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IN A WORLD OF CHANGE, SOME THINGS REMAIN THE SAME: THE IRS' PERSISTENT PURSUIT OF WEALTH TRANSFER PLANNING

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IN A WORLD OF CHANGE, SOMETHINGS REMAIN THE SAME: IRS PERSISTENT PURSUIT OF TRANSFER TAX PLANNING

1. What's up, Congress?

   a. In legislation proposed in September 2021, Congress sought to make several changes to the estate and gift tax rules.

   b. Among the most significant proposed changes were:

      i. *Reduction of Gift and Estate Tax Exemption*. The proposal called for a reversion of the gift and estate tax exemption to 2017 levels ($5,000,000 per person (indexed for inflation). The effective date for this provision would be applicable to transfers after December 31, 2021.

      ii. *Disallowance of Valuation Discounts for Nonbusiness Assets*. The proposal called for the denial of valuation discounts (typically lack of control and lack of marketability) for all "nonbusiness assets". Nonbusiness assets are defined as passive assets that are held for the production of income and not used in the active conduct of a trade or business. This provision was stated to become effective for transfers after the date of enactment of the act.

      iii. *Changes to Rules for Grantor Trusts*. This provision called for all grantor trusts to be included in the gross estate of the deemed owner (typically the grantor). Additionally, sales between grantor trusts and their deemed owner would be treated as sales between the owner and a third party. These changes would apply only to future trusts and future transfers, after the date of enactment.

   c. Fortunately, none of these proposed changes survived in the Build Back Better bill.

   d. Sitting here today, there is presently no clamp down on grantor trusts, and the exemption amount remains a hefty $11.7 million per person. Of course, this high exemption amount is only temporary, expiring December 31, 2025, at which time the exemption amount reverts to $5 million indexed for inflation.

2. Ok, so Congress is doing nothing. What's going on at the IRS?

   a. The number of estate tax returns filed continues to decline. For fiscal year 2016, the total estate returns filed was 35,592. For fiscal year 2020, it dropped to 15,023.

   b. There has been a similar drop in gift tax returns filed. For fiscal year 2016, the number of returns filed was 249,302, compared to 158,095 returns for fiscal year 2020. Note: There were 239,618 gift tax returns filed for fiscal year 2019.

   i. Texas ranks 4th in the country with regard to the number of estate and gift tax returns filed each year.

c. Collections have likewise dropped. During the period 2005 through 2009, taxpayers reported $123 billion in estate taxes (collectively) and $13 billion in gift taxes. During the period 2015 through 2019, taxpayers reported only $98 billion in estate taxes and $8 billion in gift taxes.

   i. The exemption amount during fiscal years 2005 through 2009 was around $2 million. The exemption amount for fiscal years 2015 through 2019 was $5 million (jumping to $11 million during the last fiscal year).

d. Further, audit coverage has dropped. For fiscal years 2012 through 2017, the audit coverage rate ranged from 6-8% (i.e., 6 to 8 of every 100 returns were audited). For fiscal year 2018, audit coverage plummeted to 1.1%.

e. Although gift tax return audit coverage has always been low, i.e., less than 1%, but hit a new low in fiscal year 2018 at 0.2%.

f. The limited number of audits has caused the total amount of tax recommended by IRS Exam to correspondingly decrease. During fiscal year 2014, the IRS proposed additional estate tax and gift tax as a result of audit of $1.2 billion and $283 million, respectively. For fiscal year 2018, the amount of additional estate tax recommended by IRS Exam was $2 million for estate taxes and $0 for gift taxes.

g. Fiscal year 2020, however, showed a reversal of this audit coverage decline and perhaps the start of a new trend. The audit coverage rate for estate tax returns was 4%, while the coverage rate for gift tax returns was 0.8%. IRS proposed additional taxes also increased. For estate taxes, the IRS Exam proposed $383 million. For gift tax returns, IRS Exam proposed additional gift taxes for fiscal year 2020 of $272 million.

h. Interestingly, of the 1,454 estate tax audits during fiscal year 2020, all but 79 closed agreed. Of those unagreed, the amount in dispute was $169 million. Of the 1,259 gift tax audits, all but 98 closed agreed. Of those unagreed, the amount in dispute was $258 million.

i. IRS Workforce is also shrinking. For fiscal year 2020, the IRS had 75,773 employees, a decrease of 20% over the past 10 years. The decline in revenue agents is particularly sharp. During fiscal year 2011, the IRS had 13,969 auditors. For fiscal year 2020, the IRS employed only 8,346 auditors.

j. <u>Note</u>: There was an IRS moratorium on new examinations during most of 2020, and since March 2020, IRS examiners have been "working" from home, requiring special permission to go into IRS offices.

k. <u>Note</u>: There are a limited number of Appeals Officers that work transfer tax cases nationwide, which is estimated to be less than 10. The nearest Appeals Officer is located in Houston, Texas.

