Current Federal Tax Developments

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SECTION: 61
COURT ACCEPTS IRS'S RECONSTRUCTION OF BUSINESS USING BANK DEPOSITS AND FORMS 1099K

Citation: Kahmann v. Commissioner, TC Summary Opinion 2017-35, 5/25/17

In the case of *Kahmann v. Commissioner*, TC Summary Opinion 2017-35 the IRS was suspicious that the taxpayers had understated their gross income from their business for the year. Some of this suspicion arose because the taxpayers failed to turn over bank statements for the business to the agent when they were requested.

The agent was forced to issue summonses to banks where she was aware the taxpayers maintained at least three accounts. She obtained those accounts to be able to perform a bank deposits analysis, looking for unreported income.

The presumption exists that amounts deposited into a bank account represent income. The IRS does have to remove any deposits that the agency becomes aware are not income (such as bank transfers). At that point, the burden generally shifts to the taxpayer to provide evidence to show that any other deposits were also not taxable income. To the extent the taxpayer does not produce such evidence the amounts are considered income.

In addition to the bank deposits analysis, the agent also had in her possession two Forms 1099K issued in the name of the taxpayers' business and were mailed to the address shown on the couple's income tax return for the year under examination.

When the agent concluded the bank deposits analysis she identified the following classes of deposits:

- $375.15 from Amazon
- $134,318.27 from bank card deposits
- $4,864.77 from checks made payable to the taxpayer's business
- $24,875 from cash deposits and
- $5,169.85 from ATM deposits

These amounts totaled $169,603.04, substantially more than the gross receipts reported on the Schedule C that year of $128,070. But the agent also noticed that the two Forms 1099K totaled $151,835.06, or over $17,000 more than she was able to find deposited from credit cards on the bank statements. As well, she

found that she could not reconcile many of the deposits made through the credit card processor. She believed the reason for this was the taxpayers had other bank accounts they had not informed her about.

For this reason, she substituted the Form 1099K totals for the credit card deposits in her analysis and used this gross revenue as the business's actual revenue.

IRC §6201(d) provides taxpayers with some protection against the IRS relying on information returns, including the Form 1099Ks in this case. If the conditions are fulfilled, the burden shifts to the IRS to provide "reasonable and probative information" in addition to the information return.

In this case, the taxpayers failed to meet the condition that is required to trigger this protective provision that shifts the burden on the IRS to go beyond the Form 1099K—the taxpayer must fully cooperate with the IRS in the exam. In this case, the taxpayers' failure to produce the bank statements when requested, forcing the IRS to issue summonses for them. As well, despite arguing that some of the income on the Forms 1099K represented income of his brother, he did make his brother available at trial nor to the IRS prior to trial, rather only presenting letters he indicated were written by his brothers. Such actions fell well short of "fully cooperating" with the IRS, as §6201(d) requires the taxpayer provide timely "access to and inspection of all witnesses, information, and documents within the control of the taxpayer as reasonably requested by the Secretary".

The taxpayer did list a litany of reasons why he claimed large parts of the amounts the agent showed as income were not really income. The reasons included:

- A claim the cash deposits came from a large cash hoard the taxpayers had on hand at the beginning of the year;
- The check deposits represented income of his brother, whom he claimed also operated a business with the same name;
- The unaccounted for credit card charges were "really" also his brother's income, as he allowed his brother to use the machine for his business

However, the taxpayer did not introduce evidence beyond his own statements and the letters he claimed were from his brothers to support his own assertions for these issues.

The Court noted that the Court has often heard the "cash hoard" claim and that it has almost never worked. The Court was not presented with plausible evidence, aside from the taxpayer's own claims, that the hoard existed or that it arose from inheritances and gifts from family members. The Court determined this fell far short of being evidence the "cash hoard" was actually the source of those deposits.

The Court also found the letters to be inadmissible hearsay since he did not produce his brothers to testify in the case to back him up. He provided no evidence, aside from his testimony, that his brothers had operated a business during the year in question. So, again, the Court refused to remove either the check deposits or the "extra" credit charges from income.

