Forbes

Peter J Reilly, Contributor
I focus on the tax issues of individuals, businesses & more

TAXES | 12/28/2011 @ 10:49PM | 2,133 views

5 Neglected Tax Developments of 2011

Image by 401K via Flickr

I review original source tax material looking for items that are of practical significance, provide matter for reflection or humor. Since I moved to Forbes, I have turned my old blog into a repository of the original source material that I write about - or not. Sometimes it seems interesting when I read it, but turning it into something remotely Forbes worthy is beyond me. Since many of these items do not get much attention elsewhere in the tax blogosphere, I hate to just let them wither. So here are some interesting items from the last few months that were not quite interesting enough. When I say they were neglected, I mean neglected by me, a couple did have decent coverage in the tax blogosphere:

1.Estate of Lillian Baral

Ms. Baral had been suffering from dementia. Her physician recommended that she have round-the-clock care for her safety. Her brother, who was her attorney-in-fact, at first hired an agency, but then switched to individuals to save money. The Tax Court found that even though the individuals were not licensed, their services were deductible as medical expenses. Interesting note in this case is that no return had been filed. I would speculate that if an original return had gone in with all the expenses there would have been no need for the trip to tax court. If you are looking out for someone whose income is being wiped out by medical expenses, it is worth the effort to get a tax return in, even though no tax will be due.

This case was pretty widely covered even making it into the Journal of Accountancy.

2.In Re: Duarte

This was a bankruptcy case in the Eastern District of New York. It concerns how to split a refund between a "non-debtor" spouse and a bankruptcy estate. Apparently this is not something that the bankruptcy courts have been consistent about. This particular decision adopted the IRS method, which involves preparing two pro-forma separate returns. The important planning point, though, is that filing a joint return is an election. Whether it is the best thing to do is not a simple matter of what produces the lowest tax. Having one spouse in bankruptcy changes the landscape. Craig Robins Long Island Bankruptcy Blog had a good piece on this decision.

3.David H. Zatz, et ux. v. Commissioner, TC Summary Opinion 2011-94

The taxpayers was not even trying to defend the scheme that they had entered into. They were just trying to get out of the penalties by pleading that they had relied on professionals. The Tax Court emphasized that for professional advice to be valid for penalty purposes, it must be independent.

Relying on assurances of professionals may demonstrate good faith, but only when the professionals are acting independently from the entity promoting the claimed benefits. Advice from otherwise qualified professionals with an interest in the transaction "is better classified as sales promotion.

There have been quite a few cases that support this theme. They inspired me to write a piece on the paradox of value billing in tax matters. Billing based on the value of the transaction rather than the hours worked tends to make the work worthless.

4. ESTATE OF ANNE Y. PETTER v. COMM., Cite as 108 AFTR 2d 2011-5593

This was a Ninth Circuit decision that approves a valuable planning technique for people who expect to be making large charitable bequests:

Anne Y. Petter ("Taxpayer" or "Anne") transferred membership units in a family-owned LLC partly as a gift and partly by sale to two trusts and coupled the transfers with simultaneous gifts of LLC units to two charitable foundations. The transfer documents include both a dollar formula clause —which assigns to the trusts a number of LLC units worth a specified dollar amount and assigns the remainder of the units to the foundations—and a reallocation clause—which obligates the trusts to transfer additional units to the foundations if the value of the units the trusts initially receive is finally determined for federal gift tax purposes to exceed the specified dollar amount. Based on an initial appraisal of the LLC units, each foundation received a particular number of units. But after an Internal Revenue Service ("IRS") audit determined that the units had been undervalued, the foundations discovered they would receive additional units. Everyone agrees that the Taxpayer is entitled to a charitable deduction equal to the value of the units the foundations initially received. But is the Taxpayer also entitled to a charitable deduction equal to the value of the additional units the foundations will receive? The Tax Court answered that she was. We agree.

This is not a free lunch, the formula forces assets away from heirs to charity, but if taxpayer intended a substantial amount to go to charity anyway, it can be a very valuable technique. It puts the IRS in the postion of auditing for the benefit of the charity rather than the government.

This case received a good bit of coverage including this by Wealth Strategies Journal.

5. James Ellington, et ux. v. Commissioner, TC Memo 2011-193

This was a clever attempt to get around the $1,000,000 home mortgage interest limitation. The taxpayers secured the mortgage not only by the residence but also by stock in Intel. It did not work. The general rule is that interest traces to what the borrowed funds are spent on:

Here, petitioners used investment property to secure repayment of a loan for a personal residence rather than a car. This distinction is without a difference. The use of investment property to secure repayment of indebtedness has no effect on the allocation of debt and interest. Rather, it is the "use" of the debt proceeds that determines the allocation.
