother's shares.
  - The SPA provided two methods for calculating the price at which Crown C would redeem the shares. The primary method required the brothers to execute a new "Certificate of Agreed Value" at the end of every tax year which set the price per share by mutual agreement. In the event that the brothers failed to execute a Certificate of Agreed Value, the brothers would determine the price per share by securing two or more appraisals. The brothers never signed a Certificate of Agreed Value or obtained appraisals as required by the SPA. In order to fund its redemption obligation, Crown C purchased $3.5 million in life insurance policies for both brothers.
  - Michael passed away in 2013 and, as a result, Crown C received approximately $3.5 million in life insurance proceeds. Crown C redeemed Michael's shares for $3 million. The redemption price was determined pursuant to a larger post-death agreement between Thomas and Michael's son, Michael Connelly, Jr., to resolve estate administration matters. No appraisals were obtained in determining the redemption price.

Other developments in Private Tax

Connelly v. United States, 70 F.4th 412 (8th Cir. June 2, 2023) (cont.)

- Facts (cont.)
  - Thomas, as executor of Michael's estate, filed an estate tax return valuing Michael's Crown C shares at $3 million as of the date of Michael's death and included that amount in the taxable estate. Afterward, the IRS audited the estate, challenging the $3 million valuation of Michael's Crown C shares. The IRS determined that, as of October 1, 2013, the FMV of Crown C should have included the $3 million in life insurance proceeds used to redeem the shares, resulting in a higher value for Michael's Crown C shares than reported on the estate's return. The IRS issued a notice of deficiency, assessing over $1 million in additional estate taxes. Thomas paid the additional assessment of $1 million and filed suit in District Court for a refund.
  - The estate argued that the SPA determines the value of Crown C for estate tax purposes, so the District Court need not determine Crown C's FMV. The estate argued, alternatively, that Crown C's FMV does not include $3 million of the life insurance proceeds because the SPA created an offsetting $3 million obligation for Crown C to redeem Michael's shares. The IRS argued that the SPA fails to meet the requirements under the applicable authorities to control the valuation of Crown C, and that under applicable law and customary valuation principles, the life-insurance proceeds used to redeem Michael's shares increased Crown C's FMV by $3 million.
  - The District Court granted summary judgment to the IRS and concluded that: (1) the SPA did not control the valuation of the estate's shares, and (2) the FMV of Crown C must include the life insurance proceeds.
- Issues
  - Whether the SPA should be taken into account when valuing Crown C under IRC Section 2703(a)?
  - Whether a valuation of Crown C in accordance with IRC Sections 2042 and 2031 must include the life insurance proceeds without treating the obligation to redeem shares as an offsetting liability?

Other developments in Private Tax

Connelly v. United States, 70 F.4th 412 (8th Cir. June 2, 2023) (cont.)

- Holdings
  - No, the SPA should not be taken into account when valuing Crown C under IRC Section 2703 because the SPA did not provide a fixed formula for arriving at a valuation.
  - Yes, a valuation of Crown C in accordance with IRC Sections 2402 and 2031 must include the life insurance proceeds without treating the obligation to redeem shares as an offsetting liability.
- Reasoning
  - The Eighth Circuit first considered whether the SPA controlled the valuation of Crown C. In doing so, it considered whether it should be respected or disregarded under the principals of IRC Section 2703. IRC Section 2703(a) states that the FMV of an interest in a company is determined without regard to a buy-sell agreement. However, IRC Section 2703(b) provides and exception to IRC Section 2703(a) if the agreement: (a) is a bona fide business arrangement; (b) is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth; and (c) is comparable to similar agreements entered into by persons in an arm's length transaction.
  - The Eighth Circuit noted that the estate argued that the SPA should be respected, as it satisfied the requirements of IRC Section 2703(b). The court disagreed, noting that the SPA did not contain a fixed or determinable price to measure the value of the estate's shares because the brothers and Crown C did not comply with the SPA's valuation methods in determining the FMV of Crown C. The court reasoned that, even if they had complied with the SPA, it fixed no price nor prescribed a formula for arriving at a price – it merely laid out two methods by which the brothers might agree on price. Because the SPA contained no fixed or determinable price, the requirements of IRC Section 2703(b) could not be satisfied, and the SPA could not set the price of the estate's shares for estate tax purposes.

Other developments in Private Tax

Connelly v. United States, 70 F.4th 412 (8th Cir. June 2, 2023) (cont.)