The taxpayer did produce a handwritten ledger of sorts that he claimed had been produced as the goods were sold. The Court did not find that testimony credible, noting that the entries were all written in the same handwriting and with the same shade of ink, making it far more plausible the entries were made all at one time rather than made at the time of each sale. As well, the taxpayers could not reconcile that handwritten schedule to the bank deposits.

In the end the Court agreed with the IRS's view that the taxpayer had significant unreported income, and accepted the IRS's reconstruction of income based on the bank deposits analysis and the Forms 1099K.

SECTION: 501
ORGANIZATION FORMED TO SUPPORT "COMMUNITY JOURNALISM" DID NOT QUALIFY FOR EXEMPT STATUS

Citation: PLR 201720010, 5/25/17

In PLR 201720010 the IRS ruled the fact that an organization is not being operated to generate a profit and may be providing services to organizations that are themselves performing charitable and educational purposes does not mean the organization providing the services can qualify as a §501(c)(3) organization. The organization in question was therefore denied its request to be granted §501(c)(3) status.

The organization had changed its proposed purpose a few times as it attempted to assist in the development of community oriented independent journalism initiatives. Originally the organization had planned to develop open source software to be used by such organizations, but such software became available from other sources.

At this point the group modified its mission to the following per the ruling:

> Your Form 1023 and your bylaws now indicate your mission is to provide mentorship and educational and administrative support to independent journalism initiatives across the United States to serve the growing number of communities that lack the robust sources of information that people need to make sound citizenship decisions. Your main focus is on civic learning initiatives that seek to (1) educate citizens in these communities regarding current events of significance and the workings of government and other civic institutions, and (2) strengthen the civic life of these underserved communities.

The group has developed a news co-op model to be used for community internet journalism and news to be used by community groups. Per the ruling the organization would provide the following for qualified groups:

> You will provide to your affiliates the following:
>
> - Mentorship approaches that could thrive in the digital era.
> - Training on best practices in Internet journalism.
> - Administrative and program support to minimize the time they need to spend on tasks such as bookkeeping, tracking membership and information technology, and therefore to ensure maximum staff time for news coverage and civic engagement. This will also result in lightening the load of the Affiliates, strengthen their journalism and improve reader involvement and engagement.

Specifically, the PLR notes that the organization would provide the following to its affiliates:

> During the 12 month period after an affiliate is formed and is able to launch news coverage, you will provide additional services and materials consisting of:
>
> > i) Life-issue reporting items that the affiliate can publish or adapt (or omit), as the affiliate's editor sees fit, at no charge.

> ii) Website upgrade plus training so that the affiliate can present news in a distinctive environment that invites civic engagement and editorial collaboration, at no charge
>
> iii) Continuing iterations to improve the website's effectiveness, at no charge.
>
> iv) Any upgrades or improvements of P at no charge.
>
> v) Tools that create reports on readership, membership and business analysis, delivering trends for the affiliate as well as a comparison against the full universe of affiliated sites, at no charge.
>
> vi) Resources and training to help affiliates conduct trainings, at no charge.
>
> vii) Optional on-site consulting, at your then-current consulting fee plus travel expenses.

> During Launch Stage Year 2 and subsequent years ("Operational Stage") you will continue to provide affiliates all Organization and Launch Stage services and materials in exchange for the affiliate's payment of a fee of * * *% of gross revenues to partly offset your costs of services, travel, and related administration.

The ruling goes on to note the following about the fee-based services provided:

> You have set a maximum annual fee of x dollars. You are able to offer these services to affiliates at much lower costs because you have received and continue to seek foundation funding, and because your founders have worked without compensation for many years. You also stated that your Program Support services are not currently commercially available anywhere; but if a monetary value were to be placed on them, it would be unaffordable for an affiliate. The value would far exceed the amount of any fee or revenue-sharing arrangement that could conceivably be agreed on between you and an affiliate.

The organization asked for exempt status under §501(c)(3) which would also allow for the receipt of charitable contributions by the organization.