3. <u>Okay so the IRS may be slowly jumping back on the audit train. Any new administrative developments?</u>

a. Estate closing letters – the IRS is only "mostly" done.

i. An estate closing letter is a written communication from the IRS that confirms that the estate tax return has either been accepted as filed or after an adjustment to which the estate has agreed.

ii. In Chief Counsel Advice 202142010 (October 22, 2021), IRS Counsel addressed the question: Does the issuance of an estate closing letter (Letter 627) preclude the IRS from examining the estate tax return?

iii. The answer: No. In the facts of the Advice, the IRS had issued the Letter 627 prior to any audit. But the Advice notes that even if the IRS had previously audited the estate tax return, the issuance of the Letter 627 would not prevent the IRS from examining the estate tax return a second time, provided one of three criteria are met: (1) there is evidence of fraud, malfeasance, collusion, concealment or misrepresentation of material fact, (2) the closed case involved a clearly-defined, substantial error based on an established IRS position at the time of the examination, or (3) there are "other circumstances" indicating that a failure to reopen the case would be a serious administrative omission.

iv. With respect to "other circumstances," Rev. Proc. 2005-32 states that it includes items or transactions that present significant potential for abuse for which a limited examination was performed. For example, if the IRS conducted and closed an examination that was limited to one or more tax return items or transactions with significant potential for abuse, and the IRS later determines that other tax return items or transactions for the same taxpayer merit examination, the examination may be reopened.

v. <u>Note</u>: This Advice is consistent with the IRS' victory in *Estate of Sower v. Comm'r*, 149 T.C. No. 11 (September 11, 2017). In that case, the husband died in 2012 and reported his DSUE on Form 706. The IRS issued an estate closing letter. When the wife died in 2013, her estate claimed the husband's DSUE. As part of its audit of the wife's Form 706, the IRS also audited the Form 706 filed by the husband. Without determining a deficiency, the IRS reduced the amount of the husband's DSUE, which in turn increased the estate tax owed by wife's estate. The Tax Court held that the issuance of the estate closing letter did not prevent the IRS from auditing the husband's Form 706; the SOL did not apply to prevent the IRS' adjustments, which did not create an estate tax deficiency for the husband; and that the IRS was otherwise authorized to adjust the DSUE.

b. Keep your documents forever, but IRS says it is dumping its files.

i. The IRS has policy of retaining estate tax returns and associated gift tax returns for 75 years.

ii. This month, however, the IRS announced that it is reducing the retention period to 40 years.

iii. Taxpayers have until February 11, 2022, to submit requests for the older, soon-to-be-destroyed returns.

iv. Older returns could be helpful if tax-free step-up basis is repealed in some form, as proposed by the Biden administration earlier this year.

c. What about the front lines of IRS enforcement – what's the view like?

i. Valuation discounts to continue to be front and center (and in many cases, the beginning, middle and end of the IRS examination).

ii. Tax-affecting is routinely, and rigidly, challenged at IRS examination level, although some Appellate Officers have shown a willingness to recognize hazards of litigation on this issue.

(1) Tax affecting is a valuation issue affecting S corporations. The argument is that S Corp earnings are subject to individual tax rates whether or note they distribute and that the additional cost should be factored into valuation. The IRS naturally opposes tax affecting.

(2) The Tax Court has ruled that tax affecting may be appropriate in some cases, but has not found such a case.

(3) The valuation literature, in general, supports tax affecting.

iii. IRC Sec. 2036 continues to be the weapon of choice for the IRS, with almost 40 reported cases. If the IRS is successful, discounts are a moot issue.

iv. IRS has started to poke around the implementation of "his" and "her" SLATs and the potential application of the reciprocal trust doctrine.

v. Resolution at IRS Exam level is increasingly more common.

(1) This is partly due to litigation trends upholding notable discounts for lack of control and lack of marketability.

4. <u>What about IRS/DOJ attorneys – are they working?</u>

a. *Nelson v. Comm'r*, 128 AFTR 2d 2021-XXXX (5^{th} Cir. 2021).

i. Relevant facts and holdings

(1) A married couple (Mary and James Newson) formed a family limited partnership (FLP), funded with shares of stock in a holding company (Holdco) that held interests in several family businesses. The other owners of Holdco were family members of Mary.

(2) In 2008, Mary settled a SLAT with James as trustee/ beneficiary and their kids as beneficiaries.

(3) In 2008, Mary made a gift of FLP interest to the trust on a purported defined value basis, stating that Mary desired to make a gift of FLP interest "having a FMV of $2,096,000 as of [date], as determined by a qualified appraiser within ninety days of the effective date of this Assignment."

(4) In a separate transaction in 2009, Mary sold a FLP interest to the trust using similar language, i.e., having a FMV of $20 million and providing for a determination by appraisal within 180 days.

(5) The taxpayers secured a professional appraisal and filed Form 709s consistent with the appraisal. The IRS challenged the valuations on audit and proposed gift tax deficiencies for both the 2008 gift and 2009 sale transactions.

(6) The taxpayers argued that they properly valued the FLP interests; but if not, they had sought to transfer a specific dollar amount through a formula clause and that the amount of the interests transferred should be reallocated if the valuation changes.

(7) The Tax Court rejected both arguments. First it found the valuation change proper. Second, it found the language in the transfer documents was not a valid formula clause that could support reallocation. According to the Tax Court, Mary had transferred the percentage interests that the appraiser had determined to have the values stated in the transfer documents, and those percentages were fixed once the appraisals were completed.

(8) The Fifth Circuit upheld the Tax Court on appeal. The Court noted that most formula clauses specify that FMV refers to FMV as determined for federal gift or estate tax purposes and that such a qualifier did not appear in the transfer documents at issue. Also, the transfer documents lacked specific language describing what should happen to any additional shares that were transferred should the valuation be successfully challenged.

