Presentation for the Greater Boca Raton Estate Planning Council

Tuesday, October 20, 2015

“Both Sides Now” – A view of the IRS’s Audit Process and Trends from the Perspective of both the IRS and Taxpayer

Having worked as a supervisory attorney in the IRS Estate & Gift Tax Division for over thirty years, and for the past 3½ years representing private clients in audit disputes, I’ve looked at audits, as Joni Mitchell so eloquently penned, “from both sides now.” This session will discuss the IRS audit process in detail, looking at potential issues from both the perspective of the IRS, and that of the taxpayer’s representative. We will also cover audit trends as well as recent case law dealing with valuation of art, closely held businesses, easements, penalties, and other relevant issues to those who practice in the area of estate and gift taxation.

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IRS Return Selection Process for Audits

• All returns, both estate & gift, are initially screened and reviewed at the

Cincinnati Service. Your reputation can play a role in the selection process as well as the reputation of the experts you chose.

• Returns can be sent anywhere in the USA for audit depending on local

workloads and inventories. Domicile of taxpayer no longer controlling

factor.

• Second review is performed by local estate tax manager

• If case assigned to an estate tax attorney he/she still has the

ability to approve it without an audit with secondary management approval

• Larger and more complex business valuation issues should be referred to

the IRS Engineering & Valuation Division. However, there are no “set-in-

stone” mandatory referral guidelines for businesses (artwork is different)

Current Hot IRS Valuation Related Issues

- LL.C.'s & Partnerships containing art. The leading case in this area is

-Art transactions are also being scrutinized in income tax

- See N.Y. Times “Tax Break Used by Investors in Flipping Art Faces Scrutiny” (April 26, 2015) – discussed later in detail.

- Older gift tax returns & adequate disclosure (8/5/97 magic date)

- IRC Section 2036 issues (most litigated issue) – see later detailed analysis

- Use of formula clauses to discourage audits

* The use of “defined value clauses” or “value definition formulas” in making gifts has received much attention and possibly a boost from the decision of the United States Tax Court in Wandry v. Commissioner, T.C. Memo 2012-88. Wandry seems to extend the effectiveness of such techniques beyond what previous case law permitted. But Wandry is not well-settled law on this subject, its reasoning is troubling, and it should not be relied on except with great care, especially since the IRS has filed a Notice of Appeal
* Since 1985, the IRS has become less sympathetic and has challenged such audit-resistant formulas, often citing *Commissioner v. Procter*, 142 F.2d 824 (4th Cir. 1944), a case with unusual facts in which the court found a provision in a document of transfer that “the excess property hereby transferred which is deemed by [a] court to be subject to gift tax ... shall automatically be deemed not to be included in the conveyance” to be contrary to public policy because it would discourage the collection of tax, would require the courts to rule on a moot issue, and would seek to allow what in effect would be an impermissible declaratory judgment.
* Field Service Advice 200122011 (Feb. 20, 2001) addressed, negatively, the facts generally known to be those of *McCord v. Commissioner*, 120 T.C. 358 (2003), in which the taxpayers had given limited partnership interests in amounts equal to the donors’ remaining GST exemption to GST-exempt trusts for their sons, a fixed dollar amount in excess of those GST exemptions to their sons directly, and any remaining value to two charities. The IRS refused to respect the valuation clauses. The IRS acknowledged that the approach in question was not identical to Procter, because it used a “formula” clause that defined how much was given to each donee, while Procter involved a so-called “savings” clause that required a gift to be “unwound” in the event it was found to be taxable. Nevertheless, the IRS believed the principles of Procter were applicable, because both types of clauses would recharacterize the transaction in a manner that would render any adjustment nontaxable. The IRS reached similar conclusions in Technical Advice Memoranda 200245053 (July 31, 2002) and 200337012 (May 6, 2003).
* Estate of Christiansen v. *Commissioner*, 130 T.C. 1 (2008) (reviewed by the court), addressed the use of value formulas in the different context of a disclaimer of a testamentary transfer. The decedent’s will left her entire estate to her daughter, with the proviso that anything her daughter disclaimed would pass to a charitable lead trust and a charitable foundation. The daughter disclaimed a fractional portion of the estate, with reference to values “finally determined for federal estate tax purposes.” Noting that phrase, the Tax Court, without dissent, rejected the Service’s Procter argument and upheld the disclaimer to the extent of the portion that passed to the foundation. (The court found an unrelated technical problem with the disclaimer to the extent of the portion that passed to the charitable lead trust.) In a pithy eight-page opinion, the Eighth Circuit affirmed. 586 F.3d 1061 (8th Cir. 2009).
* In Estate of *Petter v. Commissioner*, T.C. Memo 2009-280, the Tax Court upheld gifts and sales to grantor trusts, both defined by dollar amounts “as finally determined for federal gift tax purposes,” with the excess directed to two charitable community foundations. Elaborating on its Christiansen decision, the court stated that “[t]he distinction is between a donor who gives away a fixed set of rights with uncertain value—that’s Christiansen —and a donor who tries to take property back—that’s Procter.... A shorthand for this distinction is that savings clauses are void, but formula clauses are fine.” The court also noted that the Code and Regulations explicitly allow valuation formula clauses, for example to define the payout from a charitable remainder annuity trust or a grantor retained annuity trust, to define marital deduction or credit shelter bequests, and to allocate GST exemption. The court expressed disbelief that Congress and Treasury would allow such valuation formulas if there were a well-established public policy against them. On appeal, the Government did not press the “public policy” Procter argument, and the Ninth Circuit affirmed the taxpayer-friendly decision. 653 F.3d 1012 (9th Cir. 2011).
* *Hendrix v. Commissioner*, T.C. Memo 2011-133, was the fourth case to approve the use of a defined value clause with the excess going to charity, although the court emphasized the size and sophistication of the charity, the early participation of the charity and its counsel in crafting the transaction, and the charity’s engagement of its own independent appraiser.