The IRS ruled that this organization did not meet the requirements to be a §501(c)(3) organization. The IRS cited two authorities, one of which is a Revenue Ruling that described an organization that does not qualify:

> Rev. Rul. 72-369, 1972-2 C.B. 245, provides an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption. It states an organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the "operational test" the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of Section 501(c)(3) of the Code and the applicable regulations. Providing managerial and consulting services on a regular basis for a fee is trade or business ordinarily carried on for profit. The ruling holds that furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Conversely, the IRS noted a case where the organization was found to qualify:

> In *Forest Press Inc. v. Commissioner*, 22 T.C. 265 (1954), the Tax Court determined that an organization "devoted to developing and propagating the use of the Dewey Decimal Classification System and Related Index" was a charitable organization. Forest Press' primary activity was the ongoing development of the system, which required continuous revision. To this end, Forest Press regularly employed an editor-in-chief and four editorial assistants and an additional two to three editorial assistants as publication dates approached. By the time Forest Press was formed, the System had "been adopted by more than 90 percent of the libraries in the United States to classify and index their collections" and was "in use in 42 countries." Thus, the court concluded that the System was "an important aid to education and research and not a commercial enterprise.

The IRS concluded the organization was like the one described in Rev. Rul. 72-369, noting:

> You are similar to the organization described in Rev. Rul. 72-369. You are providing technical services as well as training on the use of the P Platform for an upfront fee of w dollars

> and an annual fee of * * *% of their gross revenue. Like the organization in the revenue ruling, you are providing services on a regular basis for a fee in a manner similar to a trade or business. Moreover, your services for a fee are focused on community groups organized as news co-ops unlike the organization in the revenue ruling that focused on unrelated tax exempt organizations.

The ruling also distinguished the case of this organization from the one in *Forest Press*:

> Your activities are not like those of the organization in *Forest Press Inc. v. Commissioner*, 22 T.C. 265 (1954). In *Forest Press*, the organization's primary activity was the continued development and propagation of the Dewey Decimal Classification System, which the Tax Court described as "an important aid to education and research," and which classification system was adopted by more than 90% of the libraries in the United States and in 42 foreign countries. You argue that your programs will assist communities without access to newspapers form news co-ops to operate on line news sites. You will charge fees to the groups. By providing this type of software tailored to each news co-op's needs, your activities are neither educational nor comparable to promoting the Dewey Decimal Classification System. Furthermore, you do not limit distribution of your programs. Your only control over the news co-op is a check to assure it upholds your values that the journalism published is relevant to the less-than-affluent readership. The programs are also available to all organizations, commercial or otherwise. Thus, your activities are neither educational nor advance education within the meaning of I.R.C. Section 501(c)(3).

Rather than operating for an exempt purpose, the IRS concluded the organization was competing with commercial organizations:

> You are similar to the organizations described in *B.S.W. Group, Inc. v. Commissioner* and *Easter House v. U.S.* As a substantial activity, you are developing and distributing software to community groups you help establish as news co-ops which are not exempt organizations. In addition, the news co-ops will pay for the software and its support through annual fees. Your activities compete with other commercial publishing software developers and distributors. Such

competition provides your activities with a commercial hue. More than an insubstantial part of your activities are not in furtherance of charitable or educational purposes, or other exempt purposes which precludes you from exemption under Section 501(c)(3).

SECTION: 642
IRS GRANTS ESTATE RELIEF TO MAKE LATE ELECTION TO CLAIM CHARITABLE CONTRIBUTION IN PRIOR YEAR

Citation: PLR 201720003, 5/19/17

While PLR 201720003 is not really a major ruling—the IRS is merely granting an estate a right to make a late election—it does provide a reminder about the special rules that impact trusts and estates when claiming charitable contributions. These rules are in some ways more restrictive than those imposed on other taxpayers, but in other ways they are far more generous.

IRC §642 governs the charitable contribution income tax deduction for a trust or estate. Basically, it allows a deduction on Form 1041 under the following conditions:

- The charitable contribution must be made from *gross income* (as defined under IRC §61, not the applicable uniform principal and income act or the trust document); and
- The amount must be paid pursuant to the governing instrument (trust, will, etc.).

If those two conditions are met the deduction is allowed "without limitation" unlike that of an individual (generally subject to the 50% of adjusted gross income limitation) or corporation (10% of taxable income limit for a C corporation).