(9) The taxpayers pointed to facts/evidence outside of the transfer documents to show their intent for the FLP interest to be reallocated in the event of a valuation change, but the Court correctly noted that such evidence is only considered where the contract is ambiguous and may not be used to create a contract ambiguity.

(10) The Court further noted that even if the contracts were ambiguous, there were no objective facts or circumstances surrounding the transfer that warranted a different result. The taxpayers' evidence all pointed

to the taxpayers' subjective intent – i.e., desire to protect assets while avoiding any tax liability as part of their estate planning.

ii. Observations and takeaways

(1) *Nelson* illustrates the importance of attention to detail because taxpayers will be bound by the express language of their agreements.

(2) *Nelson* is not a rejection of defined value clauses. The transfer was of a defined value of interest as determined by qualified appraisal – not as finally determined for gift tax purposes. The IRS simply sought to enforce the terms of the assignment as drafted and did not raise any objection based on values as determined by formula.

(3) *Nelson* highlights the importance of using grantor trusts with defined value transfers. In this way, even if there is an adjustment or reallocation, no corrective returns should be necessary since all of the income and deductions would have been reported on the grantor's income tax return in any event.

(4) The FLP was created only about three months before the transfers, but the IRS did not argue that the FLP should be disregarded.

(5) The Tax Court upheld multi-tiered discounts, i.e., inside and outside discounts. The Tax Court allowed a 15% LOC and 30% LOM in valuing the shares of Holdco held by the FLP. The Tax Court allowed an additional 5% LOC and 28% LOM discount on the FLP interests themselves. In fact, the IRS did not question applying discounts at both levels, just the amount of the discount.

b. *Smaldino v. Comm'r,* T.C. Memo 2021-127.

i. Relevant facts and holdings

(1) In 2012, following a health scare, the taxpayer endeavored to get his estate planning in order. He was 69 years old at that time and held approximately $80 million in real estate, among other assets. The taxpayer was currently married but had six children (with grandchildren) from a prior marriage.

(2) The taxpayer wanted to pass his real estate business to his kids, and give the remaining assets to his wife.

(3) In an attempt to achieve that objective, the taxpayer engaged in the following transactions:

(a) The taxpayer transferred several real estate holdings to a single member LLC, which was owned 100% by a revocable Family Trust.

(b) In a document dated effective April 14, 2013, the taxpayer (through the Family Trust) transferred approximately $5.2M worth of LLC units to Mrs. Smaldino.

(c) In a separate document with the same effective date, Mrs. Smaldino transferred those same LLC units to a Dynasty Trust, which the taxpayer had settled for the benefit of his children from a prior marriage.

(d) In a document dated effective one day later (April 15, 2013), the taxpayer transferred approximately $1.1M to the Dynasty Trust.

(e) At the same time, the LLC Agreement was amended to provide for guaranteed payments to the manager for services rendered in the amount of $10,000 per month. The amendment was executed by the Family Trust, as the "sole member."

(f) In exchange for Mrs. Smaldino using her exemption, the taxpayer amended the Family Trust to provide her with additional money and properties.

(g) Mrs. Smaldino was never shown as a member of the LLC on any of the governing documents.

(h) In December 2013, the LLC agreement was again amended, this time to delete the guaranteed payment provision.

(i) Both the taxpayer and Mrs. Smaldino reported their 2013 gifts on Form 709 returns. On the taxpayer's Form 709, however, he described Smaldino LLC as a "disregarded entity."

(j) On audit, the IRS determined that in substance, the taxpayer made a single gift of $8.1M to the Dynasty Trust, ignoring the intermediate transfer of LLC units to his wife and his wife's transfer of those units to the Dynasty Trust.

(k) Although the IRS determined the value of the gift to be $8.1M during audit, in Tax Court, the IRS increased the value to $8.4M (thereby increasing the deficiency) based on the findings of the IRS' valuation expert.

(l) The taxpayer did not dispute that the transactions in question were part of a prearranged plan, but argued that the transfer of LLC units to Mrs. Smaldino was sanctioned by Sec. 2523(a), which legislative history showed clear Congressional intent to treat husband and wife as a single economic unit which negates the application of substance over form principles.

(m) While noting that the transfer agreement memorializing the transfer of units to Mrs. Smaldino was a factor, the Tax Court held that it was not determinative; that the circumstances surrounding the writing must show that the writing was meant to be effective.

(n) The Tax Court found that the circumstances showed no intention for the transfer to Ms. Smaldino to be effective:

(i) The LLC agreement had provisions restricting the rights of members to transfer units. The transfer to Mrs. Smaldino was not a "permitted transfer" and thus Mrs. Smaldino never received more than an assignee's interest.

(ii) There is no express or implied consent for Mrs. Smaldino to be admitted as a member, as following the transfer, the Family Trust amended the LLC agreement as the "sole member."

(iii) As noted, Mrs. Smaldino was never reflected as an LLC member in the organizational documents.

(iv) Although the documents bore effective dates, none of the executed documents bore an execution date. And the dollar amounts stated in the transfer certificates, as well as the ownership percentages stated in the LLC operating agreement, all depended directly on a valuation report which was not rendered until four (4) months after the transactions in August 2013.