- Reasoning (cont.)
  - The Eighth Circuit next considered the FMV of Crown C at Michael's death, with the key consideration of whether the $3.5 million in insurance proceeds Crown C received upon Michael's death should be considered. The court determined, and the parties agreed, that the issue before the court presented the same issue that the Eleventh Circuit addressed in *Estate of Blount v Commissioner*, 428 F.3d 1338 (11th Cir. October 31, 2005); however, the parties disagreed on whether *Blount* was correctly decided. The Eighth Circuit determined that the Eleventh Circuit's analysis in *Blount* was flawed because a company's obligation to redeem its shares is not a liability "in the ordinary business sense." The court reasoned that in order for a willing buyer to own Crown C outright at the time of Michael's death, the willing buyer must obtain all its shares. At that point, the court determined, that the willing buyer could extinguish the SPA or redeem the shares from himself. The court opined that such a transaction was simply moving money around, as the willing buyer controlled the life insurance; therefore, there was no liability to be considered. The court concluded that a willing buyer, therefore, would pay for Crown C taking into consideration the life insurance proceeds.

Other developments in Private Tax
Advice Memorandum 2023-006 (August 18, 2023)

- The IRS addressed promotional materials circulated online describing non-grantor, irrevocable, complex, discretionary spendthrift trust structure as a way to defer or eliminate federal income taxes and protect assets from creditors and explains why the structure doesn't provide the claimed benefit.
- The advice describes the basic form and mechanics of the structure, referring to it as a self-styled spendthrift trust in which the taxpayer sells assets to the trust in exchange for a promissory note. Certain materials claim the sale of assets to the trust is a nontaxable events.
- Promotional materials also claim that almost none of the income generated by the trust is subject to current federal income tax if the trustee allocates income to corpus and refrains from making distributions to beneficiaries. Additionally, the materials claim that the trustee may characterize any remaining trust income as an "extraordinary dividend" also not subject to taxation if the trustee allocates such income to corpus.
- IRS concluded that contrary to the claims of the promoters, the trust will recognize income on its capital gains and dividends except to the extent those amounts are distributed or deemed to be distributed to its beneficiaries.

Other developments in Private Tax

Other cases and rulings on estate and gift

- Priv. Ltr. Rul. 2023-01-001 (October 7, 2022
  - The IRS ruled that the proposed transfer of trust assets to a successor trust will not cause either trust to lose its exempt status for generation-skipping transfer tax purposes and that the value of property subject to each named beneficiary's power of appointment will be includable in the beneficiary's gross estate under IRC Section 2041(a)(2)
- Priv. Ltr. Rul. 2023-03-012 (October 18, 2022)
  - The IRS ruled that a proposed division of a trust won't cause the trust or resulting trusts to become subject to the generation-skipping transfer tax and won't result in the recognition of income, gain, or loss from a disposition of property, cause trust assets to be includable in any beneficiaries' gross estate or constitute a transfer subject to the federal gift tax.
- *Richard J. O'Neill Trust v. Commissioner*, T.C. Memo. 2022-108 (October 27, 2022)
  - The Tax Court, granting the IRS partial summary judgment in a trust's challenge to a $1.5 million deficiency determination stemming from a tentative refund claim, held that the trust was not entitled to a refund under a claim of right, under the mitigation provisions in IRC Sections 1311 through 1314, or under the theory of equitable recoupment.
- *United States v. Estate of Parks*, Docket No. 2:21-cv-12676 (E.D. Mich. November 18, 2022)
  - A US District Court held that an estate could make a valid special use valuation election under IRC Section 2032A on Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*, filed five years after the decedent's death, if it was the first filed estate tax return. The court relied on Temp. Regs. Section 22.0, which expressly states that the election can be made on a late-filed estate tax return.

Other developments in Private Tax

Other cases and rulings on estate and gift

- Priv. Ltr. Rul. 2022-39-006 (July 1, 2022)
  - The IRS granted an estate consent to revoke its IRC Section 643(e)(3) election after the estate's return preparer realized that the intended effect of the election had not occurred because of the prohibition against deductions in transactions between related taxpayers under IRC Section 267.
- Priv. Ltr. Rul. 2022-39-004 (July 1, 2022)
  - The IRS ruled that the proposed modification of a trust regarding shares created for the benefit of a beneficiary will not cause the trust to lose its exempt status for GST tax purposes, and the distribution from or termination of any interest in the trust will not be subject to GST tax.
- Priv. Ltr. Rul. 2022-44-003 (August 11, 2022)
  - The IRS ruled that the rules of IRC Section 2632(c) caused the unused portion of a decedent's available GST tax exemption to be automatically allocated to a trust.
- Priv. Ltr. Rul. 2022-33-002 (August 19, 2022)
  - The IRS granted an estate an extension to allocate enough of a donor's remaining GST tax exemption to cause the CRAT for the benefit of her grandson to have an inclusion ratio of zero and to allocate any remaining GST exemption to the CRATs of her son and daughter.

