

Jewish Community Foundation
Recent Developments
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I. End of Year

A. The IRS has issued a “frequently asked questions” memo addressing some of the rules for decedents dying in 2010:

1. The IRS will not accept Form 706 or an extension to file Form 706 for decedents dying in 2010.

2. The IRS response to whether Congress will retroactively reinstate the estate tax for deaths in 2010 is “we do not know.” The IRS response to the question of whether Congress will change the exemption amount and rates for 2011 was the same.

3. Are the assets in a Qdot Trust subject to estate tax if the surviving spouse dies in 2010? Answer, “maybe.” “For more information, you should consult your tax advisor.”

4. In response to whether property in a revocable trust is eligible for the basis increase for deaths in 2010, the IRS answer is “probably yes.” The answer should be a definite yes for the typical revocable trust. The IRS also says that the survivor’s interest in the community property is eligible for a basis increase because it is deemed to have passed from the decedent. There is no double increase, but the \$1.3 million dollar increase and the \$3 million dollar increase can be applied to all or any part of the community property.

5. For decedents dying in 2010, there are several income tax filing requirements, such as decedent’s final return, fiduciary returns, and the new allocation of allowable basis adjustment return, which is due by April 15, 2011, but for which there is no form as yet. Another requirement for the new return is that within 30 days after the filing, a written statement to each recipient of property must be made showing the basis of the property in the hands of the recipient, as adjusted by the basis adjustment made by the executor.

6. Unanswered questions.

B. California has not adopted the new Federal income tax basis rules applicable to estates of 2010 decedents. Accordingly, California decedents will still receive a stepped up (or stepped down) basis for California income tax purposes, at least for the time being. If this rule remains, Californians will have separate Federal income tax basis and a separate California income tax basis for each asset acquired from a decedent who died in 2010 unless the executor allocates the Federal basis increase to certain assets to bring them up to fair market value, in which case the Federal and California bases will be the same.

II. Family Limited Partnerships/Section 2036

A. In Fisher v. U.S., 105 AFTR 2d 2010-_____ (S.D. IN. 2010), the issue was whether parents had a business purpose for creating an LLC, interests in which were transferred by gift to their children. The principle asset of the LLC was a parcel of undeveloped land that bordered Lake Michigan. The LLC operating agreement provided that the purpose of the LLC was primarily to engage in the business of holding real property for investment. The LLC was formed to control with whom the owners would be in "business," and to keep the lakefront property available for the members' use. Other objectives were to discourage disputes among family members, to prevent partition of the property, and to protect the property from individual creditors of the members. The operating agreement had typical restrictions on transfers, and granted the LLC a right of first refusal in the event of a non-permitted transfer.

The Court determined that the purposes of the LLC did not constitute a "bona fide business arrangement" that would take the LLC out of IRC § 2703, and specifically, § 2703(b)(1). The Court analogized the Fisher situation to the facts in Holman (601 F.3d 763 (8th Cir. 2010)), in which the Court held that the maintenance of family ownership and control of the business may be a bona fide business purpose. However, the Court found that holding the lakefront property did not foster an active involvement in a business. The property was a passive investment that was used primarily for personal enjoyment even though the property could be developed for commercial purposes in the future.

B. In Estate of Schurtz v. Commissioner, TC Memo 2010-21, the Court held that assets transferred to a family limited partnership, interests in which were transferred to the children, were not includable in the gross

estate under IRC § 2036. The primary asset of the partnership was a family business that managed timberland in Mississippi. The purpose of the partnership was to facilitate management of the business as ownership interests became more splintered and to avoid the litigious and “jackpot justice” society in Mississippi. The Court found that the transfer to the partnership came within the bona fide sale exception of IRC § 2036(a) because there was a legitimate and significant non-tax reason for creating the partnership, and the taxpayer received full and adequate consideration.