(v) The Tax Court determined that it was likely that the transfer documents were executed no earlier than August 2013, which meant, practically, Mrs. Smaldino would have never been able to effectively exercise any ownership rights with respect to the LLC units.

(o) Unhelpful to the taxpayer's case was Mrs. Smaldino's testimony on direct examination by the taxpayer's attorney. When asked whether she could have changed her mind if she wanted to (in making the gift to the Dynasty Trust), Mrs. Smaldino testified: "No, because I believe in fairness."

(p) On the issue of valuation, the IRS attempted to disavow the value reduction associated with the "last minute" amendment to the LLC agreement and provision for guaranteed payments. The Tax Court, however, determined that a reduction in value was appropriate. With respect to discounts, the taxpayer's expert applied a combined discount of 38% versus 36% discount determined by the IRS expert. Given the small disparity, the Tax Court applied the IRS' expert discount of 36% in its valuation conclusion.

ii. Observations and takeaways

(1) Like *Nelson, Smaldino* illustrates the importance of attention to detail because taxpayers will be bound by the express language of their agreements.

(2) Even small scrivener's errors add up and can be used to fuel a contrary IRS position.

(3) In back-to-back transfers, documenting every transaction, even those that occur for only a moment in time, is critical to establish significance and intention to each step of prearranged transaction.

(4) Also critical is reviewing the underlying LLC agreements and confirming the transfer is compliant with the provisions; and if not, seek to amend the purported transfer or amend the LLC agreement.

(5) IRS exam findings are not always the worst-case scenario. IRS has the right to plead a greater deficiency based on new issues or new information, as the IRS did in this case – raising the appraised value from $8.1M to $8.4M based on its expert's findings post audit.

(6) This is an extremely important lesson for today's SLAT planning, which begins with a transfer of property to one spouse followed by that spouse's transfer of that same property, often in a short period of time, to a trust for the benefit of the initial spouse. If these transactions are not carefully documented, under *Smaldino*, the IRS might seek to collapse the intermediary steps to find that the initial spouse settled, in whole or part, the trust, negating any asset protection and creating a transfer tax problem that is tricky to correct.

c. *Estate of Howard v. Moore*, T.C. Memo 2020-40.

i. Relevant facts and holding

(1) The taxpayer owned a farm and began negotiating its sale in September 2004. Later that year, the taxpayer experienced serious health issues, prompting his doctor to place him in hospice care by the end of the year.

(2) Four days after being discharged, on December 20, 2004, the taxpayer settled a series of trusts which in turn formed a family limited partnership. The taxpayer transferred the farm to a living trust, which

then transferred 4/5 of the farm to the FLP in exchange for LP interests.

(3) There were a number of business reasons stated as the purpose for forming the FLP, including protection against creditors and bad marriages as well as to bring the "dysfunctional" family together.

(4) Shortly after transferring the farm to the living trust, the taxpayer brokered the sale of the farm, which closed on February 4, 2005. Though the FLP owned 4/5 of the farm, the taxpayer acted unilaterally in selling it.

(5) Post-sale, the FLP paid 80% of the taxpayer's attorney's fees for the estate planning. The FLP also transferred monies to the taxpayer's kids, which were papered by notes that the FLP never made any effort to collect.

(6) The FLP also "loaned" $2 million to the living trust, primarily to cover sale expenses and the taxpayer's income taxes on the sale. The loan was never repaid by the living trust to the FLP.

(7) On March 7, 2005, the living trust sold its entire interest in the FLP to an irrevocable trust for the benefit of the taxpayer's kids. There were no negotiations over the price, nor did the trust ever repay the note.

(8) In March 2005, the taxpayer died.

(9) The IRS sought to include in the taxpayer's gross estate the full sales proceeds of the farm under IRC Sec. 2036; the Tax Court had no problem agreeing with the IRS.

(10) While the Tax Court noted that a bona fide sale is established by the existence of a legitimate non-tax reason for the creation and funding of a FLP, the transfers at issue served no non-tax purpose. The FLP did not bring the family together, as alleged, because it required no active management. The farm was sold in days, and the proceeds invested by an outside advisor without any meetings or communications among the children. The Court also found no evidence of creditor protection, and noted that the significant health problems of the taxpayer cut against the non-tax business purpose and that the entire plan had a testamentary essence.

(11) The Tax Court also found that, at the very least, there was an implied agreement to retain possession or enjoyment of the farm, as the taxpayer continued to live and manage the farm post-sale. Further, the taxpayer used FLP assets to make so called loans for personal expenses, which were never repaid.

ii. Observations and takeaways

(1) Avoid boilerplate reasons, without a story, for forming a family limited partnership.

(2) Live out the reasons for forming it.

(3) Planning is only as good as it is maintained. The Tax Court was troubled by the lack of payment of the notes and apparent abandonment of the planning post-death.

(4) It is important for adult "kids" to be involved, and perhaps have separate counsel to bolster the bona-fides of the planning and negotiations.

(5) Be mindful that pigs get fat and hogs get slaughtered. A simpler plan may have resulted in IRS settlement or a better outcome at trial.

5. <u>Thanks for the scare campaign. Got any tips?</u>

a. IRS audit tips

i. Know when to play them; know when to (temporarily) fold them.