In *Wandry v. Commissioner*, T.C. Memo 2012-88, the donors, husband and wife, each defined their gifts as follows:

I hereby assign and transfer as gifts, effective as of January 1, 2004, a sufficient number of my Units as a Member of Norseman Capital, LLC, a Colorado limited liability company, so that the fair market value of such Units for federal gift tax purposes shall be as follows: [Here each donor listed children and grandchildren with corresponding dollar amounts.]

Although the number of Units gifted is fixed on the date of the gift, that number is based on the fair market value of the gifted Units, which cannot be known on the date of the gift but must be determined after such date based on all relevant information as of that date.

The court stressed the now familiar “distinction between a ‘savings clause’, which a taxpayer may not use to avoid [gift tax], and a ‘formula clause’, which is valid.... A savings clause is void because it creates a donor that tries ‘to take property back’.... On the other hand, a ‘formula clause’ is valid because it merely transfers a ‘fixed set of rights with uncertain value’.” The Tax Court then compared the Wandrys’ gifts with the facts in Petter and determined that the Wandrys’ gifts complied. Most interesting, the court said (emphasis added):

It is inconsequential that the adjustment clause reallocates membership units among petitioners and the donees rather than a charitable organization because the reallocations do not alter the transfers. On January 1, 2004, each donee was entitled to a predefined Norseman percentage interest expressed through a formula. The gift documents do not allow for petitioners to “take property back”. Rather, the gift documents correct the allocation of Norseman membership units among petitioners and the donees because the [appraisal] report understated Norseman’s value. The clauses at issue are valid formula clauses.

* This is a fascinating comparison, because it equates the rights of the charitable foundations in Petter that were the “pourover” recipients of any value in excess of the stated values with the rights of the children and grandchildren in Wandry who were the primary recipients of the stated values themselves. In a way, the facts of Wandry were the reverse of the facts in Petter. The effect of the increased value in Petter was an increase in what the charitable foundations received, whereas the effect of the increased value in Wandry was a decrease in what the donees received. The analogs in Wandry to the charitable foundations in Petter were the donors themselves, who experienced an increase in what they retained as a result of the increases in value on audit.

- Closely held businesses & partnerships

- Tax affecting - built in capital gains

- Graegin Loans - *E/O John F. Koons III v. Comm*. T.C. Memo 2013-94 (4/8/13)

- Newest case in area, win for IRS, interest not a deductible expense

- Easements - highest & best use (exaggeration of)

Estate Tax Returns Filed (Historical Perspective)

Year Number Taxable # CHC/Partner

2013 10,568 4,687 5,051

2012 9,412 3,738 4,430

2011 12,582 1,480 2,164

2010 15,191 6,711 6,361

2001 108,071 51,736 13,464

Examination Coverage of Estate Tax Returns

Year # Examined % $5-10 m. % Over $10 m.