An interesting aspect of the case which did not have to be decided was the potential of a “mismatch” between the includable assets and the assets that funded a marital gift. The IRS argued the assets (and not the partnership interests) should be included in the gross estate under IRC § 2036, but the funding of the marital deduction with partnership interests should be limited to the discounted value of the partnership interests. Because IRC § 2036 did not apply, the included asset was the partnership interest and the funding of the marital gift with the partnership interest did not result in a mismatch.

Another aspect of the case which is helpful to taxpayers is that the Court held that as long as estate tax savings was not the primary motivation for the creation of the partnership, the fact that estate tax savings provided some of the motivation did not preclude the avoidance of IRC § 2036.

C. Holman v. Commissioner, 130 T.C. 170 (2008), has been affirmed by the 8th Circuit, 105 AFTR 2d ¶ 2010-721 (8th Circuit, April 7, 2010). Taxpayers (husband and wife) created a limited partnership and contributed Dell stock to the partnership. They then made gifts of limited partnership interests over a three year period. The partnership contained typical transfer restrictions that restricted transfers of limited partnership interests without the approval of all the partners, and the partnership had the right to purchase non-permitted transfers at fair market value, with the application of appropriate discounts. Although the taxpayers won in the Tax Court on the issue of whether gifts of limited partnership interest six days after the partnership was created was an indirect gift of the stock rather than a gift of a partnership interest, the taxpayers lost in the Tax Court on the issue of whether the transfer restrictions were effective under IRC § 2703. The 8th Circuit held that the “bona fide business arrangement” requirement in IRC § 2703(b) was not satisfied in this case. Section 2703(b) is a safe harbor from § 2703(a) (which ignores restrictions in an agreement for purposes of valuing an interest in an entity) if the restriction is a bona fide business

arrangement, it is not a device to transfer property to members of a decedents family, and its terms are comparable to similar arrangements entered into by persons in an arms-length transaction. One issue of publicly traded stock was not a “business.” Are the courts confused between a “legitimate business purpose” under IRC § 2036(a) and a “bona fide business arrangement” under § 2703?

D. In the second Pierre v. Commissioner case, T.C. Memo 2010-106 (“Pierre II”), (the first (Pierre I) was at 133 T.C. 24 (2009), the Court allowed a discount of 35.6% (cumulatively for lack of control and lack of marketability) for a gift of an interest in a single member LLC holding only marketable securities. Pierre I held that a gift of an interest in a single member LLC was a gift of an interest in the entity rather than a gift of an interest in the assets. In effect, the single member entity was not disregarded for transfer tax purposes as it is for income tax purposes. The IRS did not have Section 2036 available because the decedent transferred her entire interest to the LLC by gift and by sales to trusts for the benefit of her son and granddaughter. The decedent transferred two 9.5% interests in the LLC by gift and the remaining 81% by two sales of 40.5% to grantor trusts. All of the transactions were completed on the same day. The Court applied the step transaction doctrine to conclude that the transfers were two 50% interests rather than two transfers of 9.5% and two transfers of 40.5%. A “bad fact” was that the attorney who prepared the LLC tax return recorded the transfers as two gifts of 50% interests. The taxpayer did not lose the case in reality because the IRS failed to demonstrate that the value of a 50% interest was much less than the value of a 9.5% interest and a 40.5% interest. The taxpayer’s expert acknowledged that the lack of control discount would be less for a 50% interest than for either a 9.5% or 40.5% interest but with no contrary evidence from the IRS, the Court allowed an overall discount of 35.6% rather than the claimed 36.55%.

Same day transfers have not fared well with the Courts, although it is still unclear how much time must elapse. See, Holman, 130 T.C. 170 (2008); Shepherd, 115 T.C. 376 (2000), *aff’d.*, 283 F.3d 1258 (11th Cir. 2002); Senda, T.C. Memo 2004-160, *aff’d.*, 433 F.3d 1044 (8th Cir. 2006).

