TAX NEWS & COMMENT

© 2023 LAW OFFICES OF DAVID L. SILVERMAN, LAKE SUCCESS, NY (516) 466-5900

VOL. XXVIII NO. 1 | APRIL 2023 | nytaxattorney.com

IRS & NYS DTF MATTERS

Recent Developments & 2022 Regs. & Rulings of Note

A. Inflation Reduction Act Signed Into Law

The Inflation Reduction Act of 2022 was signed into law by President Biden on August 16. The Act is intended to reduce inflation by reducing the deficit, lower prescription drug costs, and invest in domestic clean energy. The law will (i) authorize $391 billion in spending on Energy Security and Climate Change programs over the next ten years, (ii) direct the investment of approximately $300 billion in deficit reduction, (iii) extend the Affordable Care Act by three years to 2025 while lower premiums at cost of $64 billion, (iv) allow Medicare to

(Please turn to page 8)

FROM FEDERAL COURTS NYS COURTS & TAX TRIBUNALS

Recent Developments & 2022 Decisions of Note

I. Supreme Court

On February 28 the Supreme Court heard oral arguments on a suit involving President Biden's plan to forgive $400 billion in student debt. Chief Justice Roberts voiced concern that the administration had acted without explicit congressional authorization to undertake one of the most ambitious and expensive executive actions in the nation's history, violating the separation-of-powers doctrine.

Following over three hours of oral arguments, it appeared the conservative majority was poised to reject the president's forgiveness plan — provided the petitioners establish

(Please turn to page 6)

FROM WASHINGTON & ALBANY

PRESIDENT BIDEN UNVEILS BUDGET PROPOSAL IN PRELUDE TO 2024 RUN

BILLIONS IN AID TO UKRAINE POSES DILEMMA

I. Biden's Shot Across The Bow

Tax Analysis

Speaking in Philadelphia on March 9, President Biden released his proposed $5.8 trillion budget for 2023. The budget calls for spending on public health, education, housing, crime prevention, and reducing the deficit. The proposal also seeks to expand the economy, reduce the deficit over time, and protect Social Security and Medicare. Defense spending increases, but not to the extent favored by Republicans.

The White House says the budget focuses on four themes: Expanding the economy, lowering costs, reducing the deficit, and protecting

(Please turn to page 2)

Installment Sale to Trust May Defer Capital Gain & Remove Asset From Taxable Estate

I. IRC §453: Prelude to Analysis

Federal Tax Planning

An installment sale made to a nongrantor trust in exchange for a promissory note pursuant to §453 may defer capital gains and remove the asset from the taxpayer's estate. The sale must satisfy the "economic substance doctrine." Also, two years must elapse before the trust resells the asset unless it is "established to the satisfaction of the [IRS] that neither the first disposition nor the second disposition had as one of its principal purposes the avoidance of Federal income tax." §453(e)(7).

(Please turn to page 12)

Essential Tax Provisions For 2023 Reviewed

I. Income Tax Rates

Rates begin at 10% for married taxpayers with income up to $20,550, 22% with income up to $178,150, 24% with income up to $340,100, 32% with income up to $431,900, 35% with income of up to $647,850 and 37% with income greater than $647,851. *A growing number of married taxpayers are choosing to file "married filing separately," as that filing status will sometimes yield a lower income tax liability.*

Under current law, the top tax bracket for individual taxpayers, estates and trust income is 37%. It reverts to 39.6% after 2025. In addition,

(Please turn to page 23)

APRIL COMMENT

Moving to Florida? NYS Trust and Income Tax Laws Require Clear Domicile Change

I. Introduction

NYS Tax Planning

In planning for relocation or retirement in Florida, Arizona, the Carolinas, or even Texas, New York residents must not forget that the Department of Taxation, like a wolf eyeing sheep, may scrutinize every aspect of the taxpayer's departure in search of tax revenue. There may be residency audits, capital gains audits, or other parting salvos. This note focuses on is how to best structure one's trust affairs so as not to attract scrutiny from the Department.

The primary objective when re-

(Please turn to page 26)

FROM WASHINGTON & ALBANY, CONT.

(Continued from page 1)

Social Security and Medicare. The plan seeks to reduce the federal deficit by $3 billion over the next decade. Although pledging to protect Social Security, Mr. Biden failed to set forth an initiative to extend the solvency of the program.