2013 3,250 23.7% 31.2%

2012 3,762 58.6%. 116 %

2011 4,195 24.9%. 40.3%

2010 4,288 20.8% 30.8%

For 2012 total CHC & Real Estate P'ners = 4,429

Gift Tax Returns Filed (Historical Perspective)

Year Total Taxable $1 Million Plus

2013 369,063 5,638 114,190

2012 249,000 2,469 31,529

2011 219,544 10,982 3,040

2010 223,093 9,645 1,732

2004 224,987 4,994 930

Exam Coverage of Gift Tax Returns

Year # Returns Examined % Audited

2013 2,775 1.1%

2012 3,164 1.4%

2011 2,623 1.2%

2010 1,777 .7%

2009 1,569 .6%

Hot IRS Valuation Issues in Greater Detail

1. Discounted Works of Art and Art in General – Why emphasis on art?

In 2013, most recent year with available figures, the IRS Art Advisory Panel recommended accepting 44% and adjusting 56% of the appraisals it reviewed.

IRS Art Advisory Panel Average Adjustments

Year Donation Estate/Gift

2008: -51% +91%

2009: -34% +66%

2010: -58% +43%

2011: -46% +51%

2012: -52% +47%

2013: -32% +33%

*E/O Elkins v. Commissioner*, 767 F.3d 443 (5th Cir. 2014), aff’g in part and rev’g in part 140 T.C. 86 (2013) – Deals with fractional interest in art. On his estate tax return, the estate claimed valuation discounts for the partial interests in artwork of 44.75% from the pro rata portion of the total undiscounted value, based on appraisals reflecting the lack of marketability of a partial interest and the time and expense of a partition action. (The artwork was valued by Sotheby’s, and the discount set by Deloitte LL.P.) In its notice of estate tax deficiency, the Service assessed a $9 million deficiency, based on denial of discounts in valuing the artwork. Prior to litigation, the Service and the estate agreed to the undiscounted values of the art. In litigation, the estate claimed a valuation discount of nearly 67%, based on new appraisals by art and other experts that question whether anyone would really want a partial interest in the artwork without a very substantial discount.

The Service, relying on Estate of *Scull v. Commissioner*, T.C. Memo 1994–21, and *Stone v. United States*, 103 A.F.T.R. 2d 2009-1379 (9th Cir. 2009) for its position that little or no discount would be allowable. The Tax Court (later affirmed by the Fifth Circuit Appeals Court) held that the cited cases did not support the IRS position. The court also rejected the discounts proposed by the taxpayer’s as unrealistically high. The appeals court agreed with the Tax Court’s rejection of the IRS’s “no discount” position. The court emphasized that the IRS offered no evidence of the proper amount of discount if any discount is allowed. In contrast, the estate attached an appraisal to the form 706 and offered even more evidence of discounts at trial. The court noted that the taxpayer had the burden of proof, but the burden shifted to the IRS when the estate offered credible evidence. Because of the failure on the part of the IRS to offer evidence of the amount of an appropriate discount, the court fully sustained the taxpayer’s original 44.75% discount.

Lesson: Experts do matter!

Discussion: I have been working with two extremely wealthy taxpayers on Elkins issues. My advice to practitioners based on my recent experience is………

2. Older gift tax returns and adequate disclosure

If a taxpayer does not file a tax return, the statute of limitations for most federal taxes never commences. Thus, in theory, the IRS can go back as many years as it wants to an ‘open’ year to audit and assess tax. In practice, the IRS really goes back too far. In the income tax area, six years is the general rule of thumb. In a recent case, the IRS has raised eyebrows by seeking to assess gift taxes on a transfer that occurred 41 years ago.

In 1972, Sumner Redstone transferred stock in a family company to other family members and settlement of a family dispute. The IRS is now seeking $1.1 million in gift taxes and penalties, plus interest per its view that the transfer was a gift. The interest alone has been estimated to be at least equal to, or more than the original tax and possible penalties combined.