E. In Estate of Margo Stewart v. Commissioner, T.C. Memo 2006-225, *rev’d.*, ____ F.3d ____ (2d Cir. 2010), the issue was whether I.R.C. § 2036 applied to a 49% interest in a mixed use building that the decedent gave to her son. The property in question was a five-story brownstone in New York in which decedent and her son lived and a portion of which was leased to an unrelated tenant. Decedent and her son also owned a home as

joint tenants in another section of New York. The other home was rented to third parties during the summer, and decedent and her son shared the income and expenses from that property. Over time, decedent and her son paid expenses and received income in varying amounts for both properties, and generally did not follow the strict ownership of the properties in dividing the income and expenses. The Court made it clear that the decedent did not retain the “right” to the income of the transferred property because she had no legally enforceable right to the income. The Court also clarified that if § 2036 was to apply, it was because the decedent retained the “possession or enjoyment” of the transferred property (the 49%) and not to the entire property. The fact that a decedent’s retention of a majority interest in real property does not necessarily require a finding that the decedent retain possession of the transferred, minority interest. It should be noted that the IRS did not attempt to include the 49% based on continued residence by the decedent and her son in the transferred property because co-tenants have the right to occupy the entire property.

III. Valuation

A. The issue in the Ringgold Telephone Company v. Commissioner, TC Memo 2010-103, was whether the purchase of a minority interest in a company by an unrelated purchaser who already owned a majority interest in the company was for a premium because the purchaser already had control. The taxpayer argued that when taxpayer sold its minority interest to the majority owner, the majority owner was not a hypothetical buyer because the majority owner would have paid more for the minority interest in order to consolidate further its control. The Court held that the purchase price reflected a minority interest because the purchaser did not gain anything additional with respect to control as a result of the purchase because the purchaser already owned a controlling interest.

B. The Tax Court weighed in on the amount of a discount for a 50% interest in a residence transferred to two qualified residence trusts by a husband and a wife. In Ludwick v. Commissioner, T.C. Memo 2010-104, taxpayers claimed a 30% discount for the 50% interest transferred to their respective qualified personal residence trusts. The IRS was willing to allow 15% as a settlement, but later changed its position and argued for an 11% discount. The Tax Court adopted the IRS position that the discount equals the cost to partition, but the Court took into account a “fully loaded” cost to partition, and reduced the value by the time value of money for the time it would take to sell the residence, the costs of selling the residence, the costs

of partition (legal, etc.) and the costs of maintaining the property during the two year period until partition. The Court also looked at the costs that would be incurred if no partition was necessary because one of the owners agreed to sell the property. The ultimate discount based on a weighted average of the costs of both assumptions gave the taxpayers a discount of approximately 17%.

C. Estate of Marie J. Jensen v. Commissioner, T.C. Memo 2010-182, is another case in which the Tax Court had to determine the discount available for built in capital gains tax when valuing the stock of a corporation. The courts are still wrestling with the two approaches that have permeated the opinions. One approach is to allow a dollar for dollar discount as per Eisenberg, Dunn and Jelke. The other approach is to attempt to quantify when the assets will be sold and assume that the hypothetical seller and buyer would pay more or less for the stock depending on when they thought the capital gains tax might be incurred. See Lichfield, Davis. In an opinion very short on analysis, the Court adopted the present value analysis rather than the 100% analysis, but the result was a discount greater than the dollar for dollar approach.

D. In an opinion that is probably five times as long as it needed to be, the Tax Court in Rolfs v. Commissioner, 135 T.C. No. 24 (2010), denied a charitable contribution deduction to a couple who donated their home to a local fire department for training purposes. The Court applied the two part test of American Bar Endowment, 477 U.S. 105 (1986) (now Reg. § 1.170A-1(h)(1), which requires that the gift exceed the market value of the benefit received and the excess payment must be paid with the intention of making a gift. Taxpayers intended to demolish the house and build another house, and once the Court found that the cost of demolition reduced the value of the house below its fair market value, it denied the charitable contribution deduction. Taxpayers received a free demolition when the fire department burned the house down, and the value of that benefit was enough to reduce the value of the house to below its market value.