Other developments in Private Tax
Other cases and rulings on estate and gift

- *Estate of MacElhenny v. Commissioner*, T.C. Memo 2023-033 (March 15, 2023)
  - The Tax Court denied an estate tax deduction under IRC Section 2503 for claims against a decedent that his children had repaid and had assigned to themselves. The court noted that tort or contract claims against an estate are deductible only if they are bona fide claims contradicted for an adequate and full consideration in money or money's worth. They cannot be founded on donative transfers. Once the decedent's children settled the debts with the banks, the decedent was no longer legally obligated to pay the banks, and the deductible claim ceased to exist. Assigning the judgments to themselves did not change this.
- Priv. Ltr. Rul. 202313006 (March 31, 2023)
  - The IRS determined that a settlement agreement setting forth the provisions under which a Trust was terminated (1) did not cause the Trust to lose its GST tax-exempt status; (2) did not cause any beneficiary to be treated as having made a taxable gift to another beneficiary; (3) did not result in recognition of gain or loss to any Trust beneficiary; and (4) did not result in the receipt of gross income under IRC Section 61 by any Trust beneficiary.
- *Stanojevich v. Commissioner*, 160 T.C. No. 7 (April 10, 2023)
  - The trustee filed frivolous Forms 1041 for a grantor trust, each reporting that the trust was entitled to a refund for overpayment of withheld tax. The Forms 1041 included false Forms 1099. The IRS assessed a $5,000 penalty under IRC Section 6702(a) against the trustee for each tax year a frivolous return was filed. The trustee is liable under IRC Section 6702 because IRC Section 6702 applies to any *person* who files a frivolous return.

Other developments in Private Tax
Other cases and rulings on estate and gift

- *Gerhardt v. Commissioner*, 160 T.C. No. 9 (April 20, 2023)
  - The taxpayers contributed high-value, low-basis real estate to CRATs. The CRATs sold the property and purchased 5-year single premium immediate annuities (SPIA) naming taxpayers as the recipients with the proceeds of the sale. The terms of the CRATs required that the CRAT pay an annuity amount to taxpayers equal to the greater of 10% of the initial FMV of the property transferred to the CRAT or the payments received from one or more SPIA purchased by the trustee. The taxpayers took the position that the annuity payments received from the SPIA were not income. The Tax Court held that the annuity payments were distributions from the CRATs and taxable as ordinary income.

Partnerships and S corporations

Other developments in Private Tax
Other cases and rulings on partnerships and S corporations

- Rev. Proc. 2022-19 (October 11, 2022)
  - The IRS has issued guidance providing taxpayer assistance procedures to allow S corporations and their shareholders to resolve frequently encountered issues with certainty and without requesting a private letter ruling.
- *Starer v. Commissioner,* T.C. Memo. 2022-124 (December 21, 2022)
  - The Tax Court held that the tax liabilities of an S corporation pass through to its controlling shareholders, that loans should be treated as property sales, that some property transfers were constructive distributions, that the shareholders received constructive dividends through the rent-free use of a home, that a bad debt deduction wasn't allowed, and accuracy-related penalties do not apply.
- *ES NPA Holding, LLC v. Commissioner,* T.C. Memo 2023-55 (May 3, 2023)
  - The Tax Court held, among other things, that Revenue Procedure 93-27 applies to a partnership's indirect receipt of a partnership interest, which is a profits interest and thus excludable from income. As such, the partnership did not have unreported income and was not liable for accuracy-related penalties under IRC Section 6662.

Cross-border

Other developments

Farhy v. Commissioner, 160 T.C. No. 6 (April 3, 2023)

- Facts
  - Taxpayer owned two foreign corporations in Belize during tax years 2003–2010. The parties stipulated that the Taxpayer participated in an illegal scheme at that time to reduce the income tax he owed. In 2012, he was granted immunity from prosecution. During the years at issue, the taxpayer willfully and without reasonable cause, failed to file Forms 5471.
  - In 2018, the IRS assessed an initial penalty under IRC Section 6038(b)(1) of $10,000 for the delinquent Forms 5471 for each year at issue and continuation penalties under IRC Section 6038(b)(2) totaling $50,000 for each year at issue. In 2019, the IRS attempted to collect the penalties through a levy notice. This case arises from the taxpayer's petition to review the IRS's collection action under the Collection Due Process procedures in the Tax Court.
  - Arguments of the parties:
    - The Taxpayer and the IRS agreed on all of the relevant facts and submitted the case to the Court to decide the only issue in dispute: whether the IRS had statutory authority to assess penalties under IRC Section 6038(b).
    - The Taxpayer argued that the IRS could not assess the penalty because no statutory provision in the Code or otherwise authorizes the IRS to assess IRC Section 6038(b) penalties. While IRC Section 6201 expressly allows the IRS to assess "assessable penalties," the Code does not expressly specify that IRC Section 6038 is an assessable penalty; therefore, Congress did not authorize the IRS to assess it.
    - The IRS argued that (1) "assessable penalties" should be read broadly to include any penalties in the Code that are not subject to the Code's deficiency procedures; (2) "taxes" in IRC Section 6201 is broad enough to encompass IRC Section 6038 penalties; and (3) legislative history supports the IRS's position.