3. IRC Section 2036 Issues (the most litigated)

 Section 2036 provides that:

General Rule —The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full

consideration in money or money’s worth), by trust or otherwise, under which he

has retained . . .

(1) the possession or enjoyment of, or the right to the income from, the

property, or

(2) 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

 Ramifications ― If IRS successful, all assets of entity

might be brought back into estate

 Even if interests in partnership transferred during life (Harper, Korby)

Bona Fide Sale for Adequate and

Full Consideration Exception

 Two part test:

(1) Adequate and Full Consideration ― Interests proportionate and value

of contributed property credited to capital accounts

(2) Bona fide Sale ― "Significant and legitimate non-tax reason" for

creating the entity

Case-by-case analysis:

 Centralized asset management (Stone, Kimbell, Mirowski, Black)

 Involving next generation in management (Stone, Mirowski, Murphy)

 Protect from creditors/failed marriage (Kimbell, Black, Murphy, Shurtz)

 Preservation of investment philosophy (Schutt, Murphy, Miller)

 Avoiding fractionalization of assets (Church, Kimbell, Murphy)

 Avoiding imprudent expenditures by future generations (Murphy, Black)

2036(a)(1) ― Retained Right to Possess or Enjoy

Assets Contributed or Income From Assets

 Case-by-case analysis

 Factors considered by courts:

 Non pro-rata distributions (Harper, Korby, Thompson)

 Personal expenditures with partnership funds (Strangi, Hurford, Rector)

 Personal use assets in partnership (Strangi)

 Payment of estate tax and expense when assets transferred to

partnership close to death (Miller, Strangi, Erikson)

 Accurate books and records not kept (Harper)

 Insufficient assets outside of partnership (Thompson, Miller, Strangi,

Rector)

2036(a)(2) - Retained Right to Designate Persons Who Will

Possess or Enjoy Assets Contributed or Income From Assets

 Strangi, Turner, Cohen

 Investment powers not subject to 2036(a)(2)

(Byrum v. U.S.)

 Distribution powers?

 Cohen/Byrum ― "If the agreement may be said to give the trustees

unlimited discretion . . . , so that dividends could be arbitrarily and

capriciously withheld or declared, then the dividend power would

constitute a 'right' under section 2036(a)(2); if, on the other hand,

the power is circumscribed by cognizable limits on the exercise of

discretion, then no such 'rights' exists."

 Should senior family member be general partner?

 How about co-general partner?

Prepare for Audit at Planning Stage

 IRS issues broad requests

 "All documents relating to the creation of the entity from any attorney,

accountant or firm involved in recommending the creation of the

entity . . ."

 Your files could be subpoenaed ― including emails

 You might have to testify about reasons for creating entity

 Help your client ― best evidence of non-tax reasons comes

from contemporaneous correspondence (see Stone, Schutt)

 Okay to discuss tax attributes, but talk about non-tax

attributes and reasons too (see Stone, Schutt, Mirowski)

Recent Valuation Decisions

T/P (Year) Type of Assets Court of Jurisdiction Discount

Strangi I (2000) securities Tax 31%

Knight (2000) securities/real estate Tax 15%

Dailey (2001) securities Tax 40%

Adams (2001) securities/real estate/minerals Fed. Dist. 54%

Church (2002) securities/real estate Fed. Dist. 63%

McCord (2003) securities/real estate Tax 32%

Lappo (2003) securities/real estate Tax 35.4%

Peracchio (2003) securities Tax 29.5%

Deputy (2003) boat company Tax 30%

Green (2003) bank stock Tax 46%

Thompson (2004) publishing company Tax 40.5%

Kelley (2005) cash Tax 32%

Temple (2006) marketable securities Fed. Dist. 21.25%

Temple (2006) ranch Fed. Dist. 38%

Temple (2006) winery Fed. Dist. 60%

Astleford (2008) real estate Tax 30% (GP); 36% (LP)

Holman (2008) Dell stock Tax 22.5%

Keller (2009) securities Fed. Dist. 47.5%

Murphy (2009) securities/real estate Fed. Dist. 41%

Gallagher (2011) publishing company Tax 47%

Koons (2013) cash Tax 7.5%

Richmond (2014) marketable securities Tax 46.5% (37% LOC/LOM & 15% BIG)

WHAT ARE THE FORMS IN WHICH THE SERVICE PROVIDES ADVICE TO TAXPAYERS?