E. Shark Fin CLATS – Much ado about nothing.

IV. Gift Tax

A. Price v. Commissioner, T.C. Memo 2010-2, involved the availability of the annual gift tax exclusion for gifts of limited partnership interests. The court relied on Hackl, 118 T.C. 279(2002), *aff'd*, 385 F. 3d 664(7th Cir. 2003), to deprive the donor of the annual exclusion because the

donees did not have an unrestricted right to the immediate use, possession or enjoyment of the property or the income. The partnership contained typical provisions prohibiting a limited partner from withdrawing and a prohibition on sale without the consent of the other partners. It was not clear whether distributions of income would be made because the general partner had discretion to make or not make distributions. The “solution” to this problem should be to give the donee a “put” to have his partnership interest redeemed by the partnership within a certain period of time (in effect, a Crummey provision within the partnership), or to require the donor to repurchase the partnership from the donee at fair market value.

B. The rule that gift tax paid within three years of death is includable in the donor’s estate is familiar to all. I.R.C. § 2035(b). Suppose the gift tax is paid by someone else? For example, suppose the gift is a net gift that requires the donee to pay the gift tax. Estate of Morgens v. Commissioner, 133 T.C. No. 17 (2009) answers the question by holding that the gift tax is still includable in the decedent donor’s estate. This holding makes sense in the context of the transfer tax system as a whole. To have ruled otherwise would have given taxpayers a road map to avoid the application of I.R.C. § 2035(b). Some advisors have advocated the use of a net gift in lieu of a sale to a grantor trust.

V. State Law

A. Directed trust legislation is coming – there is a proposal to add Sections 16600, et seq. to the Probate Code to enact a directed trust statute in California. The statute would permit a trustee to be exonerated for following the investment instructions of a “statutory trust advisor” who is a fiduciary under the proposed statute. While it is debatable whether California needs a directed trust statute, the corporate trustees doing business within the state do not believe that existing California law gives them the comfort that they should have when relying on a third party who has the power to direct trust investments.

B. Stoltenberg v. Newman, 179 Cal. App 4th 287 (2009), reaffirms California’s strong policy toward allowing the successors in interest of a decedent to carry on as owners of decedent’s assets free of claims against the decedent that were not brought within the one year statute of limitations of Code of Civil Procedure §366.2. The claim that was barred by C.C.P. 366.2 was a fraud claim based on the concealment of information by the decedent as general partner in a partnership. The decedent was a trustee of a trust, and his general partner interest was held in the trust. The

partners who were defrauded alleged that §366.2 should not be applicable because their claim was against the trust over which the decedent was the trustee. The Court ruled that the claim was against decedent even though it was in his capacity as a trustee, and was barred by §366.2. The reach of §366.2 seems to be all encompassing. But could it reach claims that should not be barred? For example, suppose a decedent signed a 10 year note payable interest only with a balloon payment at the end of 10 years. Decedent dies at the end of six years, and the estate continues to pay interest for one year following the decedent's death. After the expiration of one year from the decedent's death, the estate takes the position that C.C.P. §366.2 prevents the creditor from collecting any further interest and the principal. Does §366.2 apply?

C. Steinhart v. The County of Los Angeles, ___ Cal. 4th ___ (2010), appears to be a case that never should have been brought and certainly should not have reached the Supreme Court. The issue in Steinhart was whether there was a change in ownership (resulting in an increase in property taxes) when the decedent left a residence in trust for his sister for life, remainder to the decedent's siblings or their issue. Steinhart claimed that because she only received a life estate, there was no change in ownership for purposes of the property tax system. Although the case could have been decided on procedural grounds because Steinhart failed to exhaust her administrative remedies with the assessor, the Supreme Court determined that the issue was important enough to deal with the real issue of whether a bifurcated transfer at death was a change of ownership. The Supreme Court had no trouble determining that although the property interests were bifurcated between a life estate and a remainder, the entire property was transferred upon the decedent's death and change of ownership occurred.