Inflation is expected to continue to moderate in 2023. Whether the robust spending advocated by President Biden will ultimately appeal to voters, or whether voters will favor fiscal restraint urged by Republicans, remains to be seen. If inflation abates and a recession is avoided, Mr. Biden may benefit. More than $100 billion in aid has been sent to Ukraine. Thus far, Americans do not seem to object.

Budget Prioritizes Expanded Social & Educational Expenditures

The budget proposes $400 billion for affordable child care, $150 billion for home care for older Americans and the disabled, and nearly $400 billion to make permanent expanded health coverage assistance through the Affordable Care Act. A proposed $325 billion would guarantee paid leave for workers. $300 billion would provide free community college and prekindergarten. The Budget also seeks $175 billion for programs that facilitate the construction of affordable housing, and that lower housing costs for homeowners and renters. $16 billion would be earmarked for the "Neighborhood Homes Tax Credit," and $28 billion for the "Low-Income Housing Tax Credit."

The proposal would reinstate for three years an expanded child tax credit, which expired last year. The proposal would impose a $35 monthly cap on insulin (which cap has already been announced by several major drug companies).

The President's budget also proposed $9.1 billion in investments in the "Pacific Deterrence Initiative," which provides funds for weapons systems to allies such as Taiwan and is intended to defend United States interests in the region. The budget allocates $400 million to counter the influence of Chinese disinformation campaigns. Also included in the budget are allocations for agricultural research, investments in the manufacturing of semiconductors, clean energy products, and other domestic technologies.

Office:
Law Offices of David L. Silverman
2001 Marcus Avenue, Ste. N15
Lake Success, NY 11042
Tel.: (516) 466-5900 Fax: (516) 437-7292

dsilverman@nytaxattorney.com
nytaxattorney.com

Proposals Benefitting New York

The budget would also provide $4.45 billion in funding for 18 transit projects in 11 states. The funds would be provided to New York and Chicago for subway expansions, and to Denver and Charleston, for bus rapid transit projects.

New York would receive an additional $700 million for the Hudson Tunnel Project. The project is intended to prevent interruption in service when one of two existing tubes needs to be closed for repairs. The project would also be in preparation for a new rail tunnel under the Hudson River linking New Jersey and Penn Station. The funds would also be used to repair the North River Tunnel, damaged by hurricane Sandy in 2012.

The budget called for $500 million for the second phase of the 2nd Avenue Subway. Phase two will extend the 4,5 and 6 subway lines on Lexington Avenue from 96th Street to 125th Street.

The Bay Area would receive $500

(Please turn to page 3)

From Washington & Albany , Cont.

(Continued from page 2)

million to continue connecting Silicon Valley and downtown San Jose to the Bay Area's network. Los Angeles would receive $167 for light rail service. Minneapolis would receive $291 to connect its downtown Green Line to suburban areas, and Salt Lake City would receive $317 million to update an existing rail line. Houston would receive $150 million to build dedicated bus lanes on its university corridor.

* * *

Of the $5.8 trillion 2023 proposed budget, most is already mandated by federal law and is not subject to Congressional approval. Funding for Social Security and Medicare does not require annual Congressional approval. However, Senator Ron Johnson (R-Wis.) recently advocated annual congressional approval for those programs. Required interest on the federal debt also does not require annual Congressional approval. Mandatory spending consumes about one-third of all federal spending. Appropriations for the Department of Defense and other federal agencies, such as the FBI and the IRS, require annual Congressional appropriation.

Republicans Critical of Proposal

Republicans have criticized Mr. Biden's Budget Proposal on defense spending as well as on fiscal concerns associated with the cost of the programs. Republicans have lodged fewer complaints against the proposed income tax rate increase, and other provisions intended to increase corporate tax revenue. Nor have there been complaints about Mr. Biden's plan to impose new taxes on the ultra-wealthy. However, the Republican House will likely not agree with most of what is in the budget. The Senate is also problematic for Mr. Biden, given the truculence of Senator Manchen (D-WV) and the iconoclast temperament of Senator Sinema (D-AZ).

Senate Minority Leader McConnell (R-Ky.) stated that the budget "falls woefully short on defense spending," adding that Russian President Vladimir Putin and Chinese President Xi Jinping "will sleep more soundly at night if the Biden administration gets [its] way on defense spending." Senator Grassley (R-Iowa), ranking member of the Senate Budget Committee, characterized Mr. Biden's budget plan as "an unserious proposal and will be treated as such by both parties in Congress."

