

**2008 Regional Forums**  
**Partners and Partnerships**  
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- 1.) **Final Regs On Disclosures Of Reportable Transactions Reduce Compliance Burdens; "Transactions Of Interest" Category Remains Vague** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *T.D. 9350, 9351, 9352*
- 2.) **New Draft Forms 1065 And 1120 Question Ownership Structures** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *ew Draft Forms 1065 And 1120 Question Ownership Structures IR-2007-138*
- 3.) **Final Regs On Rollover Of Gain From QSB Stock Make Pro-Partnership Modifications** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *Final Regs On Rollover Of Gain From QSB Stock Make Pro-Partnership Modifications T.D. 9353*
- 4.) **IRS Will Not Look Beyond Direct Activities Of Trustees In Applying Passive Activity Loss Limits To Trusts** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *RS Will Not Look Beyond Direct Activities Of Trustees In Applying Passive Activity Loss Limits To Trusts TAM 200733023*
- 5.) **Government Prevails In Latest Son Of BOSS Case** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *Government Prevails In Latest Son Of BOSS Case Jade Trading, LLC, FCI, December 21, 2007*
- 6.) **IRS Overreached In Use Of Economic Substance Doctrine To Prevent Partnership Tax Strategy** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *IRS Overreached In Use Of Economic Substance Doctrine To Prevent Partnership Tax Strategy Countryside Limited Partnership, TC Memo 2008-3, Dec. 57,304(M)*
- 7.) **Accounting Partner In Firm Merger Not Allowed To Delay Immediate Tax On Stock Contrary To Agreement** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *Accounting Partner In Firm Merger Not Allowed To Delay Immediate Tax On Stock Contrary To Agreement M.J. Fletcher, DC Ill., January 15, 2008*
- 8.) **Decedent's Interest In Family LLC Not Included In Gross Estate** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *Decedent's Interest In Family LLC Not Included In Gross Estate Mirowski, TC Memo. 2008-74*
- 9.) **Partial Victory For Family Limited Partnership: Transfers Not Indirect Gifts Of Stock But Valuation Discounts Reduced** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *Partial Victory For Family Limited Partnership: Transfers Not Indirect Gifts Of Stock But Valuation Discounts Reduced T.H. Holman, Jr., 130 TC No. 12, CCH Dec. 57,455*
- 10.) **IRS Finalizes Automatic Extension Regs For Individuals; Reduces Extension Period For Pass-Throughs, Estates, Trusts** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *IRS Finalizes Automatic Extension Regs For Individuals; Reduces Extension Period For Pass-Throughs, Estates, Trusts IR-2008-84, T.D. 9407, NPRM REG-115457-08*
- 11.) **NEWSLETTER, Federal Tax Weekly, NO. 28, JULY 17, 2008, Limited Partner To Report Allowable Amount Of Distributive Share Of Interest Expense On Schedule E** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *Limited Partner To Report Allowable Amount Of Distributive Share Of Interest Expense On Schedule E ann. 2008-65 and Rev. Rul. 2008-38*
- 12.) **Regs Provide Deemed Election To Write Off Start-Up And Organizational Expenses** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company *Regs Provide Deemed Election To Write Off Start-Up And Organizational Expenses T.D. 9411, NPRM REG-164965-04*

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- 1.) **NEWSLETTER, Federal Tax Weekly, NO. 31, AUGUST 9, 2007, Final Regs On Disclosures Of Reportable Transactions Reduce Compliance Burdens; "Transactions Of Interest" Category Remains Vague** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

*T.D. 9350, 9351, 9352*

The IRS has released three sets of final regs that modify disclosure requirements for reportable transactions. The final regs primarily effect changes in the disclosure requirements for material advisors. While they also feature welcomed disclosure extensions for partners, shareholders, and trust beneficiaries, they do not go far enough for many practitioners in limiting "transactions of interest" as a broad new category of reportable transactions.

**CCH Take Away.** "The final regs represent Treasury's latest campaign in its war to eradicate abusive tax shelters. Greater disclosure and record keeping requirements, including the designation of transactions of interests as a new category of reportable transactions are the keys to increased transparency. Overall Treasury took a more reasonable and pragmatic approach in authoring the regs," Lawrence Hill of Dewey Ballantine, New York, told CCH.

#### **Extended deadlines**

The first of the three-part series of tax shelter regs provides that partners, shareholders of S-corps and trust beneficiaries who discover their participation in a reportable transaction from a Schedule K-1 received in less than 10 calendar days before the due date of their return will have 60 calendar days after the return due date to disclose the transaction to the IRS.