Other developments

Farhy v. Commissioner, 160 T.C. No. 6 (April 3, 2023) (cont.)

- Ruling
  - The Tax Court rejected the IRS's arguments, concluding that "Congress has explicitly authorized assessment with respect to myriad penalty provisions in the Code, but not for [IRC S]ection 6038(b) penalties." The court went on to say "we are loath to disturb this well-established statutory framework by inferring the power to administratively assess and collect the [IRC S]ection 6038(b) penalties when Congress did not see fit to grant that power to the Secretary of the Treasury expressly as it did for other penalties in the Code."
- Implications
  - The decision of the Tax Court, if unchanged on appeal, would broadly undermine the IRS's current practices for assessing and collecting penalties under IRC Section 6038.
    - The Tax Court suggests in its decision that the IRS pursue such penalties through civil action under 28 USC. Section 2461(a).
    - Without a court decision imposing the penalties, the IRS's administrative determination, standing alone, would be insufficient to impose any payment obligation on taxpayers for the penalty under IRC Section 6038. Similar reasoning may apply to other penalties in the Code that are not specifically identified as assessable.
  - While the Tax Court's decision remains subject to appeal and only addresses IRC Section 6038, taxpayers who have paid penalties under IRC section 6038 (or similar penalty provisions not specifically identified as assessable penalties) based only upon the IRS's assertion of such penalties may consider whether a timely refund claim or other action is warranted in light of the Tax Court's decision. Timely refund claims may be appropriately filed on a protective basis while awaiting the resolution of any appeal or other action required for the Tax Court's decision to become final.

Other developments

Bittner v. United States, 598 US 85, 143 S. Ct. 713, 215 L. Ed. 2d 1 (2023)

- On February 28, 2023, the U.S. Supreme Court held in *Bittner v. United States* that the $10,000 penalty for nonwillful failure to file foreign bank and financial account (FBAR) reports imposed under 31 USC Section 5321 applies per annual report/filing, not per account.
- The 5-4 decision rejected the government's argument that the nonwillful penalty applies on a per-account basis and resolves divergent positions held by two appellate courts.
- The Court did not address, except by way of dicta, the more serious penalty for willful failure to file.
- In *Bittner*, the Fifth Circuit held that a separate violation had occurred for each foreign account not timely reported on an FBAR and imposed a penalty of $2.72 million over five years.
  - The filer argued the penalty should apply on a per-report basis, which would reduce the penalty to $50,000 (i.e., one $10,000 violation per year), consistent with the Ninth Circuit's decision in *United States v. Boyd*, 991 F. 3d 1077. In *Boyd*, the court held that the nonwillful penalty applies on a per-report basis, regardless of the number of unreported foreign accounts. The government did not question the completeness or accuracy of the final filings submitted by the defendant in either case. It asserted the nonwillful violation based on the number of accounts reported by the filer on his late filed FBAR.

Other developments

Bittner v. United States, 598 US 85, 143 S. Ct. 713, 215 L. Ed. 2d 1 (2023) (cont.)

- Although the Supreme Court decision is pro-filer for accidental or negligent failures to file, taxpayers nonetheless should bear in mind that the more severe willful penalty explicitly applies to each account by statute and that the government can assess the willful violation where it deems appropriate.
- The civil penalty for willful failure to report is the greater of $100,000 (adjusted for inflation) or 50% of the balance in the account at the time of the violation.
- The government has broad latitude to interpret when a violation is willful, particularly where it deems a taxpayer has exercised “willful blindness“ regarding an obligation to file. Courts have held that the failure to answer “yes“ to the question on a Form 1040 asking whether an FBAR is required is significant evidence of willfulness.
- Implications
  - Taxpayers who have failed to file complete and accurate prior year FBARs and who have not yet come into compliance should carefully consider options for filing, including the IRS’s Delinquent FBAR Submission Procedures and Streamlined Filing Compliance Procedures.
  - A strong nonwillful failure to file a statement included with such a filing is important to prevent potential challenges that a failure to file was willful.

Other developments

Other developments

Notice 2023-21

- In Notice 2023-21, the IRS changed the lookback period for calculating refunds and credits for taxpayers who delayed filing their tax returns under COVID-19-related relief. For purposes of the lookback period, the Notice disregards April 15, 2020, to July 15, 2020, and April 15, 2021, to May 17, 2021, to align the lookback periods with the postponed return filing due dates.
- Background
  - Under IRC Section 6511(a), a taxpayer must file a claim for a refund or credit within three years of filing a tax return or two years of paying the tax, whichever period expires later. Under IRC Section 6511(b)(2), the refund or credit is limited to the tax paid within the lookback period, which is three years plus any extension for filing the return. For calendar-year taxpayers, withheld and estimated income taxes are generally deemed paid on April 15 of each year.
  - Notice 2020-23 postponed until July 15, 2020, the deadline for most taxpayers with a filing or payment deadline falling on or after April 1, 2020, and before July 15, 2020 (see Tax Alert 2020-0961). Notice 2021-21 postponed until May 17, 2021, the deadline for filing and payments for Form 1040 series income tax returns that were due April 15, 2021 (see Tax Alert 2021-0671).

