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Tax Court determines estate and gift tax values of leased fee interests

A recent Tax Court case determined the estate and gift tax values of limited liability companies (LLCs) that held ground leases in several properties (*M.M. Warne, Est.*, TC Memo. 2021-17, Dec. 61,821(M)).

The decedent and her predeceased husband created a family trust that became the majority interest holder of five LLCs. In 2012, the decedent gave interests in each of the LLCs to her two sons and three granddaughters. At her death, the decedent transferred 75% of her interest in one of the LLCs to a family charitable foundation, and the remaining 25% to a church. On the estate tax return, the estate deducted the full value of the 100% interest in the LLC that was shown on the return.

Estate and gift tax valuations

Both parties presented valuations of three disputed leased fee interests as of the date of the gift and the date of death. The experts' computations were based on the fair market value of the land, with an appropriate discount rate applied to that figure. Discounts for lack of control and marketability for the family trust's majority interests in the LLCs on the date of death were also applied. After evaluating the values and methods used by the experts, the court settled on values based on comparable properties and accepted the estate's discount rate. Because the LLC's operating agreements granted considerable power to the majority interest holder, the discount for lack of control was low. The evidence showed that family members owning minority interests were unlikely to pursue litigation if the LLCs were dissolved. Thus, the estate's discount for lack of control was rejected, and the court concluded that 4% was appropriate. The expert's report supported the estate's discount for lack of marketability, but 5%, the low end of the range, was adopted.

Charitable contributions

The government argued that discounts for lack of control and marketability should be applied to the charitable contributions to reflect the value of the property received by the charities. Pursuant to *Ahmanson Foundation*, CA-9, 81-2 USTC ¶13,438, the estate was required to include 100% of the value of the LLC in the gross estate but could only deduct the 25% and 75% interests given to the charities. A discount, which was stipulated by the parties, was applied to the charitable contribution deduction.

Failure to file penalty

The decedent's gift tax return was filed late and the government imposed a penalty under Code Sec. 6651(a)(1). Although the estate claimed the decedent had reasonable cause for the failure to file, it produced no evidence to support the claim. If the Rule 155 computation showed gift tax was due, the Code Sec. 6651(a)(1) addition to tax applied. ◆

Corporate tax reform is key to funding Biden infrastructure plan

The Made in America Tax Plan, providing corporate tax reform, is the centerpiece of funding the $2 trillion-plus American Jobs Plan that President Joe Biden announced on March 31, 2021. The spending would happen over eight years, paid for by business tax increases over 15 years. If enacted, it would be the largest tax increase at the federal level since 1942.

"No one making under $400,000 will see their taxes go up," Biden said in a speech unveiling the package.

The Biden administration has not set a public goal for when it would like the legislation enacted. "It's going to take some time," White House Principal Deputy Press Secretary Karine Jean-Pierre said.

The package raises the corporate tax rate to 28%, which the White House said would be lower than at any time since World War II, other than the 21% set by the 2017 Tax Cuts and Jobs Act (TCJA) (P.L. 115-97).

Corporate tax increase

The Made in America Tax Plan would increase the minimum tax on U.S. corporations to 21% and calculate on a country-by-country basis to affect profits in tax havens. In the wake of the TCJA, the average tax rate for U.S. multinationals has fallen from 16% to 8%.

The proposal would eliminate the rule allowing U.S. companies to pay zero taxes on the first 10% of return when they locate investments in foreign countries. It would deny deductions to foreign corporations on payments that could allow them to strip profits out of the United States if they are based in a country without a strong minimum tax. Further, it would replace a provision in the TCJA that tried to stop foreign corporations from stripping profits out of the U.S.

"The United States is now seeking a global agreement on a strong minimum tax through multilateral negotiations. This provision makes our commitment to a global minimum tax clear. The time has come to level the playing field and no longer allow countries to gain a competitive edge by slashing corporate tax rates," said a fact sheet accompanying the unveiling of the program.

15% minimum tax on book income

The proposal would establish a 15% minimum tax on "book income," the income corporations use to report their profits to investors.

Corporate tax inversions prohibited

If enacted, the package would prevent U.S. corporations from inverting or claiming tax havens as their residence. Currently, U.S. corporations can acquire or merge with a foreign company to avoid U.S. taxes by claiming to be a foreign company, even though their place of management and operations is in the United States.

On tax incentives, the administration is proposing a 10-year extension and phasedown of an expanded direct-pay investment tax credit and production tax credit for clean energy generation and storage.