The Service provides advice in the form of letter rulings, closing agreements, determination letters, information letters, and oral advice.

A **“letter ruling**” is a written determination issued to a taxpayer by an Associate office in response to the taxpayer’s written inquiry, filed prior to the filing of returns or reports that are required by the tax laws, about its status for tax purposes or the tax effects of its acts or transactions. A letter ruling interprets the tax laws and applies them to the taxpayer’s specific set of facts. A letter ruling is issued when appropriate in the interest of sound tax administration. One type of letter ruling is an Associate office’s response granting or denying a request for a change in a taxpayer’s method of accounting or accounting period. Once issued, a letter ruling may be revoked or modified for a number of reasons. A letter ruling may be issued with a closing agreement, however, and a closing agreement is final unless fraud, malfeasance, or misrepresentation of a material fact can be shown.

A “**closing agreement**” is a final agreement between the Service and a taxpayer on a specific issue or liability. It is entered into under the authority of IRC § 7121, and it is final unless fraud, malfeasance, or misrepresentation of a material fact can be shown.

A taxpayer may request a closing agreement with a letter ruling or in lieu of a letter ruling, with respect to a transaction that would be eligible for a letter ruling. In such situations, the Associate Chief Counsel with subject matter jurisdiction signs the closing agreement on behalf of the Service.

A closing agreement may be entered into when it is advantageous to have the matter permanently and conclusively closed or when a taxpayer can show that there are good reasons for an agreement and that making the agreement will not prejudice the interests of the Government. In appropriate cases, a taxpayer may be asked to enter into a closing agreement as a condition for the issuance of a letter ruling.

A “**determination letter**” is a written determination issued by a Director that applies the principles and precedents previously announced by the Service to a specific set of facts. It is issued only when a determination can be made based on clearly established rules in a statute, a tax treaty, the regulations, a conclusion in a revenue ruling, or an opinion or court decision that represents the position of the Service.

An “**information letter**” is a statement issued by an Associate office or Director that calls attention to a well-established interpretation or principle of tax law (including a tax treaty) without applying it to a specific set of facts. An information letter may be issued if the taxpayer’s inquiry indicates a need for general information or if the taxpayer’s request does not meet the requirements of this revenue procedure and the Service concludes that general information will help the taxpayer. An information letter is advisory only and has no binding effect on the Service. If the Associate office issues an information letter in response to a request for a letter ruling that does not meet the requirements of this revenue procedure, the information letter is not a substitute for a letter ruling. The taxpayer should provide a daytime telephone number with the taxpayer’s request for an information letter.

Information letters that are issued by the Associate offices to members of the public are made available to the public. Information letters that are issued by the Field offices are generally not made available to the public.

Because information letters do not constitute written determinations as defined in § 6110, they are not subject to public inspection under § 6110. The Service makes the information letters available to the public under the Freedom of Information Act (the “FOIA”). Before any information letter is made available to the public, an Associate office will redact any information exempt from disclosure under the FOIA. See, e.g., 5 U.S.C. § 552(b)(6) (exemption for information the disclosure of which would constitute a clearly unwarranted invasion of personal privacy); 5 U.S.C. § 552(b)(3) in conjunction with § 6103 (exemption for returns and return information as defined in § 6103(b)).

The following documents also will **not** be available for public inspection as part of this process:

(1) transmittal letters in which the Service furnishes publications or other publicly available material to taxpayers, without any significant legal discussion;

(2) responses to taxpayer or third party contacts that are inquiries with respect to a pending request for a letter ruling, technical advice memorandum, or Chief Counsel Advice (which are subject to public inspection under § 6110 after their issuance); and

(3) responses to taxpayer or third party communications with respect to any investigation, audit, litigation, or other enforcement action.