Other developments
Notice 2023-21 (cont.)

- New lookback period applies
  - Notice 2023-21 specifies that the filing dates were postponed, not extended. Therefore, the lookback period was not extended by Notice 2020-23 or 2021-21 and remained at three years unless a taxpayer secured an extension to file. Taxpayers who did not receive an extension, and did not pay their taxes before April 15, 2020, or April 15, 2021, as applicable, would only have three years from those dates to claim their refunds, not from the date they filed the return.
  - Under Notice 2023-21, the IRS is disregarding the periods from April 15, 2020, to July 15, 2020, and April 15, 2021, to May 17, 2021, in determining the beginning of the lookback period for claiming refunds or credits under IRC Section 6511(b)(2)(A). This will allow affected taxpayers to claim the refunds or credits by three years after the later dates. The IRS gave an example in the notice to illustrate how the calculation works with the new lookback period.
- Implications
  - Many taxpayers were not aware of the potential disconnect created by the postponement of payment deadlines for tax years 2019 and 2020. The IRS's decision to disregard the postponement periods will avert confusion and benefit affected taxpayers who still have refund claims.

Charitable contributions

Charitable contributions
Proposed regulations

- The IRS has issued proposed regulations (REG-106134-22 (December 6, 2022)) identifying certain syndicated conservation easement transactions as listed transactions. Material advisers and certain participants in these transactions must file disclosures with the IRS. The new guidance proposes to exclude qualified organizations from being treated as participants or parties to a prohibited tax shelter transaction subject to excise tax but also requests comments on whether this exclusion should carry over to the final regulations. Comments are due by February 6, and a public hearing is scheduled for March 1, 2023.

Charitable contributions
Other cases and rulings

- *Champions Retreat Golf Founders LLC v. Commissioner,* T.C. Memo. 2022-106 (October 17, 2022)
  - The Tax Court supplemented a prior opinion after an Eleventh Circuit remand to determine the amount a partnership could deduct for the donation of a conservation easement on a golf course and held that the value of the easement was $7.8 million, finding that while the partnership's expert valuation was too high, the easement value was not de minimis as the IRS expert concluded.
- *Schweizer v. Commissioner,* T.C. Memo. 2022-102 (October 6, 2022)
  - The Tax Court sustained the IRS's disallowance of an art dealer's charitable contribution deduction for a sculpture he donated to a museum because he failed to satisfy the substantiation requirements in IRC Section 170(f)(11) by attaching a completed Form 8283 or a qualified appraisal to his return, finding that he did not have reasonable cause for the failure.

Other developments in Private Tax
Other cases and rulings on charitable contributions

- *GBX Associates LLC v. United States*, Docket No. 1:22-cv-00401 (N.D. Oh. November 14, 2022)
  - A District Court held that Notice 2017-10 requiring the reporting of conservation easement transactions is unlawful based on the Sixth Circuit's decision in Mann Construction Inc. v. United States but limited relief to the real estate developer challenging the notice, finding that setting aside the notice in whole might inhibit other courts from addressing its validity.
- *Brooks v. Commissioner*, T.C. Memo. 2022-122 (December 19, 2022)
  - The Tax Court, sustaining gross valuation misstatement penalties, held that the IRS properly disallowed a charitable contribution deduction for a conservation easement donation, finding that the easement deed did not meet the contemporaneous written acknowledgment requirement in IRC Section 170(f)(8), and the requirements in Treas. Reg. Sections 1.170A-14(g)(5) and 1.170A-13(c) were not met.
- *Lim v. Commissioner*, T.C. Memo. 2023-11 (January 23, 2023)
  - The Tax Court, granting partial summary judgment to the IRS, held that a couple claiming charitable donation deductions failed to show they in fact made the donations and they failed to satisfy the substantiation requirements, including those related to qualified appraisals, but the court allowed the couple to pursue their reasonable cause defense.

Other developments in Private Tax
Other cases and rulings on charitable contributions

- *Green Valley Investors LLC v. Commissioner*, Docket No. 17379-19 (T.C. January 23, 2023)
  - The Tax Court denied the IRS's motion for reconsideration of its decision that held Notice 2017-10 invalid, finding that reconsideration is inappropriate because the court considered the arguments the IRS made in its motion and supplement and the court is not required to address every argument raised by a party.
- *Green Rock LLC v. IRS*, Docket No. 2:21-cv-01320 (N.D. Ala. February 2, 2023)
  - A District Court granted a material adviser summary judgment in its suit to set aside Notice 2017-10, which requires disclosure of syndicated conservation easement transactions to the IRS as listed transactions, finding that the notice was passed without using notice-and-comment rulemaking as required by the Administrative Procedure Act.
- *Seabrook Property LLC v. Commissioner*, Docket No. 5071-21 (T.C. February 8, 2023)
  - The Tax Court granted a partnership partial summary judgment in a conservation easement case, finding that penalties cannot be imposed on the partnership under IRC Section 6662A because Notice 2017-10 that identified conservation easement transactions as listed transactions is invalid and rejecting the IRS's claim that the court's decision invalidating the notice was erroneous.