The final regs also provide, if a transaction in which a taxpayer participates becomes a listed transaction or "transaction of interest" after the taxpayer files a return (including an amended return), the taxpayer is allowed 90 days from the date the transaction became a reportable transaction to disclose their participation. The disclosure statement must be made on Form 8886, Reportable Transaction Disclosure Statement.

#### **Transactions of interest**

A significant component of the final regs is the official addition of "transactions of interest" as a new category of reportable transactions, applicable to transactions entered into on or after November 2, 2006. The IRS left unchanged its original definition of a "transaction of interest" as first introduced in the proposed regs last year. A transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest.

Taxpayers will have to wait until a specific transaction is identified in published guidance as a transaction of interest. The IRS rejected suggestions that advance notice be provided if it is considering the designation of a certain transaction as a transaction of interest. Instead, advance notice will be provided only on a case by case basis.

#### **Comment:**

The IRS has two years in which to determine whether a transaction of interest will remain as such. Hill told CCH that this is an "unduly long period of time."

## Material advisors

The final regs lighten the burden of material advisors by allowing them to provide a reportable transaction number to only those taxpayers and material advisors for whom the material advisor acts as such. The final regs also permit material advisors to only report the identities of other material advisors who the material advisor knows, or had reason to know, acted in such a capacity with respect to the transaction. Potential material advisors who are uncertain as to whether a transaction must be disclosed may file a protective disclosure.

## List requirements

The final regs lengthen the time that a material advisor has to deliver to the IRS a list of information regarding reportable transactions from 20 days to a longer period. The IRS will address an alternative production schedule for furnishing the list or its components in future guidance.

### *Comment:*

"Lengthening the amount of time that a material advisor has to turn over a list from 20 days to a longer period to be set forth in subsequent guidance is a welcome development," Hill told CCH.

## Eliminations

The final regs eliminate for most taxpayers Form 8271, *Investor Reporting of Tax Shelter Registration Number*. Under T.D. 9350, only investors in pre- *American Jobs Creation Act of 2004* tax shelters must continue to file the form. The regs also eliminate from the reportable transaction category "transactions with a brief asset holding period."

## 2.) NEWSLETTER, Federal Tax Weekly, NO. 31, AUGUST 9, 2007, New Draft Forms 1065 And 1120 Question Ownership Structures © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

### **New Draft Forms 1065 And 1120 Question Ownership Structures**

*IR-2007-138*

Newly-released draft Form 1065, *U.S. Return of Partnership Income*, and Form 1120, *U.S. Corporations Income Tax Return*, include new questions on ownership issues. The IRS released both revised forms for comment on whether the draft revisions would improve compliance and the extent to which the changes would increase taxpayer burden.

**CCH Take Away.** The IRS claims that they are necessary to increase transparency and to enable it to focus its compliance resources on those returns and issues that warrant examination. While not wanting to predict taxpayer response, an IRS spokesperson told CCH that, with the significant increase in information requested on the new forms and the resulting compliance burdens upon taxpayers, the IRS is bracing for an onslaught of comments.

### **Form 1065**

Draft Form 1065 adds new questions to the existing Schedule B, which includes reporting requirements for partnerships with complex ownership structures. Draft Form 1065 requires partnerships to identify entities having direct and indirect (through attribution) ownership interests of 10 percent or more in the partnership and to identify entities in which the partnership owns interests of 10 percent or more. Revised Schedule B also requests information about cancelled debt, and like-kind exchanges the partnership participated in at any time during the tax year.

In addition, Form 1065 filers required to file Schedule M-3, Net Income (Loss) Reconciliation for Certain Partnerships, will find a new Schedule C, in which partnerships must identify individuals or entities that own 50 percent or more of the partnership and of other entities required to file U.S. income tax returns.

**Schedule K-1 changes.** Draft Form 1065 also includes revisions to Schedule K-1. The changes require a partnership to identify contributions and distributions of built-in gain or loss property and to identify the maximum percentage of a partner's share of profit, loss and capital in cases where those amounts change during the year.

**Comment:**

The IRS anticipates certain small partnerships will experience a reduced filing burden since the asset threshold for filing certain schedules with Form 1065 would be increased from \$600,000 to \$1 million. On the other hand, partnerships with complicated ownership structures, related-party transactions, contributions and distributions of built-in gain or loss property, special allocation issues, and optional basis adjustments may spend more time assimilating the required information, the IRS predicted.