As well, the trust or estate will have a choice of which year in which to claim the deduction, a truly unique feature rarely seen in the tax law. Normally the year an item must be recognized is not an item a taxpayer may "elect" to select. But for a charitable contribution of a trust or estate that meets the rules to be deductible under IRC §642(c), the amount may be deducted in either:

- The year in which the contribution was paid;
- On the return for the year prior to the year the contribution was paid if the trust elects this option (IRC §642(c)(1)) or

- For an estate or certain trusts created on or before October 9, 1969, the year in which amounts are permanently set aside by the trust or estate for charitable purposes. (IRC §642(c)(2))

The last option was discussed in prior articles on the Current Federal Tax Developments website[1] and is a tough standard to meet as those articles discuss. But the prior year election has no such complex hurdles to clear.

All the fiduciary must do to claim this election is comply with the requirements of Reg. §1.642(c)-1(b). The PLR describes the process as follows:

> Section 1.642(c)-1(b)(2) provides that the election under § 1.642(c)-1(b)(1) shall be made not later than the time, including extensions thereof, prescribed by law for filing the income tax return for the succeeding taxable year.
>
> Section 1.642(c)-1(b)(3) provides that the election shall be made by filing with the income tax return (or an amended return) for the taxable year in which the contribution is treated as paid a statement which (i) states the name and address of the fiduciary, (ii) identifies the estate or trust for which the fiduciary is acting, (iii) indicates that the fiduciary is making an election under § 642(c)(1) in respect of contributions treated as paid during such taxable year, (iv) gives the name and address of each organization to which any such contribution is paid, and (v) states the amount of each contribution and date of actual payment or, if applicable, the total amount of contributions paid to each organization during the succeeding taxable year, to be treated as paid in the preceding taxable year.

In this case the estate, for whatever reason, failed to make the election and take those deductions in the year prior to the year paid. The ruling text does not tell us whether this was due to a failure to obtain

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[1] *Estate Did Not Permanently Set Aside Funds for Charitable Purpose When It Knew of Possibility of Prolonged Litigation*, https://www.currentfederaltaxdevelopments.com/blog/2015/2/20/estate-did-not-permanently-set-aside-funds-for-charitable-purpose-when-it-knew-of-possibility-of-prolonged-litigation, February 20, 2015 and *Existence of Potential Dispute in Estate Sufficient to Block Estate from Treating Funds as Permanently Set Aside for Charity*, https://www.currentfederaltaxdevelopments.com/blog/2015/9/25/existence-of-potential-dispute-in-estate-sufficient-to-block-estate-from-treating-funds-as-permanently-set-aside-for-charity?rq=set%20aside, September 25, 2015

advice, erroneous advice from an adviser or some other reason—rather it just states the election was not made. Now the estate asks, under the provisions of Reg. §301.9100-1(c), for the IRS to allow the estate to make a late election and to move the charitable deductions into the earlier years.

Reg. §301.9100-1(c) provides the method by which a taxpayer may request, by applying (and paying) for a private letter ruling, that the IRS grant the right to make a late election where the date is set by regulation and not by statute.[2] It is used for extensions that aren't available under the automatic late election relief provisions of Reg. §301.9100-1(c). As the PLR notes:

> Under § 301.9100-3, a request for relief will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that (1) the taxpayer acted reasonably and in good faith, and (2) granting relief will not prejudice the interests of the government.

In this case, the IRS granted the relief under the following conditions:

> Accordingly, Estate is granted an extension of time of 120 days from the date of this letter to file an election under § 642(c)(1) to claim a deduction in the Year 1 taxable year for charitable contributions made in Year 2. Further, Estate is granted an extension of time of 120 days from the date of this letter to file an election under § 642(c) to claim a deduction in the Year 2 taxable year for charitable contributions made in Year 3. This ruling is conditioned on the Estate filing amended returns for Year 1, Year 2, and Year 3 on which the Estate must: (1) make the election under § 642(c)(1) to claim a deduction on the Year 1 amended return for the distributions made by the close of Year 2 and (2) make the election under § 642(c)(1) to claim a deduction on the Year 2 amended return for the distributions made by the close of Year 3. The amended returns must be filed within the 120-day period following the date of this letter with the service center where the Estate files its returns. A copy of this letter should be attached to the amended return.