Other developments in Private Tax

Other cases and rulings on charitable contributions

- *Cattail Holdings LLC v. Commissioner*, T.C. Memo. 2023-17 (February 14, 2023)
  - The Tax Court denied the IRS summary judgment on the issue of whether a conservation easement was protected in perpetuity under IRC Section 170(h)(5) in a partnership's case challenging the disallowance of a conservation easement deduction and imposition of penalties but held that the IRS complied with the supervisory penalty approval requirements in IRC Section 6751(b)(1).
- *Estate of Heonsheid v. Commissioner*, T.C. Memo 2023-34 (Mar. 15, 2023)
  - The Tax Court held that the donors made a valid gift of appreciated stock in a closely held corporation to a charitable organization that administered donor-advised funds, the gift was an assignment of income, and the charitable deduction failed because taxpayers did not meet IRC Section 170(f)'s qualified appraisal requirement for substantiation.

IRC Section 501(c)(3) and 501(c)(4) organizations

IRC Section 501(c)(3) and 501(c)(4) organizations

GLAM AB 2023-004

- In generic legal advice memorandum (GLAM) AB 2023-004, the IRS asserted that many nonprofit organizations that develop name, image, and likeness (NIL) collectives do not qualify as tax-exempt organizations under IRC Section 501(c)(3) because they more than incidentally further the private interests of student-athletes.
  - Background
    - In 2021, a college-level athletic organization adopted a policy allowing student-athletes to be compensated for use of their NIL without impacting their eligibility.
    - "NIL collectives" were established by boosters and fans of university athletic programs to develop, fund or otherwise facilitate NIL deals for student-athletes.
      - Some NIL collectives were formed as nonprofit entities and were granted tax-exempt status under IRC Section 501(c)(3).
      - Other NIL collectives were established through a fiscal sponsorship agreement or as an activity or program of an existing IRC Section 501(c)(3) organization.
    - Nonprofit NIL collectives pool contributions, identify and partner with charities to develop paid NIL opportunities for student-athletes and compensate the student-athletes in exchange for their NIL.
      - The paid NIL opportunities typically include having the student-athletes promote the collective or a partner charity through social media, attend fundraising events, autograph memorabilia for the collective or a partner charity to sell, or participate in or lead sports camps.

IRC Section 501(c)(3) and 501(c)(4) organizations

GLAM AB 2023-004 (cont.)

- Background (cont.))
  - According to the IRS, nonprofit NIL collectives often serve two stated purposes: “(1) to raise awareness and to support the mission of the nonprofit NIL collective or of its charitable partners and (2) to compensate student-athletes for use of their NIL in the collective’s activities.“
- Law
  - To qualify for tax-exempt status as an organization described in IRC Section 501(c)(3), an entity must be organized and operated exclusively for exempt purposes, which may be charitable, scientific or educational. Further, an entity must establish that it is not organized or operated to serve private interests (Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii)).
  - Under Treas. Reg. Section 1.501(c)(3)-1(c)(1), an organization is considered to operate exclusively for one or more exempt purposes only if it engages primarily, and not insubstantially, in activities that accomplish one or more of the exempt purposes specified in IRC Section 501(c)(3).
  - Under the operational test, a private benefit will not preclude an organization from exemption under IRC Section 501(c)(3) if the private benefit “is incidental in both a qualitative and quantitative sense.“
    - To be qualitatively incidental, the private benefit must be a “byproduct of the exempt activity or a necessary concomitant to the accomplishment of the exempt purpose.“ A private benefit is not qualitatively incidental to exempt purposes when its activities result in a direct benefit to designated or identifiable individuals. To be quantitatively incidental, the private benefit must be insubstantial when compared to the overall public benefit resulting from the activity.

IRC Section 501(c)(3) and 501(c)(4) organizations
GLAM AB 2023-004 (cont.)