3.) **NEWSLETTER, Federal Tax Weekly, NO. 33, AUGUST 23, 2007, Final Regs On Rollover Of Gain From QSB Stock Make Pro-Partnership Modifications** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

**Final Regs On Rollover Of Gain From QSB Stock Make Pro-Partnership Modifications**

*T.D. 9353*

Final regs governing the application of Code Sec. 1045 to partnerships and their partners include some important taxpayer-friendly changes to proposed regs issued in 2006. The final regs explain and liberalize, among other things, the replacement qualified small business (QSB) stock requirement, calculating the amount of gain a partner may defer and how to opt out of a partnership Code Sec. 1045 election.

**CCH Take Away.** The rollover provisions in Code Sec. 1045 did not always apply to partnerships. Originally, only individuals were eligible. The *IRS Restructuring and Reform Act of 1998* clarified that the rollover provisions apply to certain partnerships and S corporations. The change validated the way in which a relatively large number of individuals are able to take advantage of the rollover: through venture capital partnerships.

**Background**

Under Code Sec. 1045, a non-corporate taxpayer that sells QSB stock it has held for more than six months can elect to defer recognizing gain, other than gain treated as ordinary income, on the sale. To successfully defer gain after the election, the taxpayer must purchase QSB replacement stock within a 60-day period beginning on the date of the sale of the QSB stock. Any gain deferred and not recognized reduces the cost basis of the replacement QSB stock. The taxpayer recognizes gain, however, to the extent the amount realized on the sale of the QSB stock exceeds the cost basis of the replacement QSB stock.

**Replacement QSB**

Some practitioners suggested that the final regs should permit a partner that makes a Code Sec. 1045 election with respect to QSB stock sold by one partnership to satisfy the replacement QSB stock requirement by holding an interest in a partnership, which acquires QSB stock within the statutory period. This suggestion, the IRS determined, was consistent with Congress' intent to encourage investment in QSB stock and is reflected in the final regs.

A taxpayer, other than a C corporation, that sells QSB stock and elects to apply Code Sec. 1045, may satisfy the replacement QSB stock requirement with QSB stock that is purchased within the statutory period by a partnership in which the taxpayer is a partner on the date the QSB stock is purchased (purchasing partnership), the IRS explained. Additionally, an eligible partner of a partnership that sells QSB stock (selling partnership) and elects to apply Code Sec. 1045 may satisfy the replacement QSB stock requirement with QSB stock purchased by a purchasing partnership during the statutory period. A partner that sells its interest in the purchasing partnership is not treated as selling replacement QSB stock, the IRS explained.

**Nonrecognition**

The IRS has also modified the nonrecognition rule in the proposed regs. The amount of gain that an eligible partner may defer under Code Sec. 1045 may not exceed:

1 The partner's smallest percentage interest in partnership capital from the time the QSB stock is acquired until the time the QSB stock is sold, multiplied by

1 The partnership's realized gain from the sale of the stock.

**Comment:**

The proposed regs looked instead to the partner's smallest percentage interest in partnership income, gain or loss with respect to the QSB stock sold.

**Opting out**

The final regs also allow a partner to opt out of a partnership Code Sec. 1045 election. The partner must notify the partnership in writing that it is opting out of the election. Opting out is not a revocation of the partnership Code Sec. 1045 election, which continues to apply to the other partners.

**More guidance**

Despite some concerns from practitioners, the final regs reiterate that the partnership is the proper party to make the appropriate basis requirements. The final regs also address tiered-partnerships and describe election procedures and reporting rules.

- 4.) **NEWSLETTER, Federal Tax Weekly, NO. 34, AUGUST 30, 2007, IRS Will Not Look Beyond Direct Activities Of Trustees In Applying Passive Activity Loss Limits To Trusts** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

**IRS Will Not Look Beyond Direct Activities Of Trustees In Applying Passive Activity Loss Limits To Trusts**

*TAM 200733023*

A recent Technical Advice Memorandum (TAM) appears to finally flesh out the IRS's position on determining whether a trust has materially participated in a business activity to avoid the Code Sec. 469 passive activity loss (PAL) limitations. The IRS considered a trust to have materially participated in a business activity for PAL purposes only if its fiduciaries directly participate in the activity on a regular, continuous and substantial basis. Having the trustees hire someone else to be active is not good enough, according to the IRS.