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[2] The IRS position is that the agency cannot grant relief for missing a date set by statute unless Congress has specifically authorized the agency to grant such relief, which generally is not the case.

SECTION: 2036
TAX COURT FINDS §2036(A)(2) TRIGGERS INCLUSION IN ESTATE

Citation: Estate of Powell v. Commissioner, 148 TC No. 18, 5/18/17

The Tax Court again agreed with the IRS that a family limited partnership arrangement (FLP) had run afoul of IRC §2036(a), the IRS's most successful route to undo such planning due to "bad facts." But, in the case of *Estate of Powell v. Commissioner*, 148 TC No. 18 the Tax Court, for the first time since it proposed a "lack of real fiduciary duties" theory for invoking IRC §2036(a)(2) in the case of *Estate of Strangi v. Commissioner*¸ TC Memo 2003-145 that the Court invoked that provision, rather than the general "implied life estate" theory under IRC §2036(a)(1) to unwind the plan. Also, the majority opinion also provided that IRC §2043 served to limit the inclusion in the estate to only the excess value of the assets transferred over the interest received.

The plan in this case was very much a "deathbed" plan, with the transfers occurring one week before Nancy Powell died. As well, at the time of the transfers Nancy was incapacitated as well as terminally ill, so her son, acting under a Power of Attorney (POA), formed the partnership with himself as general partner and then transferred Nancy's assets into the partnership in exchange for a 99% limited partnership interest. On that same day, her son, again acting under the POA, transferred Nancy's limited partnership interest to a charitable lead annuity trust (CLAT).

Clearly, this is a very "bad facts" case and a taxpayer loss probably isn't surprising for most readers. But the Court's analysis in this case did both finally invoke the "second" §2036(a) option from the *Strangi* case and broke some new ground on the proper amount to be included in the decedent's estate in the case of a §2036(a) problem.

Since, under the plan, the decedent had transferred her interests in the assets during her life, the transfer was reported on a gift tax return. At the end of the day, following the discounts both for the transfer of assets to the FLP and then a second discount to arrive at the remainder interest gifted via the CLAT, Nancy's Form 709 reported only a net transfer of $1,661,422 despite starting with assets valued at over $10,000,000.

The IRS position was that all this final week of life frenzy of paper asset transfers should be ignored via one of three grounds:

> It is determined that the decedent retained at her death the possession, enjoyment, or right to the income from property she transferred to NHP * * * or the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income there from such that the property transferred to the partnership valued at $10,022,570 on the valuation date is includible in the gross estate under IRC § 2036(a).
>
> Alternatively, it is determined that the decedent retained at her death a power to change the enjoyment of property transferred to NHP * * * through exercise of a power * * * by the decedent alone or in conjunction with any other person * * * to alter, amend, revoke, or terminate such that the property transferred to the partnership valued at $10,022,570 on the valuation date is includible in the gross estate under IRC § 2038(a).
>
> Alternatively, it is determined that the decedent retained at her death a power to change the enjoyment of a 99% limited partnership interest in NHP * * * through exercise of a power * * * by the decedent alone or in conjunction with any other person * * * to alter, amend, revoke, or terminate such that the value of the 99% limited partnership interest is includible in her gross estate under IRC § 2038(a) at its fair market value of $10,022,570. The fair market value of the 99% partnership interest is determined without regard to certain rights and restrictions identified in IRC § 2703(a).

The Tax Court looked at the §2036(a) issue. The IRS advanced two different theories for why §2036(a) should bring the assets back into the estate.

- The transfer was subject to an implied agreement under which Nancy would retain the possession or enjoyment of the property, or the right to receive income under the proper as described in IRC §2036(a)(1)
- Nancy retained the right, in conjunction with her sons, to dissolve the partnership and thus control who would enjoy the property, a violation of IRC §2036(a)(2).

While neither provision would apply had Nancy transferred her interest in a "bona side" for full and adequate consideration per §2036(a), the IRS argued that the estate had failed to show any significant nontax consideration for the formation of the partnership.