Tax credit to onshore jobs

The plan creates a tax credit to spur the onshoring of jobs. The tax incentives in the TCJA for foreign derived intangible income would be eliminated.

The Advanced Manufacturing Tax Credit program would be extended.

Targeted tax credits to promote affordable housing

The tax package establishes targeted tax credits to produce, preserve and retrofit more than a million affordable, resilient, accessible, energy efficient and electrified housing units. President Biden is also asking Congress to pass the Neighborhood Homes Investment Act, which would offer $20 billion of tax credits over the next five years.

The measure would result in approximately 500,000 newly built or rehabilitated homes.

Another incentive in the package is an expanded tax credit encouraging businesses to build childcare facilities at places of work.

"The measure would result in approximately 500,000 newly built or rehabilitated homes."

Notable progressive proposals absent

The Made in America Tax Plan and other legislation referred to in the tax elements of the package do not contain an elimination of the cap on state and local tax deductions that progressive Democrats in Congress say is vital, particularly those in high-tax states such as New York and New Jersey. Additionally, the capital gains rate is untouched in the package. Senator Elizabeth Warren's proposed wealth tax is also not included. ◆

Entity not allowed to challenge tax liability

The Court of Appeals for the Sixth Circuit affirmed the Tax Court's decision that an entity was not entitled to challenge its tax liability under Code Sec. 6330 (*Patrick's Payroll Services, Inc.*, CA-6, 2021-1 USTC ¶50,111). The taxpayer was an employee leasing company that provided payroll services to a private security company. The taxpayer paid wages to its employees and issued Forms W-2, *Wage and Tax Statement*, but failed to pay employment taxes to the IRS or file the required employment tax returns.

Following an audit, an IRS revenue agent determined the taxpayer was liable for taxes and penalties based on the wages it reported on its W-2 forms for two tax years at issue. Subsequently, the IRS issued a notice of intent to levy and notified the taxpayer of its right to a collection due process hearing. The taxpayer requested a hearing and unsuccessfully contested the amount of liability assessed at the appeals hearing and the Tax Court.

The taxpayer appealed the Tax Court's grant of summary judgment, contending that it had the right to challenge its tax liability under Code Sec. 6330 because it had not received a notice of deficiency. Further, the taxpayer argued that it was entitled to contest its liability, even though it had a prior opportunity to dispute its liability, because it claimed Code Sec. 6330(c)(2)(B) should be read disjunctively to allow taxpayers to dispute liability anytime the taxes in question are not the type of taxes for which deficiency notices are issued.

The Sixth Circuit determined that because the taxpayer raised its interpretation of Code Sec. 6330 for the first time in a motion for reconsideration, this issue did not have to be considered on appeal. Notwithstanding its untimeliness, the appellate court determined the taxpayer's argument would have failed anyway.

As the court observed, Code Sec. 6330(c)(2)(B) specifies that a taxpayer may challenge underlying tax liability in a collection hearing if it "did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability." However, the taxpayer argued that it needed to meet only one of the two conditions; in other words, because it did not receive a notice of deficiency, it could contest its tax liability despite having had an opportunity to dispute its liability in a prior hearing. The court found the taxpayer's argument was not a natural reading of the statute. ◆

IRS guidance for health FSAs and dependent care assistance programs

The IRS has released guidance that highlights the application of recently enacted §214 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Division EE of P.L. 116-260), which provides temporary special rules for health flexible spending arrangements (FSAs) and dependent care assistance programs under Code Sec. 125 cafeteria plans (Notice 2021-15, IR-2021-40).

Specifically, §214 of the act:

- Provides flexibility with respect to carryovers of unused amounts from the 2020 and 2021 plan years
- Extends the permissible grace period for plan years ending in 2020 and 2021
- Provides a special rule regarding post-termination reimbursements from health FSAs
- Provides a special carryover rule for dependent care assistance programs when a dependent "ages out" during the public health emergency posed by COVID-19
- Allows certain mid-year election changes for health FSAs and dependent care assistance programs for plan years ending in 2021

Salary reduction contributions

In addition, the guidance provides that a Code Sec. 125 cafeteria plan may permit employees who are eligible to make salary reduction contributions under the plan to do the following with respect to employer-sponsored health coverage:

- Make a new election on a prospective basis, if the employee initially declined to elect employer-sponsored health coverage
- Revoke an existing election and make a new election to enroll in different health coverage sponsored by the same employer on a prospective basis
- Revoke an existing election on a prospective basis, provided the employee attests in writing that they are enrolled, or immediately will enroll, in other health coverage not sponsored by the employer