(1) It is common for the IRS examiner to latch on to a single issue and not let go.

(2) There is a tendency to act out of principle and push back.

(3) Be careful, however, not to miss an opportunity to bury the dead bodies, i.e., other "soft" spots in the return that the IRS examiner has either turned a blind eye or identified only at a high level. A continuation of the audit will almost certainly prompt the IRS examiner to either discover or develop these spots.

(4) Consider agreeing to the adjustment, provided it brings closure to the IRS audit. Almost always, the audit is resolved in a manner where the taxpayer retains its rights to later file a refund claim.

(5) In one recent audit, the estate discovered that the it had overreported gifts and was owed a refund of $100,000. Despite undisputable evidence, the IRS examiner refused to allow the correction, and in completing the IRS audit, proposed a $36,000 estate tax deficiency on an unrelated issue. The IRS examiner, however, had proposed no adjustment to the value of LP interests in a real estate partnership, which reported land values based on county appraisal and for which the estate took a combined 71% discount on the valuation of the includable LP interests. By agreeing to the $36,000 additional tax, the

estate was able to close the audit and avoid a much larger adjustment based on its valuation. The estate later filed a refund claim based on the overreported gifts, which the IRS processed and issued a refund.

(6) Another recent example involves a gift tax audit where the IRS proposed a gift tax deficiency based on the disallowance of tax-effecting in the valuation of S corporation stock. The taxpayer agreed to the adjustment, which ended the audit. The IRS never raised an issue with the subsequent sale of the S corporation at a multiple many times higher than the gift tax valuation. The taxpayer has since filed a gift tax refund claim on the disallowed tax-affecting, which it is now pursuing.

(7) Typically, you will want to file the refund claim shortly before the 3-year statute of limitations expires on assessment. While the IRS can always raise "offsets" to a taxpayer's claimed refund, once the SOL expires on assessment, the IRS generally will not be able to assess any additional taxes against the Estate. In other words, generally, the worst possible outcome is only a disallowance of the refund.

ii. Find the weakest link and consider putting it at the front of the chain.

(1) Invariably, there are soft spots in every estate tax return filing.

(2) Consider a pre-audit review, whereby you identify and quantify potential exposure items.

(3) For those fruits that are particularly low hanging, consider a strategy for pushing that issue into the limelight early to draw IRS attention.

(4) In recent experiences, the IRS has been less inclined to develop multiple issues or take a kitchen sink approach. Therefore, there may be opportunities to engage the IRS examiner on some issues that leave little time/interest for review of others.

(5) Remember that the IRS can not seek an extension of the SOL for estate taxes, and think LONG AND HARD about any extension of the gift tax SOL. Rarely (if ever) does giving the IRS examiner more time produce a better outcome for the client.

iii. Save your bullets when expert input is sought by IRS examiner.

(1) Where the IRS examiner seeks expert input on valuation issues from the IRS valuation engineer or an independent valuation analyst, you should expect very limited (if any) deviation from the expert's findings.

(2) This is true at Exam and IRS Appeals levels.

iv. Know what the examiner can and can't do.

(1) An estate tax examiner has the authority to resolve legal and factual issues, such as valuation discounts, by considering all of the evidence. They do not, however, have authority to settle cases based on hazards of litigation. Also, the IRS has been extremely strict with the concession of penalties, which requires a reasonable cause statement and manager approval. The IRS has been adamant that penalties should never be compromised based on the taxpayer's concession of tax issues, and has taken steps to prevent such bartering.

(2) Most cases are resolved by IRS Appeals. Although generally not available publicly, in a 2017 report by the Treasury Inspector General, it was disclosed that for fiscal year 2016, IRS Appeals sustained only 12% of the additional estate taxes and 20% of the additional gift taxes recommended by IRS Exam.

v. Know when you need back up.

(1) You are never stuck with your original valuation. Consider a second evaluation. Such engagement should be through counsel to take advantage of attorney-client privilege. p

vi. Be ready for a long-distance relationship.

(1) The IRS has developed and implemented the concept of a national workload. This means that cases are assigned to the field based on the location of resources and personnel necessary to complete the work as quickly and expeditiously as possible, not the geographic location of the taxpayer.

(2) Agents may be unfamiliar with mineral law or community property while examining Texas estate and gift returns. Likewise, understanding ranch land and operations has proven difficult for some agents who live in areas where these holdings are less common.

(3) Most recent estimates (circa 2016) place the number of estate and gift tax agents nationwide at 250.

vii. Be diligent in preparing for post-audit.

(1) Consider filing a FOIA request to secure a copy of the IRS admin file.

(2) Be sure to request a copy of the IRS examiner's rebuttal report.

(3) Decide on forum and make expert choices accordingly.

(a) The core issue for most transfer tax cases is valuation.

(b) Transfer tax cases can be tried prepayment in Tax Court or through a refund lawsuit in district court.

(c) In Tax Court, the expert's report is generally their direct testimony so you want to select a good writer who generates a very thorough report.

(d) In refund litigation, the expert will testify on direct and possibly to a jury so you want someone who is a good communicator and can explain complicated issues in a simple way.

b. Pre-IRS-audit tips

i. Know the process.

(1) Every single return (taxable and nontaxable) is reviewed by a classifier, and large estates have a virtual 100% audit rate.