While §2036(a)(1) has most often been used by the Court to justify an inclusion under §2036(a) of assets in an estate, in this case the Tax Court skipped any analysis regarding whether IRC §2036(a)(1) would apply and instead concluded that IRC §2036(a)(2) applied, rendering the question of whether there was an implied retained interest no longer relevant.

The estate's defense regarding the §2036(a)(2) issue is rather unique, as the estate did not appear to contest the issue. Rather, as the Court described it:

> The estate does not deny that decedent's ability to dissolve NHP with the consent of her sons constituted a "right * * * in conjunction with * * * [others], to designate the persons who shall possess or enjoy the property [she transferred to the partnership] or the income therefrom", within the meaning of section 2036(a)(2). Nor does the estate challenge respondent's assertion that decedent's transfer of cash and securities to the partnership was "not a bona fide sale for an adequate and full consideration in money or money's worth". The estate's only response to respondent's section 2036(a)(2) argument is that, upon her death, decedent did not retain her interest in NHP. The estate apparently reasons that, even if decedent's interest in NHP gave her the right to designate the beneficiaries of the assets she transferred to the partnership, she did not retain that right for the remainder of her life (and the brief period for which she held the right was not ascertainable only by reference to her death). Consequently, the estate argues, section 2036(a)(2) does not apply to decedent's transfer of cash and securities to NHP.

However, the Tax Court rejected this idea for two separate reasons. First, as it would be a transfer within three years of her death, IRC §2035 would bring the cash and securities transferred back into her estate if there had been a valid gift of her interest, along with any gift tax paid.

Second, there was a more basic problem—the Power of Attorney did not grant the son the right to make any gifts in excess of the annual exclusion. The estate argued that while it was true that the POA did

have that limitation in it, the son's general authority to manage Nancy's property allowed him to make such a transfer. The Tax Court turned to the applicable state law (California in this case) to determine if he did have the authority to make the gift.

> California caselaw contravenes the estate's claim that the general authority granted to Mr. Powell to convey decedent's property included the power to make gifts. California courts have long applied the general principle requiring an express grant of authority to make gifts to hold that general grants of authority to convey property do not provide the power to make gifts. See *Shields v. Shields*, 19 Cal. Rptr. 129, 130-131 (Ct. App. 1962) (citations omitted) ("A power of attorney conferring authority to sell, exchange, transfer or convey real property for the benefit of the principal does not authorize a conveyance as a gift or without a substantial consideration[,] and a conveyance without the scope of the power conferred is void."); *Bertelsen v. Bertelson*, 122 P.2d 130 (Cal. Ct. App. 1942) (holding that grant of general authority to convey property did not encompass gifts); see also *Estate of Swanson v. United States*, 46 Fed. Cl. 388, 392 (2000) (applying California law in Federal estate tax case and concluding that a power of attorney that gave an attorney-in-fact "significant powers to manage and convey" the decedent's property "could not give him the power to make gifts without expressly doing so"), aff'd, 10 F. App'x 833 (Fed. Cir. 2001).

The Court thus found that §2036(a)(2) applied in this case, as there was no authority to make the gift, so Nancy had not disposed of the interest in the FLP. As the Court did in *Strangi*, the Court found this case did not invoke the fiduciary duty of the donor to other partners, a duty that lead the Supreme Court to find that such rights had not been retained in the case of *United States v. Byrum*, 408 U.S. 125 (1972).

Byrum is key to virtually all family limited partnership planning if a bona fide sale cannot be shown, since the inclusion is triggered if there is available to the donor "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." Obviously, the partners acting as a whole almost always could undertake the prohibited designation. *Byrum* has been interpreted by most practitioners to hold that there was not such a right when the partner owed a fiduciary duty to other partners.

As the Tax Court explains:

> In *Byrum*, the (Supreme) Court held that a decedent's retained right to vote shares of stock in three corporations that he had transferred to a trust for the benefit of his children did not cause the value of those shares to be included in the value of his estate under section 2036(a)(2). The Court rejected the Government's argument that, through his ability to vote the transferred shares, the decedent could affect the corporations' dividend policy and thus the trust's income. Among other things, the Court noted that the decedent, as the controlling shareholder of each corporation, owed fiduciary duties to the minority shareholders that circumscribed his influence over the corporations' dividend policies.