**CCH Take Away:** David Nave, senior vice president and tax director, Pitcairn Financial Group, told CCH that he "wasn't sure if the TAM gives a lot more guidance than we had before." Nave reported that there was a question in the past as to whether taxpayers should look to the beneficiary or trustee for application of the Code Sec. 469 passive activity loss rules. However, he emphasized that while the passive activity rules have been around for 21 years and the IRS has even reserved space for guidance on material participation of trusts and estates under Reg. §1.469-5T(g), no definitive guidance on the issue has been released. Nave stated it was "like reserving a table and never showing up for dinner." When asked about the idea, Nave agreed that it would be wise for the IRS to seek guidance in this area from practitioners or look at how passive activity losses by trusts are being treated in actual practice.

Nonetheless, Nave advised practitioners to take heed of this TAM, as it is likely that, since there is no other guidance for the application of passive activity loss rules to trusts, the IRS will challenge any contrary tax positions.

**Background**

A testamentary trust acquired an interest in a limited liability company (LLC), classified as a partnership for federal income tax purposes. The trustees performed some minor administrative and operational activities in the business. However, the will establishing the trust also required "special trustees" to perform other duties related to the business. These included reviewing operational budgets, analyzing a tax dispute that arose between partners, and preparing and analyzing financial documents.

**IRS analysis**

Under Code Sec. 469, trusts may not deduct losses related to passive activities that exceed related gains. Passive activities include those in which the trust does not materially participate. There currently is no statutory or regulatory authority to explain when a trust is deemed to have materially participated in the activity.

Relying on Congressional statements of intent, the IRS has concluded that trusts may meet the material participation qualification through the activities of their fiduciaries. However, they may not look to the activities of their employees.

Since the trustees themselves did not materially participate in the business, the trust was not entitled to deduct the passive activity loss. The activities of the special trustees did not count towards the trust's material participation because they were not considered true fiduciaries of the trust.

**Comment:**

Nave noted that trusts participating in active businesses such as this are quite rare. A more common situation is the trust that holds on to real property interests. In such situations, the question arises as to whether the trust (and now the fiduciary) actively participates in real estate activities. Nave explained that the dearth of guidance leaves open such questions as whether a trustee who is a real estate professional may qualify for the real estate professional exception under Reg. §1.469-5T(g) so that the trust itself may be deemed to have materially participated in the activity.

**Previous authority**

The IRS acknowledged that the TAM's interpretation differs from the only previous authority on the issue, *Mattie K. Carter Trust, N.D., April 11, 2003*, that involved a non-grantor trust that held a working cattle ranch. The court held that employees could help the trust avoid passive activity loss limitations. The court found that "common sense" dictated that the participation of the trust in the ranch operations involved looking to the activities of those who worked on the ranch to further its business. The court was persuaded by the taxpayer's argument that a trust, similar to a C corporation, had to have a living person act on its behalf. The IRS flatly rejected this interpretation in the TAM, stating that, since businesses cannot look to the owner's employees to satisfy the material participation requirement, neither should trusts.

- 5.) **NEWSLETTER, Federal Tax Weekly, NO. 1, JANUARY 3, 2008, Government Prevails In Latest Son Of BOSS Case © 2008, CCH INCORPORATED.** All Rights Reserved. A WoltersKluwer Company

**Government Prevails In Latest Son Of BOSS Case**

*Jade Trading, LLC, FCI, December 21, 2007*

The Federal Claims Court handed the IRS a major victory in its war on tax shelters recently when it ruled that a Son of BOSS transaction lacked economic substance. The court found that *Coltec v. U.S., 454 F.3d 1340, (Fed. Cir. 2006)* reaffirmed the validity of the economic substance doctrine and mandated additional scrutiny of these transactions.

**Comment:**

IRS Chief Counsel Donald Korb told CCH, "this case was tried two years ago, but it was certainly worth the wait." Furthermore, he stated "the holding should leave no doubt that the judicially developed economic substance doctrine does not need to be incorporated into the tax code. Even without an act of Congress, the court in *Jade Trading* had all of the tools it needed not only to decide the case in favor of the government but also to sustain a 40 percent penalty against the partnership."

**Background**

The tax shelter involved limited liability companies (LLCs) that each purchased a spread position with foreign currency options based on the value of the euro. The two options were "reverse knock-out" options.

All of the LLCs then contributed their options to a single partnership. They each computed the basis of their partnership interests solely based on the \$15 million premium of the purchased options. They interpreted Code Sec. 752(b) to mean that, while partners must decrease their partnership basis by any liabilities assumed by the partnership, this did not apply for contingent obligations. They argued that the short-sold options were contingent obligations.