- Analysis and conclusion
  - The IRS concluded that for many nonprofit NIL collectives, the benefit to private interests of student-athletes is more than incidental, both qualitatively and quantitively, to the collectives’ tax-exempt purposes. Therefore, the NIL collectives do not qualify for tax exemption under IRC Section 501(c)(3).
  - The IRS based its conclusion on the following facts:
    - Compensation to student-athletes is a fundamental part and the primary purpose of many nonprofit NIL collectives’ activities, not a byproduct and, therefore, is not qualitatively incidental to those NIL collectives’ exempt purposes.
    - The private benefit to student-athletes is not quantitively incidental because it is substantial compared to the overall public benefit from the collectives’ activities.
    - The private benefit to student-athletes is not a necessary concomitant to the nonprofit NIL collectives’ exempt purpose of promoting themselves or their partner charities.
    - Nonprofit NIL collectives often benefit student-athletes in ways beyond compensation, such as by working out deals with partner charities and providing services such as financial planning, tax assistance, legal advice and personal brand development.
    - Student-athletes that benefit from the nonprofit NIL collectives are not a recognized charitable class.
    - The IRS noted in the GLAM that it may reconsider the exempt status of NIL collectives that have already applied for and received favorable IRC Section 501(c)(3) determination letters. The IRS, however, may be able to grant relief to those organizations under IRC Section 7805(b) to limit the retroactive effect of any revocations of their tax exemption.

IRC Section 501(c)(3) and 501(c)(4) organizations
GLAM AB 2023-004 (cont.)

- Implications
  - Although the GLAM is not an official IRS ruling and, therefore, cannot be used as precedent, it does reflect the IRS's current perspective on NIL collectives, so it helps predict the IRS's future actions regarding the exempt status of NIL collectives.
  - Accordingly, it is crucial for existing tax-exempt NIL collectives, higher education organizations and athletic boosters that are considering establishing tax-exempt NIL collectives to carefully review the GLAM and take steps to avoid generating more than incidental private benefit to student-athletes. The GLAM leaves open the possibility that an NIL collective could be structured to avoid prohibited private benefit and obtain or retain exemption under IRC Section 501(c)(3) but does not specify how it could do so.
  - As a result of this GLAM, the IRS may examine and revoke the tax exemption of some NIL collectives and may deny pending applications for exemption of others. The GLAM could also have implications for donors to NIL collectives, who would not qualify to take an IRC Section 170 charitable deduction for a contribution to an NIL collective after its exemption has been revoked or its application for exemption denied by the IRS.
  - The GLAM does not address possible unrelated business taxable income (UBTI) implications of NIL collectives, higher education organizations or booster clubs that receive contribution income for programs that promote NIL opportunities for student-athletes. Presumably, that contribution income would be UBTI if any exempt purpose furthered by the NIL activity were secondary and incidental to its nonexempt purpose of benefitting student-athletes, suggesting that the activity is not substantially related to exempt purposes.

IRC Section 501(c)(3) and 501(c)(4) organizations
Recent PLRs revoking/denying tax-exempt status

- The IRS revoked tax exemptions in recent rulings and declined to issue exempt status in another ruling:
  - Priv. Ltr. Rul. 2023-21-005 (May 26, 2023).
    - The IRS revoked the IRC Section 501(c)(3) tax-exempt status of an organization that operated a coffee shop on the grounds that it was operated similarly to a for-profit organization. According to the IRS, the organization was granted tax-exempt status based on its claims that it would provide in-house training programs and employment opportunities for a certain population to enable it to reintegrate back into society. The IRS found, among other factors, that (1) the organization's emphasis was on profits and it only gave a small percentage of actual assistance to the targeted population it said it was trying to help; (2) the organization had no records of assisting the targeted population and no programs to reintroduce it into society; and (3) the internal controls of the organization were inadequate (e.g., the founder/executive director was in charge of opening the organization's mail, making deposits, and writing and signing checks).
    - In revoking the tax-exempt status, the IRS said the organization was operating similarly to a for-profit organization because (1) its primary purpose was carrying on a trade or business that does not further charitable purposes; (2) it was operated for the substantial commercial purpose of selling to the public; and (3) the income, expenses and time spent on the activities that were unrelated to the exempt purpose were substantial.

IRC Section 501(c)(3) and 501(c)(4) organizations
Recent PLRs revoking/denying tax-exempt status

- Priv. Ltr. Rul. 2023-21-013 (May 26, 2023)
  - In PLR 202321013, the IRS revoked the IRC Section 501(c)(3) tax-exempt status of an organization that was organized and initially operated to provide underprivileged youth the opportunity to participate in sports activities but had sold its operations to a for-profit organization. The IRS revoked the organization's exemption on the grounds that it failed the operational test after ceasing its activities. The IRS noted that the organization never engaged in any substantial activity that accomplished one or more exempt purposes after selling its operations to the for-profit organization.
- Priv. Ltr. Rul. 2023-21-016 (May 26, 2023)
  - In Priv. Ltr. Rul. 2023-21-016, the IRS denied an organization's Form 1023-EZ application for recognition of IRC Section 501(c)(3) tax-exempt status. The organization partnered with an insurance provider to provide benefits to its members and assisted members in career development. The IRS denied the application on the grounds that the organization was operated for the substantial non-exempt purpose of serving the private interests of its members.
  - The organization claimed that its primary purpose was to partner with an insurance provider to assist the organization's members (all from a specific industry) in gaining access to medical, dental, disability and life insurance at affordable group rates, as well as free financial-planning advice. The organization also assisted members in career development and promotion by providing electronic press kits, webinars and travel discounts. Anyone in the organization's industry could become a member. The organization is supported solely by membership dues.
  - In denying tax-exempt status, the IRS determined that the organization did not meet the operational test because it was not operating exclusively for tax-exempt purposes. Rather, the IRS concluded that a substantial part of the organization's activities furthered the private business interests of members. "Your organization is a vehicle for advancing the personal careers of your members," according to the IRS. "This is a substantial non-exempt purpose that will destroy exemption regardless of the number and importance of any truly exempt purposes."