Oral Advice

No oral rulings and no written rulings in response to oral requests. The Service does not orally issue letter rulings or determination letters, nor does it issue letter rulings or determination letters in response to oral requests from taxpayers. Service employees ordinarily will discuss with taxpayers or their representatives inquiries about whether the Service will rule on particular issues and about procedural matters regarding the submission of requests for letter rulings or determination letters for a particular case

Discussion is possible on substantive issues. At the discretion of the Service and as time permits, Service employees may also discuss substantive issues with taxpayers or their representatives. Such a discussion will not bind the Service or the Office of Chief Counsel, and it cannot be relied upon as a basis for obtaining retroactive relief under the provisions of § 7805(b).

Service employees who are not directly involved in the examination, appeal, or litigation of particular substantive tax issues will not discuss those issues with taxpayers or their representatives unless the discussion is coordinated with Service employees who are directly involved. **The taxpayer or the taxpayer’s representative ordinarily will be asked whether an oral request for advice or information relates to a matter pending before another office of the Service or before a Federal court.**

If a tax issue is not under examination, in appeals, or in litigation, the tax issue may be discussed even though the issue is affected by a nontax issue pending in litigation.

A taxpayer may seek oral technical guidance from a taxpayer service representative in a Field office or Service Center when preparing a return or report.

The Service does not respond to letters seeking to confirm the substance of oral discussions, and the absence of a response to such a letter is not a confirmation.

**Important:** Oral guidance is advisory only, and the Service is not bound by it. Oral guidance is advisory only, and the Service is not bound by it, for example, when examining the taxpayer’s return.

IRC Section 9100 Relief

The stated purpose of this Section is to grant taxpayers extra time to make elections. For an excellent detailed analysis of IRC Section 9100 see the 2015 Heckerling Outline prepared by M. Reade Moore titled “Important Procedural Rules for Estate Planners.” There are three types of relief available under this section. All require that you act in good faith and granting relief will not prejudice the interests of the government. Reasonable action is presumed if the request is made before the government discovers the failure to timely elect (one small benefit to the IRS being so slow to audit estate tax returns).

The taxpayer is deemed to have acted reasonably and in good faith if they:

1. inadvertently failed to make the election because of intervening events beyond their control;
2. failed to make the election because, after exercising due diligence (taking into account the taxpayer’s experience and complexity of the issue) the taxpayer was unaware of the necessity for the election;
3. reasonably relied on the written advice of the IRS; or
4. reasonably relied on a qualified tax professional who failed to make, or advise the taxpayer to make, the election.

Prejudice is deemed to exist only if granting the requested relief gives the taxpayer a lower tax liability than if the election had been timely made.

Type 1 - 9100(2)(a)(2) - automatic extension to elect up to 12 months after filing a timely return to elect only Section 2032(a) or alternate valuation treatment. Total can be up to 27 months after d/d if return was filed with a timely 6 month extension.

Type 2 - 9100(2)(b) – automatic extension of 6 months from filing of return, including extensions, to elect most 706 elections. Must file request with statement on top saying “Filed Pursuant to Section 9100 – 2.” Taxpayer must demonstrate they acted in good faith and granting relief will not prejudice the government.

Type 3 – 9100(3)(b)(3) – This is a last resort measure when no other type of relief is still available. Is actually a request for a revenue ruling and requires payment of appropriate fee. Can be used for missed portability, QTIP, reverse GST, etc.

**Note**: Nothing can cure a blown section 6166 election. This election must be made on a timely filed return.

User fees - Letter Rulings Before 2/5/14 After 2/5/14

(c) (i) Letter ruling request for relief under § 301.9100–3 $10,000 $6,900

Reason Cause for Abatement of Late Filing Penalties

Surprisingly I am now involved in my third estate having failure to file timely penalties being assessed by the IRS.

If for some reason you miss the legal filing date, mail the return as early as possible after that date. The longer you wait to file after the due date has passed, the more difficult it will be to have the penalties abated. The leading authority in the estate tax area on reasonable cause for late filing is the Supreme Court case of *United States v. Boyle,* 469 U.S. 241 (1985). The Court in Boyle gave us the following guidelines on this issue:

To avoid a penalty for a late-filed return, the taxpayer bears the "**heavy burden**" of proving its failure to file timely was due to reasonable cause and not willful neglect. *Boyle*, 469 U.S. at 245 (citing I.R.C. § 6651(a)(1)). In order to prove "reasonable cause," a taxpayer must show that it "exercised 'ordinary business care and prudence' but nevertheless was 'unable to file the return within the prescribed time.'" "Willful neglect" requires a "conscious, intentional failure or reckless indifference."