**Reminder.** Reg. §1.752-6 now prevents taxpayers from failing to reduce their partnership interest basis by liabilities not covered in Code Sec. 752(a) or (b). The regulation was not in existence nor effective during the tax years at issue in this case.

The LLCs later caused the partnership to redeem their partnership interests in exchange for assets. When they later sold these assets, they claimed a basis equal to that of their partnership interest. The result was a \$14.9 million tax loss.

## **Economic substance**

The court found that the transaction lacked economic substance. The claimed losses were purely fictitious." The transaction was developed as a tax avoidance mechanism and not as a legitimate investment strategy.

The court also found that the transaction had no reasonable profit potential. The structure of the transaction and the unusually high fees required for participation prevented it from being profitable, no matter how the value of the euro performed.

- 6.) **NEWSLETTER, Federal Tax Weekly, NO. 2, JANUARY 10, 2008, IRS Overreached In Use Of Economic Substance Doctrine To Prevent Partnership Tax Strategy** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

### **IRS Overreached In Use Of Economic Substance Doctrine To Prevent Partnership Tax Strategy**

The IRS recently lost a significant battle in the Tax Court over when the economic substance doctrine can override technical compliance with partnership tax rules. The court determined that partners receiving liquidating distribution consisting of third-party promissory notes did not have to recognize any gain from under Code Sec. 731(a)(1) since the notes were neither cash nor marketable securities. Additionally, they were allowed to increase their partnership interest basis by their pro rata share of debt assumed by the partnership to purchase the notes under Code Sec. 752.

The taxpayer admitted that the distribution was structured to defer tax. However, the court still ruled that these actions had economic substance because all of the parties involved had a business purpose for their actions. The partnership sought to eliminate the partnership interests, while the partners wanted to convert their partnership investment into interest-bearing promissory notes. The manner in which these goals were accomplished, the court reported, only had a "collateral favorable tax effect."

*Countryside Limited Partnership, TC Memo 2008-3, Dec. 57,304(M)*

- 7.) **NEWSLETTER, Federal Tax Weekly, NO. 6, FEBRUARY 7, 2008, Accounting Partner In Firm Merger Not Allowed To Delay Immediate Tax On Stock Contrary To Agreement** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

### **Accounting Partner In Firm Merger Not Allowed To Delay Immediate Tax On Stock Contrary To Agreement**

*M.J. Fletcher, DC Ill., January 15, 2008 - Ernst & Young.Cap Gemini*

A district court has rejected the argument that the IRS cannot recover a refund based on an amended return that claimed a partner in an acquired tax and accounting firm should not be taxed immediately on all the stock received in the acquisition, even though much of it had some restrictions on its sale. Transaction documents, read and signed by the taxpayer, and additional extrinsic evidence indicated that the transaction participants intended to realize income from the entire value of their interest in the transaction in the year the deal closed. Absent fraud or strong proof of the parties' contrary intention, the court would not upset the tax allocations agreed to in the transaction agreement.

The transaction

The taxpayer was a partner in a large tax and accounting firm, a cash method taxpayer. Her firm sold part of its business in return for shares of the acquiring company. As a result of the transaction, the taxpayer and other partners received restricted stock shares in the newly formed company. Upon closing in 2000, there was to be an immediate sale of 25 percent of the taxpayer's stock in the company and the 75 percent balance transferred to her account. The documents stipulated that the taxpayer was to report the transaction as a taxable sale of her entire \$2.5 million partnership interest in the year of closing, despite restrictions placed on her ability to sell the stock.

Erroneous refund

The court rejected the taxpayer's arguments that the provisions of the documents requiring the realization of income for the entire amount of stock violated public policy and were inconsistent with stock transfer restrictions set forth in the transaction documents. The court reasoned that respect for a strict interpretation of Code Sec. 451 was not the only public policy consideration in this case; the ability of parties to contract freely and predict reliably the tax consequences of their business decisions was also critical.

#### Undue influence and duress

The court also found that the taxpayer was not under duress or undue influence when she entered into the transaction. The taxpayer was unable to overcome with "strong proof" the presumption that the tax consequences of the deal were not intended by the parties to be as stated in the documents. Moreover, she failed to provide testimony or other evidence that she would have been fired if she did not agree to the transaction.

*References: 2008-1 USTC ¶50,149;*

#### 8.) **NEWSLETTER, Federal Tax Weekly, NO. 15, APRIL 10, 2008, Decedent's Interest In Family LLC Not Included In Gross Estate** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

##### **Decedent's Interest In Family LLC Not Included In Gross Estate**

*Mirowski, TC Memo. 2008-74*

After closely examining the facts surrounding the formation of a family limited liability company (FLLC), the Tax Court found that assets transferred to the FLLC by the decedent two weeks before her death were not includible in her gross estate under Code Sec. 2036(a), 2038(a) or 2035(a).