IRC Section 501(c)(3) and 501(c)(4) organizations

Recent PLRs revoking/denying tax-exempt status

- Priv. Ltr. Rul. 2023-21-009 (May 26, 2023).
  - The IRS revoked the IRC Section 501(c)(4) tax-exempt status of an organization that operated a bar and game room on the grounds it did not exclusively promote social welfare. According to the IRS, the primary activity of the organization was operating a bar and game room for members of a related veterans' organization. All of the organization's revenue and expenditures were related to operating the bar, restaurant and gaming activities, which were open to the public and had paid employees.
  - In revoking the organization's tax-exempt status, the IRS noted that IRC Section IRC 501(c)(4) exempts civic leagues or organizations that are not organized for profit but operated exclusively for promoting social welfare. In contrast, the IRS explained that the primary activities of the organization were operating a bar and gaming room for members of a related exempt organization, and that its business was carried out in a manner similar to organizations operated for profit. Therefore, the organization did not exclusively promote social welfare.
- Implications
  - These IRS rulings demonstrate the importance of maintaining compliance with the organizational and operational tests under IRC Sections 501(c)(3) and (4) by making certain that an organization's activities are substantially related to its exempt purposes rather than substantially benefitting private interests.
  - Of note is Priv. Ltr. Rul. 2023-21-013, in which the organization was forced to change its activities due to special circumstances (presumably COVID-19). Even though the organization initially complied with the operational test, it went dormant after selling its operations to a for-profit organization, thereby failing the operational test for IRC Section 501(c)(3) tax exemption. As this and the other revocations have shown, it is important for organizations to maintain at least some level of tax-exempt activity, which could include board/committee/officer meetings to plan activities in the near future, rather than ceasing exempt activity for even a short period.

IRC Section 501(c)(3) and 501(c)(4) organizations

Other cases and rulings

- Priv. Ltr. Rul. 202302014 (January 13, 2023)
  - The IRS approved a PF's request to establish a "set-aside" under IRC Section 4942(g)(2) so that funds the foundation retains to spend on a future construction renovation project will not be subject to the 30% excise tax on undistributed income under IRC Section 4942.
- Priv. Ltr. Rul. 2023-05-020 (February 2, 2023)
  - The IRS ruled that a one-time cash grant that a tax-exempt public charity anticipates receiving from a dissolving tax-exempt hospital will constitute an "unusual grant" and therefore will be excludible from the charity's public support calculation for purposes of determining whether the charity meets the public support test.
- Priv. Ltr. Rul. 2023-08-013 (February 24, 2023)
  - The IRS approved a PF's request to set aside funds under IRC Section 4942(g)(2) to allow the foundation to pay for construction work on an "as work is done" basis rather than by immediate payment.
- Priv. Ltr. Rul. 2023-18-021 (May 5, 2023)
  - The IRS determined that a health care sharing organization did not qualify as a tax-exempt organization under IRC Section 501(c)(3) because it offered benefits to any member who paid a fee and, thus, its operations were not exclusively charitable, but were conducted in a commercial manner.

IRC Section 501(c)(3) and 501(c)(4) organizations

Other cases and rulings

- Priv. Ltr. Rul. 202328004 (July 14, 2023)
  - Proposed transfer from exempt organization to “recipient foundation“ of substantially all of its assets, which won’t be out of current income and will be for no consideration, will qualify as a transfer of assets under IRC Section 507(b)(2) and won’t result in termination tax under IRC Section 507(c).
- Priv. Ltr. Rul. 202331004 (August 4, 2023)
  - The IRS determined that an organization that claimed it was an alternative to a traditional pharmacy benefit manager (PBM) did not qualify for tax-exempt status under IRC Section 501(c)(4) because it carried on a pharmacy administration business that competed with taxable PBMs, even though its purpose was, in part, to provide access to health benefits to uninsured and underinsured individuals. The IRS concluded that the organization did not operate exclusively for the promotion of social welfare and, therefore, did not qualify as tax-exempt under IRC Section 501(c)(4).

Questions

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