(2) During classification, the returns are checked for math errors as well as potential audit issues based on program priorities and work plan needs.

(3) According to 2010 guidance by IRS Estate and Gift General Program, the following is a list of reasons a return is audited:

(a) Failure to include wills, trusts, backup material.

(b) Failure to include appraisal and/or the summary page indicating the major factors of the appraisal.

(c) Failure to include prior gifts.

(d) Answers on page 3 of the Form 706 checked "yes" without including explanations/documents.

ii. Know when to run for cover.

(1) It is not uncommon for the executor to identify errors in prior year income tax reporting during the course of an estate's administration.

(2) Real-life examples of such errors is the omission of cryptocurrency income or plain-vanilla underreporting of business income. Other examples include missed filings for foreign accounts or foreign entity structures.

(3) To avoid potential personal liability for the executor with respect to this prior year income tax and penalty exposure, consider making a voluntary disclosure with the IRS.

(4) Under the current version of the voluntary disclosure program, taxpayers must file 6 years of corrective returns and agree to a single civil penalty of 75% of the highest tax deficiency reported on the corrective returns. For estates with international issues, an additional 50% FBAR penalty (i.e., 50% of the balance of the unreported account) may apply.

(5) In our experiences, the filing of a voluntary disclosure by the estate does not increase the chances of an IRS examination of the estate tax return. Further, the liabilities owed under the voluntary disclosure program may serve to reduce the estate's estate tax liability.

iii. Never sell yourself short on discounting.

(1) Most practitioners focus on valuation discounts for lack of marketability and lack of control. But there may be other potential discounts that are available to the estate. For this reason, a valuation expert should always be consulted. This is especially true in cases where the estate plan was created but not fully executed.

(2) For example, suppose a taxpayer created a family limited partnership but died before he was able to make any transfer, such that he owned 100% of the GP and LPs interests of the FLP. Although traditional discounts may be difficult to support on these facts, there could be a discount for the nuisance associated with unwinding the planning and liquidating the assets from the FLP.

iv. FLP planning tips

(1) Whatever the wording of the business purpose requirement, a good believable non-tax purpose is a must.

(2) Typical rote reasons like unified management, training for younger generation, and avoidance of fractionalization are not persuasive unless they can be fleshed out in the factual development of the case.

(3) In other words, have a story.

v. Other tips for "stress testing" prior planning and mitigating IRS risk

(1) Have gift tax returns been filed and do they adequately disclose gifts?

(2) Consider filing a zero-tax return to start the SOL on sale transactions.

(3) Have all income tax returns been filed?

(4) Do the tax returns, transfer documents, and appraisals match?

(5) Are the entities in good standing?

(6) Are the clients respecting the legitimacy of the entities?

(a) Remediate/address personal expenses or disproportionate distributions.

(7) Is the client commingling personal assets with entity assets (or using entity assets without providing value for use)?

(8) Is every transfer fully documented and reflected in organizational documents of the entities (ala *Smaldino*)?

(a) Review contribution schedules, ownership percentages, and capital account ledgers.

(9) Have you documented the non-tax purposes for the entity?

(a) Remember: Tell your story.

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Biography

Anthony P. Daddino, P.C. is Managing Partner of the firm. Anthony devotes his practice to handling complex, and often times delicate, tax issues that successful businesses and their owners face. For nearly two decades, he has counseled clients on income and estate tax issues both in the planning stage (before contact by the Internal Revenue Service) as well as in the controversy stage (after IRS contact).

On planning matters, Anthony commonly works with business entrepreneurs and their families on wealth preservation and transfer strategies. His work focuses on structuring their business and personal financial affairs in a way that accomplishes global wealth preservation goals and that is efficient from both an income and estate and gift tax perspective.

On controversy matters, Anthony routinely represents taxpayers at every stage of the life cycle of a tax dispute, both criminally and civilly. He has resolved disputes involving a wide variety of tax matters, ranging from business and personal income tax, international tax, employment tax, estate and gift tax, and employee benefit and exempt organization tax matters. His experiences include representing businesses before the Texas Comptroller and Texas Workforce Commission. As a trial attorney, Anthony has litigated multi-million dollar tax cases in the Court of Federal Claims and the federal district courts for the Western District and Northern District of Texas, as well as argued tax cases before the Courts of Appeals for both the Ninth Circuit and Fifth Circuit.

Anthony Daddino served on the law faculty at Southern Methodist University Dedman School of Law, where he taught Corporate Taxation and Income Taxation. He is a frequent speaker on a variety of topics, including IRS controversy, partnership tax, employment tax, international tax, and ethics issues.

Mr. Daddino was admitted to practice in Texas in 2002. He is married and has three children.