**CCH Take Away.** The case reinforces the fact-intensive scrutiny these entities will undergo and the formalities that must be followed in order to legitimize the family FLLC or limited partnership. Nevertheless, it does prove that the FLLC is alive and well under circumstances that may be less than wholly conservative.

##### **Background**

The decedent, who was in good health, had for more than a year contemplated consolidating millions of dollars of assets into a single account; she had 84 accounts in 10 different banks. Two weeks prior to her unexpected death she finally formed a FLLC to which she transferred a substantial amount of property, primarily inherited securities and intellectual property rights. However, she retained a substantial amount of property outside the FLLC.

Days before her death she gifted 16 percent interests in the FLLC to her daughters' previously created trusts. She wanted to consolidate her assets and enable her daughters to participate in their management. The decedent's estate used \$11 million of funds distributed to it from the FLLC to pay gift tax. The IRS asserted a deficiency of \$14 million, increasing the gross estate by the decedent's interest in the FLLC.

##### **Bona fide sale**

The decedent's transfer of property to the FLLC qualified as a bona fide sale for full and adequate consideration under the exceptions to Code Sections 2036(a) and 2038(a). The decedent had adequate and significant non-tax purposes for forming, and transferring assets to, the FLLC, which included: joint maintenance of the family's assets by her children; maintenance of the property in a single pool of assets for investment purposes; provision for her children/grandchildren on an equal basis; and protection of family assets from creditors and divorce.

The decedent also received an FLLC interest proportionate to the value of the property transferred and her capital account was properly credited with those assets. The decedent also maintained significant assets outside of the FLLC to meet personal obligations, including gift tax on the FLLC interests she gifted to her daughters.

##### **No express or implied agreement**

There was no express or implied agreement that the decedent would retain any interest in the FLLC interests she transferred to her daughters' trusts, the Tax Court found. The court rejected the IRS's assertion that by virtue of her management duties under the operating agreement as the FLLC's general manager/majority member she had the right to control the timing and amount of distributions.

### **No retained Code Sec. 2038(a) influence**

The Tax Court also rejected the IRS's assertion that the decedent retained the power under Code Sec. 2038(a) to affect the enjoyment of the FLLC interests transferred to her daughters' trust. The decedent's authority as general manager/majority member to dispose of assets was not a retention of power within the meaning of Code Sec. 2038(a).

*References: CCH Dec. 57,379(M)*

- 9.) **NEWSLETTER, Federal Tax Weekly, NO. 23, JUNE 5, 2008, Partial Victory For Family Limited Partnership: Transfers Not Indirect Gifts Of Stock But Valuation Discounts Reduced** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

### **Partial Victory For Family Limited Partnership: Transfers Not Indirect Gifts Of Stock But Valuation Discounts Reduced**

In a partial victory for a family limited partnership (FLP), the Tax Court has found that the transfer of limited partnership (LP) interests in an FLP were not indirect gifts of stock held by the FLP. However, the court rejected the substantial valuation discounts claimed by the taxpayers for federal gift tax purposes.

#### **Comment:**

Despite IRS attacks on their legitimacy, FLPs remain a valuable estate planning tool to transfer wealth in the eyes of the courts. However, in its fight to minimize the tax savings associated with FLPs, the IRS has been successful in attacking "overzealous" valuation discounts claimed by taxpayers.

**No indirect gift or step transaction.** The Tax Court rejected the IRS's argument that the gift of the LP interests was an indirect gift of stock to the children. In cases holding there was an indirect gift of the stock, the transfers were made on the same day, or the stock was contributed to the FLP after the transfer of LP interests to the children, not six days after the funding of the FLP. So, too, the step transaction doctrine was inapplicable because the six days separating the contribution of stock to the FLP and the taxpayers' gift of LP interests subjected the taxpayers to a real economic risk of a significant change in the value of the LP interests.

**Taxpayers lose on valuation.** The court adjusted the value of the gifts of the LP interests, reducing the marketability discount claimed by the taxpayers from 35 percent to 12.5 percent. The court found no bona fide business purpose for the transfer restrictions in the partnership agreement.