In *Boyle*, the Supreme Court observed that "[c]ourts have differed over whether a taxpayer demonstrates 'reasonable cause' when, in reliance on the advice of his accountant or attorney, the taxpayer files a return after the actual due date but within the time the adviser erroneously told him was available." The Court's decision in *Boyle* did not resolve those differences. The Court did state, however, that:

“When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a "second opinion," or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place. "Ordinary business care and prudence" do not demand such actions.

By contrast, one does not have to be a tax expert to know that tax returns have fixed filing dates and that taxes must be paid when they are due. In short, tax returns imply deadlines. Reliance by a layperson on a lawyer is of course common; but that reliance cannot function as a substitute for compliance with an unambiguous statute. Among the first duties of the representative of a decedent's estate is to identify and assemble the assets of the decedent and to ascertain tax obligations. Although it is common practice for an executor to engage a professional to prepare and file an estate tax return, a person experienced in business matters can perform that task personally. It is not unknown for an executor to prepare tax returns, take inventories, and carry out other significant steps in the probate of an estate. It is even not uncommon for an executor to conduct probate proceedings without counsel. “

Also see recent cases of *Estate of Morton Liftin v. United States,* 110 Fed. Ct. Cl. 119 (2013) and *Knappe v. United States,* 713 F.3d 1164 (9th Cir. 2013) for additional examples of just how difficult it is to overcome the assessment of late filing penalties for estate tax returns.

Future Portability Audits or how important is getting an appraisal for hard to value assets when the first to die has a below the level exclusion amount and you are only filing to protect portability when and if you file a return for the second to die?

Answer – it depends

**Update on Estate & Gift Tax Appeals (thanks to Maricarmen Cuello)**

Appeals Mission – to resolve tax disputes, without litigation, on a basis which is fair and impartial to both the government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the IRS.

Independence is the most important of Appeals’ core values.

Currently there are two Estate & Gift Tax Teams

- East Coast – Maricarmen Cuello, Mgr. (Miami)

New York (3)

Philadelphia (1)

Jacksonville (2)

- West Coast – Kym Taborn, Mgr. (Los Angeles)

Seattle (1)

Los Angeles (1)

Houston (1)

Dallas (1)

Chicago (1)

Indianapolis (1)

Sources of Cases

* Appeals from 706 and 709 examinations
* Denial of 706 and 709 claims
* 6166 qualification denials
* Terminations of 6166 elections
* Denials of 6161 payment extension requests
* Penalty appeals stemming from estate and gift tax returns
* Occasionally, unagreed 1041 cases

**Fast Track Settlement**

* Settling issues at the earliest possible stage in the examination or collection process reduces the burden on taxpayer and IRS resources.
* Appeals’ Fast Track programs provide taxpayers with an opportunity for quality, accelerated case resolutions by having Appeals employees serve as mediators while cases are still in Compliance’s jurisdiction.
* As of July 2013, the SB/SE Fast Track Settlement Process was expanded nationwide.
* All parties participate in the FTS session
* The FTS official is trained in mediation techniques and has been delegated settlement authority.
* The resolution goal is 60 days for SB/SE cases & 120 days for LB&I cases

Fast Track Settlement Procedures

* Exam will complete the FTS application - Form 14017
* Exam group manager ensures the FTS qualifications are met
* If case qualifies, Exam will send the FTS package to Appeals to confirm and accept the case into the FTS program
* FTS session arranged by FTS Official
* FTS Official facilitates discussions utilizing mediation techniques and settlement authority.
* If an agreement is reached, the parties sign Form 1400 FT Session Report agreeing to the settlement.
* Report of final agreement will be prepared by Exam and executed by taxpayer and/or representative.
* Generally Exam will prepare agreement forms.
* Appeals will prepare agreement forms if 870AD, or 890AD, or closing agreement is required.
* Case is closed by SB/SE

Fast Track Eligibility

* Non-docketed cases
* Fully-developed cases

Fast Track Exclusions

* TEFRA cases
* Collection Due Process, Offer in Compromise, and Trust Fund Recovery Penalty cases
* Whipsaw issues
* Correspondence cases worked solely at a campus
* Frivolous issues
* Uncooperative taxpayers