Education

- Southern Methodist University School of Law, J.D., *cum laude*, 2002
  - Order of the Coif
  - Member, *Southern Methodist University Law Review*, 2000-2002

- Southern Methodist University, B.B.A., *magna cum laude*, 1999

Memberships

- American Bar Association
- State Bar of Texas
    - Vice Chair, Tax Controversy Committee
- Dallas Bar Association
    - Council Member, Tax Section
- Collin County Bar Association

Teaching

Law Professor, Dedman School of Law, Southern Methodist University

- Corporate Taxation, Spring 2009 through 2013
- Income Taxation, Spring 2014

Honors & Awards

- Texas Rising Stars, as published in *Texas Monthly and in Texas Super Lawyers - Rising Stars Edition*and on the web at *superlawyers.com*, 2007-2011 and 2017
- Best Lawyers in Dallas, *D Magazine*, 2015-2016, 2021-Tax Litigation
- The Best Lawyers in America © , 2021-2022, Tax Law
- Texas Super Lawyers-Tax as listed in *Texas Super Lawyers Magazine*: 2018, 2020 and 2021

Publications

- "Worried About Employment Taxes? Do Not Fear.", *BarTabs*, October 2011, Collin County Bar Association
- "The IRS Is Looking For Non-Compliant Taxpayers With Foreign Interests: Is Your Taxpayer One Of Them?," *The Practical Tax Lawyer*, Volume 22, Number 3, Spring 2008 (published four times a year by American Law Institute-American Bar Association Continuing Professional Education in cooperation with the ABA Section of Taxation)

Presentations

- December 15, 2021 - Estate Planning Council of North Texas
- November 9, 2021 - TXCPA Summit 2021
- November 4, 2021 - 2021 Austin Chapter/TXCPA Annual Tax Conference
- November 2, 2021 - 23rd Annual Meadows Collier Tax Conference
- October 28, 2021 - Texas Management Group (TMG) Conference
- July 25, 2019 - July 26, 2019 - Fort Worth Chapter/TSCPA Tax Institute 2019
- May 23, 2019 - Wichita Falls Chapter/TXCPA Free CPE Day
- January 29, 2019 - Whitley Penn Houston Conference
- January 23, 2019 - Whitley Penn Dallas Conference
- January 22, 2019 - Whitley Penn Fort Worth Conference

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Blog

- April 20, 2021 - More Clouds on the Horizon for Micro Captives and Syndicated Conservation Easements, as the IRS unveils the Newly-Established Office of Promoter
  Yesterday, the Internal Revenue Service announced the establishment of the IRS Office of Promoter Investigations. The new office will further expand on the efforts of the Promoter Investigations Coordinator that began last summer and will continue to focus on micro captives and syndicated conservation easements
- April 9, 2021 - IRS Attempts to Use its latest Judicial Win to Scare Micro-Captive Participants into Submissio
  On the heels of its fourth judicial win in Tax Court, today the IRS urged participants in allegedly abusive micro-captive insurance arrangements to exit these transactions as soon as possible. For many taxpayers, this approach is akin to throwing the baby out with the bathwater, as contrary to the IRS' belief, not every micro-captive arrangement is abusive.
- October 22, 2020 - IRS Stays True to its Word and Stiffens Microcaptive Settlement Terms
  Earlier today, the IRS announced a second time-limited settlement initiative for certain taxpayers under audit who participated in micro-captive insurance transactions.
- October 9, 2020 - The IRS uses the 5-Letter "F" word in relation to Syndicated Conservation Easements
  I know what you are thinking: I can't count letters. But the truth is far worse. The IRS used the five-letter "F" word: Fraud.
- October 2, 2020 - IRS Stands Firm on Microcaptive Settlement Terms and Warns of Similar Treatment for Variations
  Lest we forget the IRS' position on microcaptives, yesterday the IRS issued a reminder to taxpayers that they should consult an "independent tax advisor" to size-up their captive insurance planning because "any future settlement terms will only get worse, not better." This warning applies not only to Section 831(b) microcaptives, but also variations that do not involve a Section 831(b) election that the IRS also identified as abusive.
- September 17, 2020 - COVID Crisis Prompting the Need for a Private Letter Ruling in a Flash? No Problem.
  Is COVID to blame for you missing a tax election, inadvertently terminating an election, or making the wrong election? Do you need immediate IRS attentionâ¦ during a global pandemic when most IRS offices are closed? Don't you worry - the IRS is urging taxpayers to take advantage of expedited handling for private letter ruling requests to give you the tax certainty you need, when you need it.
- September 16, 2020 - To Forgive or Not to Forgive (in 2020): That is the PPP Question
  For the many businesses that secured a potentially forgivable loan under the Paycheck Protection Program (PPP), one of the more pressing issues is whether to apply for forgiveness now or later and the tax implications of forgiveness in 2021 with respect to 2020 expenses that may become non-deductible upon forgiveness. So what is the right answer?
- September 16, 2020 - Missed Yesterday's Deadline? Just "COVID-19" It.
  While the IRS has refused any formal program for late penalty relief, informally the IRS is embracing the virtue of forgiveness, with the magic word being "COVID-19."
- September 2, 2020 - IRS Launches Helpful Learning Resource on the New Rules Governing Partnership Audits
  Yesterday the IRS launched a new website for taxpayers and tax practitioners seeking information on the centralized partnership audit regime. As many of you will recall, in 2015 Congress exchanged one set of overly-complicated audit rules applicable to partnerships, known as TEFRA, with a different but comparably complicated set of partnership audit rules known as BBA (after the enacting legislation, the Bipartisan Budget Act). The new audit regime is generally effective for tax years beginning January 2018.