*T.H. Holman, Jr., 130 TC No. 12, CCH Dec. 57,455*

- 10.) **NEWSLETTER, Federal Tax Weekly, NO. 27, JULY 10, 2008, IRS Finalizes Automatic Extension Regs For Individuals; Reduces Extension Period For Pass-Throughs, Estates, Trusts** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

### **IRS Finalizes Automatic Extension Regs For Individuals; Reduces Extension Period For Pass-Throughs, Estates, Trusts**

*IR-2008-84, T.D. 9407, NPRM REG-115457-08*

The IRS has at last gotten around to finalizing regs that give taxpayers an automatic six-month extension to file individual returns, an extension that has been in place administratively since the 2006 filing season. In bigger news, however, the IRS has also issued temporary and proposed regs that, starting immediately with the 2009 filing season, will reduce the six-month extension for partnerships, estates and trusts to five months.

**CCH Take Away.** Shortening by one month to September 15 the time allowed for calendar-year partnerships and estate and trusts to file their returns on extension will ease the problem that has bedeviled individuals on six-month extensions waiting for their Schedule K-1 information from these entities. "We are eliminating the same-day deadline for these returns, which causes needless hardship and puts the individual taxpayer in an awkward position," IRS Commissioner Douglas Shulman said. "We want to correct this timing issue to ensure that all taxpayers have the information they need to file timely and stay in compliance with the law." S corps remain on a six-month extension and are not impacted by the new regs since their extension brings their filing deadline to September 15, already one month in advance of individuals on extension.

***Comment:***

"This is good news for the "downstream" taxpayers and practitioners that serve them. The earlier we can get the K-1's the better," Jane Searing, CPA, shareholder, Clark Nuber, PS, Bellevue, Wash., told CCH. However, Searing noted that for practitioners serving hedge funds that have trouble meeting the current deadlines because audits are not wrapped up sooner, the earlier deadline will be a real challenge. "I had heard rumblings about the need for a change I'm just not sure the earlier due date will solve the problems with timely K-1's because these funds are often times stacked several tiers deep."

**Individuals**

In 2005, the IRS announced that all extensions for individuals residing in the U.S. will automatically last for six months. Individuals no longer have to file one form for an automatic four-month extension and a second form for an additional two-month discretionary extension.

***Comment:***

Individuals residing outside of the U.S. are allowed six-month extensions. Commentators suggested that the IRS retain Form 2688, Application for Additional Extension of Time to File Individual Income Tax Return, for use by taxpayers who are abroad and require more than a six-month extension of time to file. The IRS declined to keep Form 2688 for such a limited purpose. Taxpayers abroad must continue to file a letter with the IRS explaining their need for an extension.

Under the final regs, an individual automatically obtains a six-month filing extension if:

1 The individual prepares and files an application for the extension on Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, or in any other manner authorized by the IRS, and includes an estimate of taxes due for the year; and

1 The individual files the application on or before the return due date at the IRS office designated in the application.

**Partnerships, estates and trusts**

At the same time the IRS simplified extensions for individuals, it also overhauled extensions for certain pass-through entities, estates and trusts. Proposed regs provided for an automatic six-month extension.

***Comment:***

The extension was immediately problematic. An individual with a six-month extension of time to October 15 to file Form 1040 may not receive a Schedule K-1 from a partnership until after the partnership files its Form 1065 on its extended due date of October 15.

Now, the IRS has reduced the six-month extension to five months for partnerships filing Form 1065, U.S. Partnership Return of Income or Form 8804, Annual Return for Partnership Withholding Tax. The extension is also reduced from six to five months for estates and trusts filing Form 1041, U.S. Income Tax Return for Estates and Trusts.

The five-month extension is effective for returns due on or after January 1, 2009. A partnership required to file Form 1065 or Form 8804 on or after July 1, 2008 and before January 1, 2009, will be allowed an automatic six-month extension. A similar rule applies to estates and trusts.

***Comment:***

The IRS is requesting comments on whether the five-month automatic extension of time to file for these pass-through entities increases or reduces overall taxpayer burden.

**Affiliated groups**

The final regs clarify extensions for affiliated groups of corporations filing a consolidated return. The requirement to list with an extension request the name and address of each member of an affiliated group effectively grants an extension for each member's separate return if the member does not file as part of the consolidated group.

- 11.) **NEWSLETTER, Federal Tax Weekly, NO. 28, JULY 17, 2008, Limited Partner To Report Allowable Amount Of Distributive Share Of Interest Expense On Schedule E** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

### **Limited Partner To Report Allowable Amount Of Distributive Share Of Interest Expense On Schedule E**

Earlier this year, the IRS determined in Rev. Rul. 2008-12 that a noncorporate limited partner's distributive share of partnership interest expense incurred in the business of the partnership is subject to the Code Sec. 163(d) limitation on the deduction of investment interest. Now, the IRS has clarified how a nonmaterially participating individual limited partner described in Rev. Rul. 2008-12 should report the allowable amount of his or her distributive share.