The *Strangi* decision had held *Byrum* did not apply if there were no equity holders with an adverse interest. Again, in this case, the Court found that the only true "duty" that the son held in this case under the POA was to the decedent, holding:

> In addition to his duties as NHP's general partner, Mr. Powell owed duties to decedent that he assumed either before he created the partnership or at about the same time. Nothing in the circumstances of the present cases suggests that Mr. Powell would have exercised his responsibility as general partner of NHP in ways that would have prejudiced decedent's interests. Because decedent held a 99% interest in NHP, whatever fiduciary duties limited Mr. Powell's discretion in determining partnership distributions were duties that he owed almost exclusively to decedent herself. Finally, the record provides no indication that NHP conducted meaningful business operations or was anything other than an investment vehicle for decedent and her sons. We conclude that any fiduciary duties that limited Mr. Powell's discretion in regard to distributions by NHP were "illusory" and thus do not prevent his authority over partnership distributions from being a right that, if retained by decedent at her death, would be described in section 2036(a)(2).

The Court did go down one unique path, this time not just accepting that the property transferred should be treated as part of the decedent's estate, but rather looking to IRC §2043(a) to limit the

inclusion to the value transferred in excess of the value of the partnership interest the decedent received. That interest, due to the Court's view that the transfer to the CLAT was void or voidable, was included in Nancy's estate and, the Court noted, if the full value transferred to the FLP was included in Nancy's estate, this would result in a double taxation result.

As the Court notes, Section 2043 reads:

> SEC. 2043. TRANSFERS FOR INSUFFICIENT CONSIDERATION
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> (a) In General. — If any one of the transfers, trusts, interests, rights, or powers enumerated and described in sections 2035 to 2038, inclusive * * * is made, created, exercised, or relinquished for a consideration in money or money's worth, but is not a bona fide sale for an adequate and full consideration in money or money's worth, there shall be included in the gross estate only the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent.

Judge Lauber, in an opinion that concurred in result only, argued the Court had gone down this path without any compelling need to do so. First, the Court has not felt a need to deal with this in the past, since the holding generally results in the partnership being a non-entity. As the concurrence notes:

> This is where I part company with the Court, because I do not see any "double inclusion" problem. The decedent's supposed partnership interest obviously had no value apart from the cash and securities that she allegedly contributed to the partnership. The partnership was an empty box into which the $10 million was notionally placed. Once that $10 million is included in her gross estate under section 2036(a)(2), it seems perfectly reasonable to regard the partnership interest as having no distinct value because it was an alter ego for the $10 million of cash and securities.
>
> This is the approach that we have previously taken to this problem. See *Estate of Thompson,* 84 T.C.M. (CCH) at 391 (concluding that the decedent's interest in the partnership had no value apart from the assets he contributed to the partnership); *Estate of Harper v. Commissioner*, T.C. Memo. 2002-121, 83 T.C.M. (CCH) 1641, 1654; cf. *Estate of*

> *Gregory v. Commissioner*, 39 T.C. 1012, 1020 (1963) (holding that a decedent's retained interest in her own property cannot constitute consideration under section 2043(a)). And this is the approach that I would take here. There is no double-counting problem if we read section 2036(a)(2), as it always has been read, to disregard a "transfer with a string" and include in the decedent's estate what she held before the purported transfer — the $10 million in cash and securities.

The Judge Lauber goes on to describe the majority's machinations as "a solution in search of a problem," and voices a concern that the Court may have opened the door to aggressive tax planning attempting to make use of this analysis.

> Indeed, the Court seems to acknowledge the analytical infirmities of its approach, conceding that its formulation could "result in a duplicative reduction in transfer tax." See op. Ct. n.7. The possibility of a "duplicative reduction in transfer tax" may invite overly aggressive tax planning. By adopting an untried new theory without first hearing from the parties, we risk creating problems that we do not yet know about. The more prudent (and conservative) approach in my view would be to adhere to the letter and spirit of our precedent, leaving the law in the relatively stable position it appears to occupy now.