The guidance also provides relief with respect to the effective date of amendments to Code Sec. 125 cafeteria plans to implement the expansion under the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) of allowed expenses for health FSAs and health reimbursement arrangements to include over-the-counter drugs and menstrual care products. ◆

Eleventh Circuit affirms Tax Court's denial of innocent spouse relief

The Eleventh Circuit Court of Appeals affirmed the Tax Court's denial of innocent spouse relief under Code Sec. 6015(f) associated with joint tax returns for three tax years at issue (*L.D. Sleeth*, CA-11, 2021-1 USTC ¶50,109). The couple divorced, and under their divorce agreement, the ex-spouse accepted full responsibility for their outstanding tax liabilities and agreed to support the taxpayer claim for innocent spouse relief. The claim, if granted, would render her ex-spouse solely liable for their unpaid taxes. The IRS denied the taxpayer's request for innocent spouse relief for the tax years at issue, determining the taxpayer did not have a reasonable expectation that her ex-spouse would or could pay the tax at the time she signed the returns, and that she had not shown that she would experience economic hardship absent relief.

The Tax Court applied the nonexclusive list of seven factors in Rev. Proc. 2013-34 to decide whether the taxpayer was eligible for equitable relief, and found that three factors (marital status, lack of significant benefit, and later compliance with tax laws) favored relief and another three factors (economic hardship, legal obligation, and health) were neutral. However, the court concluded that the factor of "knowledge or reason to know" weighed strongly against relief and denied the taxpayer's claim.

The taxpayer claimed the denial of equitable relief was an abuse of discretion because her economic hardship was a positive factor in favor of relief rather than a neutral one. She also disputed that the knowledge or reason-to-know factor weighed against relief and argued the Tax Court placed too much weight on that factor when balancing the factors.

The Eleventh Circuit ruled that the taxpayer had failed to provide any evidence of the amount and nature of her living expenses to properly evaluate the economic hardship factor, and that she was aware of their shared financial troubles. Further, the Tax Court had properly considered the facts and circumstances, evaluated all relevant factors and concluded that the taxpayer's unwillingness to confront the financial problems she faced weighed strongly against equitable relief. Therefore, no abuse of discretion by the Tax Court was found. ◆

> "The claim, if granted, would render her ex-spouse solely liable for their unpaid taxes."

Amounts paid for COVID-19 PPE are deductible medical expenses

The IRS has issued guidance clarifying that payments for personal protective equipment (PPE) (such as masks, hand sanitizer and sanitizing wipes) for the primary purpose of preventing the spread of COVID-19 are treated as amounts paid for medical care under Code Sec. 213(d) (Ann. 2021-7, IR-2021-66).

Therefore, amounts paid by an individual taxpayer for COVID-19 PPE for use by the taxpayer, the taxpayer's spouse or the taxpayer's dependent(s), and not compensated by insurance or otherwise, are deductible under Code Sec. 213(a) if the taxpayer's total medical expenses exceed 7.5% of adjusted gross income.

Because amounts paid for COVID-19 PPE are medical care expenses under Code Sec. 213(d), they are also eligible to be paid or reimbursed under:

- Health flexible spending arrangements (FSAs)
- Archer medical savings accounts (MSAs)
- Health reimbursement arrangements (HRAs)
- Health savings accounts (HSAs)

However, amounts paid or reimbursed with one of these arrangements or accounts are not deductible under Code Sec. 213.

Group health plans

If COVID-19 PPE expenses cannot be reimbursed under the terms of a group health plan (including health FSA or HRA), the plan can be amended under this IRS guidance to provide for reimbursements of expenses for COVID-19 PPE incurred for any period beginning on or after Jan. 1, 2020. Such an amendment will not be treated as causing a failure of any reimbursement to be excludable from income under Code Sec. 105(b), or as causing a cafeteria plan to fail to meet the requirements of Code Sec. 125.

> "However, amounts paid or reimbursed with one of these arrangements or accounts are not deductible under Code Sec. 213."

Group health plans can be amended under this IRS guidance if the following conditions are met:

- The amendment is adopted no later than the last day of the first calendar year beginning after the end of the plan year in which the amendment is effective.
- No amendment with retroactive effect is adopted after Dec. 31, 2022.
- The plan is operated consistent with the terms of the amendment, including during the period beginning on the effective date of the amendment through the date the amendment is adopted. ◆

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