D. No contest clause legislation reminder.

Effective January 1, 2010, the impact of no contest clauses on estate plans has been curtailed. The safe harbor petition under § 21320 has been abandoned. Under the new statute, Probate Code § 21311, a no contest clause can only be enforced against three types of actions:

1. A direct contest that challenges the invalidity of an instrument based on forgery, lack of due execution, lack of capacity, menace, duress, fraud or undue influence, revocation, or disqualification of a beneficiary (P.C. §§21350, 6112), if such contest is brought without probable cause.

2. A challenge to a transfer of property on the grounds that it was not the transferor's property at the time of the transfer if the no contest clause expressly provides that such a challenge is a contest.

3. A creditor's claim or a lawsuit based upon a claim if the no contest clause expressly provides that such actions are contests.

E. N.Y. EPTL §2-1.13 saves formula clauses for 2010 deaths with pre-2010 instruments where the formula provisions have no meaning in 2010. California has yet to follow.

F. In Estate of Hastie, 186 C.A.4th 1285 (2010), the Court was faced with facts that required a certain result even though the statute that authorized the Court to reach the result seems flawed. An incapacitated individual gave a power of attorney to his friend. The friend named himself and his child as beneficiaries of an annuity following the decedent's death. Following the decedent's death, the administrator of the estate sued to declare the beneficiary designation invalid under Probate Code § 21356 because the friend was an fiduciary as to the decedent, and gifts to fiduciaries are void unless they are approved by a certificate of independent review or a court using the procedure set forth in the statute. The defense was that the statute of limitations had run on the decedent's ability to set aside the gift. The statute provides that any action to set aside the gift must be brought within three years after the transfer becomes irrevocable or three years from the date the person bringing the action discovers the facts material to the transfer. By the time the decedent died, the three year statute had run, and the defense was that the administrator of the estate should not be permitted to bring an action that the decedent would have been barred from bringing had the decedent brought the action during his lifetime. The Court held for the estate on the grounds that the administrator brought the action within three years of discovery of the material facts (e.g., the beneficiary designation). The result in this case is obviously correct. It is unreasonable to expect an incapacitated individual to bring a lawsuit to revoke a gift that he made while incapacitated, especially if the incapacity continues to exist until death. The statute should be amended to make it clear that successors in interest to a person making the transfer can bring the action after the donor's death based on discovery of the facts.

G. The case of Breakiron v. Gudonis, _____ F. Supp. ____ (D.C. Mass. 2010) is interesting not only for its holding, but because of the procedural aspects. Parents created a qualified personal residence trust that provided that after a 10-year term, the assets in the trust would pass to

their children in equal shares. The parents had two children, Craig and Lauren. The parents survived the trust term, and the asset, a valuable home on Nantucket, would have been distributable to the two children in equal shares. However, Craig wanted to transfer his interest to his sister, and sought the advice of an estate planning lawyer in order to minimize the transfer tax costs of the transfer. The estate planning lawyer erroneously advised Craig that Craig could make a disclaimer of his half interest, and the effect of the disclaimer would be to have Craig's interest pass to Lauren without gift tax. The mistake the estate planning attorney made was that he advised Craig that the disclaimer had to be made within nine months from the termination of the parents' interest in the trust. The law is that the disclaimer had to be made within nine months of the creation of the trust because the nine month rule applies to contingent as well as vested interests. Thus, Craig's disclaimer was about nine years late.

Craig filed an action in Massachusetts state court against his sister to rescind the disclaimer, which presumably would have resulted in a reversion of the property in himself. The IRS was served, and for some strange reason (not so strange as it turned out), appeared in the case, and the case was removed to the federal court. In the federal court proceeding, the federal court, sitting as a state court applying Massachusetts law, decided (correctly) that the disclaimer should be rescinded. Craig was under a mistake when he executed the disclaimer because it was clear that his intention was to minimize the transfer tax cost, and that did not occur because the disclaimer was invalid. It is not clear from the opinion whether the IRS seriously questioned the holding that the disclaimer should be rescinded because all of the facts clearly showed that but for the erroneous advice, Craig would not have signed the disclaimer.