Summary of Fast Track Benefits to Taxpayer

* Significantly reduces case resolution time
* Reduced interest costs
* Fewer IRS contacts
* Prompt resolution

**Appeals Judicial Approach and Culture (AJAC)**

* AJAC clarifies the independence and impartial role of Appeals
* It clarifies the distinction between the roles of Compliance and Appeals
* It emphasizes a quasi-judicial approach to dispute resolution

Statute of Limitation Requirements for Appeals

* In general, all new case receipts in Appeals from Compliance must have **at least** **365** days remaining on the statute of limitations (SOL) when received in Appeals
* Estate Tax cases must have **at least 270 days** remaining on the SOL.

**The Three (3) News & Appeals Jurisdiction**

* New information
* New issues
* New argument/theory

New Information (first new)

* What is “new information?” – New information or new evidence is any item that the taxpayer did not previously share with the examiner, and in the judgment of the Appeals Hearing Officer, merits **additional analysis** or **investigative action** by Examination.
* What is Additional Analysis? – Additional analysis means anything that is not self evident, or involves voluminous information. Simply adding up items that are not voluminous does not constitute additional analysis. Categorizing, sorting, reviewing large volumes of records, or requiring additional steps or reasoning to reach a conclusion constitutes additional analysis.
* What is an investigative action? – Investigative action means actions required for fact finding, to make inquiries or to verify the authenticity of an item.
* If Appeals receives **new information** from the TP that, in the judgment of the Appeals Hearing Officer, merits **additional analysis and/or investigative action**, the case will be returned to the originating function (jurisdiction released) to examine the new information. The **rationale** behind this procedure is that a first review by Compliance ensures that the TP is afforded a true appeal with respect to their position/issue. If Appeals conducts the initial review, the TP is not getting a “true appeal” or second look at their case.

New Issue (second new)

* Appeals will not raise new issues and will focus its efforts on resolving points of disagreement by the parties.
* Appeals will attempt to settle a case on factual hazards when the case submitted by compliance is not fully developed and the TP has presented no new information or evidence.
* When a TP raises a new issue to Appeals on a non-docked case and sufficient time remains on the SOL, **jurisdiction of the case will be released** to the originating function to allow for their examination of the new issue. The new issue must be relevant to the case.
* **Docketed Cases:** Appeals will consider a new issue affirmatively raised by the government in pleadings and may consider any new evidence developed by Compliance or Counsel to support the government’s position on the new issue. The Appeals hearing officer’s consideration of a new issue on a docketed case will take into account that the government has the burden of proof. Disagreements between Appeals and Counsel on whether a settlement offer should be accepted **is resolved by Area Counsel,** with the advice and assistance of the Appeals Area Director and Associate Chief Counsel responsible for the issue.

Releasing Jurisdiction to Compliance: There are three factors to consider prior to releasing jurisdiction:

* Statute Date: There must be at least 210 days remaining on the SOL if case is to be returned to Compliance to consider new information. Compliance must then return case back to Appeals with at least 180 on the SOL.
* Relevance
* Additional Analysis/Investigative Action

New Argument/Theory (third new)

* Appeals may consider new theories and/or alternative legal arguments that support the parties’ positions when evaluating the hazards of litigation.
* The Appeals hearing officer will not develop evidence that is not in the case file to support the new theory or argument.
* If a TP presents a relevant new theory or alternative legal argument to Appeals:

1. Appeals will send the information to the Estate Tax Attorney for an opportunity to review and comment. Jurisdiction is not released.
2. EXAM function has 45 days to provide written comments (can be extended by mutual agreement).
3. The originating function’s response will be shared with the TP, who will be allowed time to review and provide a response.

Additional Administrative Expenses

* There is a **special exemption** for administrative expenses defined under IRC 2053
* Appeals will not release jurisdiction
* Information will be sent to Compliance for review and comment.
* Compliance will have 45 days to review and provide their determination.

**Key messages to PRACTIONER**

* Raise a new issue or provide new information to the examiner and DON’T wait until your case is in Appeals
* Raise new issues or provide new information in the protest to a 30-Day Letter.
* Very important to document the items you provided to the examiner.