This information, the IRS announced, should be reported on Schedule E. Interest paid or accrued on indebtedness allocable to property held for investment described in Code Sec. 163(d)(5)(A)(ii) is a trade or business deduction under Code Sec. 62(a)(1). It is deductible -- after the application of the Code Sec. 163(d)(1) limitation -- in determining the taxpayer's adjusted gross income.

#### **Comment:**

The interest deduction of the limited partner that is properly reportable on Schedule E should be identified on a separate line in Part II, Line 28, column (a), as "investment interest," followed by the name of the trading partnership that paid or incurred the interest expense, and the amount of such interest expense should be entered in column (h).

*Ann. 2008-65 and Rev. Rul. 2008-38*

- 12.) **NEWSLETTER, Federal Tax Weekly, NO. 28, JULY 17, 2008, Regs Provide Deemed Election To Write Off Start-Up And Organizational Expenses** © 2008, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

### **Regs Provide Deemed Election To Write Off Start-Up And Organizational Expenses**

*T.D. 9411, NPRM REG-164965-04*

The IRS issued temporary, final and proposed regs providing deemed elections to deduct start-up and organizational expenses. Allowing a deemed election now avoids the necessity of taxpayers having to formally file a separate election on Form 4562, Depreciation and Amortization. The regs apply to a proprietorship's start-up expenses and to a corporation's or partnership's organizational expenses. They also reflect enhancements to the deduction rules enacted in the *American Jobs Creation Act of 2004* (*2004 Jobs Act*).

**CCH Take Away.** The IRS stated that the deemed election rule was appropriate because most taxpayers elect to deduct the expenses and the rule would reduce the administrative burden of making an election. "The fact that you're deemed to make the election in the year the trade or business begins is quite helpful," Ellen McElroy of Pepper Hamilton LLP, Washington, D.C., told CCH. The regs address the problems of a company that failed to make the election and clarify what happens when a company makes a mistake.

#### **Start-up and organizational expenses**

Individuals may begin to write-off expenses under Code Sec. 195 in the year in which they begin an active trade or business. Corporations may begin to deduct organizational expenses under Code Sec. 248, and partnerships may begin to deduct organizational expenses under Code Sec. 709, in the year that the corporation or partnership begins business. The expenses include amounts incurred in prior years.

The *2004 Jobs Act* changed each provision to allow a first-year deduction of the lesser of \$5,000 or the start-up/organizational expenses, reduced dollar-for-dollar by the amount that the expenses exceed \$50,000. The reduction is based on total expenses, including those incurred on or before October 22, 2004. Expenses that cannot be deducted in the first year must be amortized over 15 years. Prior to the *2004 Jobs Act*, taxpayers could elect to amortize start-up and organizational expenses over 60 months.

#### **Comment:**

The first-year write-off of up to \$5,000 will benefit small businesses. The longer amortization period will hurt larger businesses but is consistent with the 15-year amortization period for Code Sec. 197 intangibles. The deduction cannot be accelerated under the Code Sec. 179 expensing rules or the Code Sec. 168 bonus depreciation rules.

***Comment:***

The regs "didn't tackle the really difficult question of whether a company is in a start-up mode or is expanding its business," McElroy commented. If a company expands its business with an acquisition, it can deduct the expenses currently rather than have to amortize them over 15 years, she indicated.

**Elections**

The deemed election will replace a requirement to make a separate written election and to identify the amount of start-up or organizational expenses. The election is irrevocable. Changing the election, or changing the year in which the business begins, is a change of accounting method requiring the IRS's consent.

***Caution:***

The election restrictions also apply if the taxpayer chooses to capitalize the expenses rather than write them off as start-up or organizational expenses. Taxpayers may forego the deemed election by clearly electing to capitalize the expenses on a timely return for the year the trade or business begins. McElroy observed that the regs "don't specify exactly how to do [this election]." McElroy also speculated that some IRS agents might use the lack of an affirmative election under the new rule as a sword to challenge the year that the taxpayer wrote off the expenses.

**Effective date**

The temporary regs apply to expenses paid or incurred after September 8, 2008. Taxpayers may choose to apply all the regs to expenses paid or incurred after October 22, 2004, the effective date of the *2004 Jobs Act*, provided the statute of limitations has not expired for the particular year.