However, the IRS took the position that notwithstanding that the disclaimer was rescinded, Craig still owed gift tax on the transfer of his half of the residence to his sister by invalid disclaimer. The court addressed two lines of cases, one of which would have resulted in a gift tax liability and one of which would not.

The theory of the first line of cases is that the IRS should not be bound by what could be a collusive state court proceeding in which the IRS was not a party and which retroactively altered the tax consequences of a transaction that had already occurred. The other line of cases relies on the IRS' own regulations which provide that there is no completed gift until the donor has parted with complete dominion and control. If the donor has the right to rescind under state law, he has not parted with dominion and

control. The Court held that there was no gift tax liability, primarily because the lawsuit was not collusive, the same federal court that was deciding the gift tax issue decided that Craig had a right to rescind under state law, and the IRS had the opportunity in the case to examine the parties, review the evidence, and participate (which it did) in the proceedings.

H. Lancashire v. Lancashire, is an unreported (and unreportable) California divorce case with some novel facts. Husband and wife transferred community property to a charitable remainder trust with typical provisions for transfers of community property. Each party reserved a unitrust amount for his or her life, the combined unitrust amount was paid to the survivor for his or her life, and upon death of the survivor, the assets passed to charity. The trust did not contain a transmutation provision, nor did the parties have a transmutation agreement. Such a provision or an agreement would be extremely rare in the context of creating a charitable remainder trust to which community property was transferred. At the time of the parties' divorce, the issue was whether the court could award the retained interest in the trust to one of the parties, with an offset of other property to the other party, as the Court would have the power to do if the retained interest was community property. One of the spouses took the position that the trust was not subject to the divorce court's jurisdiction because once the property was transferred to the trust, it was no longer community property. The Court ruled that while the property no longer was community property because it had been transferred to an irrevocable trust, the spouses' retained interests were still community property, and the Court had the jurisdiction to deal with those retained interests in the same manner as any other community property. It is unclear why this case will not be published other than perhaps the Court's lack of confidence that its result is correct.

VI. Charitable Issues

A. In IRS Information Letter 2010-0052, a private foundation made a grant to a limited liability company, the sole member of which was a public charity. The question was whether the private foundation had to exercise expenditure responsibility because the grant was not made to a public charity, but rather to a disregarded entity owned by a public charity. The letter concluded that expenditure responsibility was not necessary because the limited liability company, as a disregarded entity, should be disregarded for this purpose. While the conclusion in this ruling seems self-evident, a disregarded entity is not always disregarded, and at this time, it is not clear whether a gift by an individual to a limited liability company owned entirely by a public charity is a deductible gift for income tax

purposes. See Pierre I, 133 T.C. 24 (2009). An information letter is a statement issued by the IRS that calls attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts. It is advisory only, has no binding effect on the IRS, and cannot be relied upon by the taxpayer requesting it. See Rev. Proc. 2010-4, 2010-1 I.R.B. 122.

B. Private Letter Ruling 201032002 is another in a string of rulings that permits an individual to disclaim an interest and have that interest pass to a foundation of which the individual is an officer or director, provided that the foundation's governing instruments prohibit the individual from exercising any control over the disclaimed assets. A disclaimer is invalid if the disclaimant has the power to direct the disposition of the disclaimed assets, and the IRS consistently and correctly has taken the position that the power to deal with the assets in a charitable foundation over which the individual was an officer or director is a retained power to direct the disposition. The "flaw" in the ruling and in all prior rulings is that it may not be possible to provide in the corporate context that one director has no responsibility over a particular set of assets owned by the corporation. It is possible in the trust context to provide that one trustee has power over one bundle of assets and another trustee has power over another bundle of trust assets, and accordingly, foundations in trust form may be more flexible than foundations in corporate form. However, this ruling (and all prior rulings) does not comment on the possible inability of a corporation to bifurcate its directors' roles, but assumes that if the corporate governing documents do so, the bifurcation is valid.