- August 28, 2020 - New Senate Committee Report Delivers More Bad News for Syndicated Conservation Easement Transactions
  As if the onslaught of recent losses in Tax Court was not enough, investors in syndicated conservation easements now have more to worry about. On August 25, 2020, the Senate Finance Committee released a bipartisan report condemning syndicated conservation easements as abusive and encouraging the IRS to take further action to ferret out such abuses.
- August 26, 2020 - Second Verse, Same as the First: The IRS Sends Another Wave of Warning Letters Regarding Virtual Currency
  As previously reported (Prior Blog Post), last summer the IRS sent letters to taxpayers with virtual currency transactions that potentially failed to report income and pay the resulting tax from those transactions or did not report them properly. Well as the old saying goes, 1 is good, but 2 is better, as this summer the IRS initiates a second wave of letters to cryptocurrency users that suggest they may have misreported their transactions.
- July 17, 2020 - Form 8275 Disclosure Statement: A Tax Practitioner's Best Friend Forever
  There is no denying it. My Best Friend Forever, my BFF, is IRS Form 8275 - which I affectionately call Disclosure Statement. The reason being, Form 8275 keeps me and my clients (mostly) out of trouble. And it can do the same for you and your clients.
- July 16, 2020 - IRS Releases 2020 Dirty Dozen List: What Made the Cut?
  Sometimes it better not to be noticed. And that is certainly true when it comes to the IRS' Dirty Dozen list - the IRS' proverbial "naughty" list of abusive transactions, fraudulent schemes, and criminal scams. In the list for 2020 released today, the IRS focuses on scams that target taxpayers. And for the first time since 2014, the IRS leaves off one allegedly-abusive transaction.
- June 23, 2020 - IRS Finds New Target in Microcaptive Enforcement: The State of Delaware
  Just when you thought the IRS hit full speed in its enforcement campaign against microcaptives, the IRS found another gear. After pursuing captive management companies, tax advisors, and taxpayers alike, the IRS has set its sights on a new foe: the Delaware Department of Insurance.
- June 17, 2020 - Things that Make You Go Hmmm: Tax Court Orders Partnership to Explain Over 480% Increase in Value in 3 Days to Avoid 40% Penalty in Conservation Easement Dispute
  If Tax Court Judge Lauber's June 15, 2020 order is any indication, the Tax Court has grown tired of syndicated conservation easement cases.
- April 2, 2020 - Recent Microcaptive Letters are an IRS Gift in Disguise
  I recently blogged on the IRS' mass mailing of soft-contact letters to microcaptive participants. Although perceived as a nuisance, it is an early Christmas present from the IRS - the gift of time to assess the planning, shore up defenses, and in some instances, to remediate.
- March 24, 2020 - So You Think the IRS Extended All April 2020 Deadlines? Think Again. **And Again.**
  In IRS Notice 2020-18, the IRS automatically extended the April 15, 2020 due date for federal income tax returns and federal income tax payments to July 15, 2020. The IRS made clear, however, that "no extension" is provided for the payment or deposit of any other Federal tax or the filing of any other Federal return. So what stays on the April 2020 to-do list?

- March 24, 2020 - IRS Invites En Masse Microcaptive Participants to Amend Returns: Should Taxpayers Accept?
  In a move that some might consider tone-deaf, the IRS has done a mass mailing to microcaptive participants, boasting of its wins in Tax Court, and inviting taxpayers to amend prior year returns to remove the Federal tax benefits claimed relative to their captive insurance planning. Do taxpayers accept this invite and if not, how should they respond to this IRS letter?
- March 24, 2020 - UPDATED: So You Think the IRS Extended All April 2020 Deadlines? Think Again. **And Again.** And Again.**
  In IRS Notice 2020-18, the IRS automatically extended the April 15, 2020 due date for federal income tax returns and federal income tax payments to July 15, 2020. The IRS made clear, however, that "no extension" is provided for the payment or deposit of any other Federal tax or the filing of any other Federal return. So what stays on the April 2020 to-do list?
- February 28, 2020 - "Please Sir, I Want Some More" Information About Your Reportable Transactions in 2019, Says the IRS
  Each year taxpayers are required to disclose their participation in a reportable transaction by filing a Form 8886 with the IRS. In recent years the IRS has added both Section 831(b) micro captives and syndicated conservation easements to the list of reportable transactions. As taxpayers eye the filing deadline for their 2019 disclosures, the IRS has revised the Form 8886 and instructions to request even more information about a taxpayer's reportable transactions.
- January 22, 2020 - PLR Update: IRS Issues its "No Ruling" List for 2020 as well as Extends a Surprising Invitation for PLR Requests in a Hot Button Area
  In a previous blog post, I outlined the IRS private letter ruling process, including the mechanics of making a request and tips for presenting your ruling request to the IRS. In this blog post, I touch on the IRS' "no ruling" lists issued this month as well as discuss a strange invitation by the IRS for taxpayers to use the private letter ruling process to seek guidance on â¦. wait for itâ¦.. cryptocurrency taxation.
- January 22, 2020 - Another Arrow in the Taxpayer's Quiver against Trust Fund Penalties: Supervisory Approval
  We all know that the IRS is quick to pull the trigger on penalties, especially trust fund penalties, which the IRS rightfully views as Uncle Sam's money. But the Tax Court's January 21st decision in Chadwick vs. Commissioner makes clear that even trust fund penalties must be approved by a supervisor when proposed; otherwise, the penalties are invalid.