C. In Private Letter Ruling 201026005, the IRS ruled that the repayment of overpaid charitable remainder trust payments was not an act of self dealing on the part of the recipient. As a result of a scrivener's error, a charitable remainder unitrust had an incorrect payout percentage. The trust was reformed by the local court, and as a result of the reformation, the income beneficiary returned the excess payments that had been made to him based upon the incorrect percentage. The IRS cited § 4947(a)(2) in ruling that § 4941 does not apply to any amounts payable from a split interest trust to income beneficiaries as long as no deduction was allowed for such income interest under the relevant charitable deduction sections of the Internal Revenue Code. The income beneficiary did not take an income tax deduction for the amount returned to the charitable remainder trust, and accordingly the IRS found no self dealing either for the reformation or for the returned distribution.

D. A rescission of a charitable remainder trust worked out well for the taxpayers in Private Letter Ruling 201040021. Taxpayers created a 7% charitable remainder annuity trust, claiming an income tax deduction for the value of the remainder interest. Taxpayers received payments for two years, and at some point, the state income tax authorities requested a computation of the remainder interest to validate the state income tax deduction. The calculation showed that the charitable remainder had a negative value as of the date the trust was created. Taxpayers, the charitable remainderman, and the state attorney general agreed to a rescission. The agreement treated the trust as void ab initio and returned the assets to taxpayers. Taxpayers amended all income tax returns to reflect the rescission. The IRS ruled that the return of the assets to the donors was not an act of self-dealing, did not constitute a taxable expenditure and did not subject the trustee to the tax on termination of private foundation status. The theory of the ruling was that the relevant sections (IRC §§ 507, 4941 and 4945) apply to split interests trusts for which a charitable deduction was allowed. Because the remainder interest was negative at the time the trust was created, no deduction was allowed. Accordingly, the rescission of the trust and the return of the assets to the taxpayers did not fall within the appropriate sections of the Code.

VII. Miscellaneous

A. In Naify v. U.S., ___ F.Supp. ___ (N.D. CA. 2010), a decedent's estate deducted as a liability a possible California income tax liability based upon the tax that would have been payable to California had a certain transaction been subject to tax in California. Ultimately, California settled the income tax claim at substantially less than the amount claimed as a deduction on the estate tax return. The IRS allowed the amount of the settlement as a deduction, and the Court ruled in favor of the IRS. The test at the time the return was filed was whether the claim was "ascertainable with reasonable certainty, and will be paid." In this case, as of the date of death, there had been no California audit of the income tax return, no finding that the transaction was taxable in California, and no payment of the tax.

B. A simple case made complex due to the lack of clarity of state law is Estate of Franklin M. Tatum, Jr. v. U.S., D.C.S.D. Miss. 2010). Decedent left a simple Will that left 60% of his residuary estate to his son and 20% of his residuary estate to each of his two grandchildren. The Will provided that should any beneficiary predecease the decedent, the beneficiary's descendants would take the share of the deceased ancestor.

Decedent's son disclaimed his interest in the residuary estate in a timely manner, and the estate took the position that the property passed to the other residuary beneficiaries. The IRS took the position that the property passed back to the disclaimant by intestacy. The District Court, sitting as a state court for purposes of determining state law, ruled that state law determines the disposition of property as a result of a disclaimer (a correct statement). The issue was that Mississippi law was unclear as to what happened in the event of a disclaimer under the terms of the decedent's Will. One alternative was that the disclaimed property passed to the next takers (which would have been the decedent's grandchildren), and another alternative was that the property passed by intestacy, in which case the property would have passed back to the disclaimant, and the disclaimer would have been invalid because the disclaimant retained an interest in the disclaimed property as an intestate heir. The Court concluded that Mississippi law was the latter interpretation, and accordingly, the disclaimer was invalid. The Court noted that the uniform disclaimer act, which had not been adopted in Mississippi, clearly would have provided that the property passed to the decedent's grandchildren, which was the intended result.