Senator Paul (R-Ky.) states that the U.S. "must give up the sacred cow" of military spending in order to balance the budget and address the debt ceiling. However, most Republicans disagree, and support higher defense spending.

Senator Romney (R-Utah) voiced concerns which seemed to question the priorities of Mr. Biden:

> [r]aising taxes would cause companies and good jobs to leave America, as they have in the past. . . Rather than aggressively beefing up the number of border agents to . . . Counter the fentanyl crisis, he balloons the number of IRS agents. And while talking tough about China, he allows our Navy to fall even further behind. Let's put the President's political foray aside and work on a bipartisan plan that can become law and that will work for America.

Senator Wicker (R. Miss.), the top Republican on the Senate Armed Services Committee, characterized Mr. Biden's proposal as "woefully inadequate and disappointing." He and other Republicans advocate an increase in military spending and urged spending be increased by at least 5% over the rate of inflation.

House Minority Leader McCarthy (R-Calif.) voiced concerns about the budget, stating "And we will do the numbers, but if you look at the president's budget, all it does is — more debt?" Mr. McCarthy believes that the U.S. is at a "tipping point" with respect the nation's debt. He recalls meeting with Mr. Biden on February 1st:

> When I sat with the president I said, 'We're going to be responsible, we're not going to raise taxes taxes, and we're gonna spend less money than we've spent before."

Echoing the sentiments of other Republicans, he warned that "wasteful government spending" will threaten the economy, and argued that debt is one of the greatest problems facing the country. The warning appears to have some credibility as the economy, which the administration expected to grow at 4.2% in 2022 after inflation, grew at only 2.1%, and is expected to grow at just 0.6% in 2023, after adjusting for inflation.

* * *

Mr. Biden perhaps buoyed by an rise his approval rating from 37% last July to about 4% today, displayed a new found confidence ahead of an expected presidential announcement. Mr. Biden has a history of lengthy deliberation before announcing an intention to run. He referred to Mr. McCarthy as "a very conservative guy," and challenged him to discuss the budget face-to-face:

> I'm ready to meet with the Speaker anytime, tomorrow if he has his budget. Lay it down, show me what you want to do, I'll show you what I want to do. We can see what we can agree on, see what we don't agree on and we vote on it.

For his part, Mr. Biden has stated that "I will not allow cuts to the needs of the intelligence community or military that help keep us safe."

Ukraine Divides Republicans

There appears to be a lack of consensus among Senate Republicans and other prominent Republicans concerning military aid to Ukraine. Senators McConnell (R-Ky.), Portman (R-Ohio), Graham (R-SC), Scott (R-Fl.), and Shelby (R-Ala.) appear to strongly supporting further aid to Ukraine, while Senator Paul (R-Ky.) flatly opposes any aid. Former President Trump also appears to favor ending the war quickly.

Governor DeSantis, and Speaker McCarthy both oppose writing a "blank check" to Ukraine. Governor DeSantis, whose views on Ukraine are close to those of Mr. Trump, has gone so far as to characterize the conflict as a "territorial dispute," and that sup-

(Please turn to page 4)

FROM WASHINGTON & ALBANY , CONT.

(Continued from page 3)

porting Ukraine was not in the interest of the U.S. His statements have been criticized in the media, notably by editorials in the Wall Street Journal. He recently stated that he does not support military aid to Ukraine, and has balked at the threat that Russia poses to NATO member countries.

Whether this position is part intended to lure Trump supporters ahead of the Republican primaries may or may not be true. Regardless of intention, the effect may be just that. Mr. DeSantis is a good politician, but he also seems to say what he believes, both of which qualities are also possessed by Mr. Biden, and Mr. Trump for that matter.

Mr. Biden has steadfastly supported increased aid to Ukraine. His initial reluctance to provide higher grade munitions has morphed into a tacit agreement with Poland and other NATO members close to Russia that tanks and warplanes should be provided to Ukraine. It appears doubtful that the U.S., France, or the UK will agree to send their own modern warplanes to Ukraine. Initially, Mr. Biden was concerned that sending advanced arms to Ukraine would start "World War III." However, his initial reticence has softened, and the fear that Russia will use nuclear weapons in Ukraine has diminished.

Not surprisingly, the view of Senator McConnell concerning the war in Ukraine and NATO is diametrically opposed to the view of former President Trump, who in the past said he would "certainly look at" pulling the U.S. out of the alliance because it is "obsolete" and is "costing us a fortune." More than a few House Republicans seem to agree with Mr. Trump, and now appear unwilling to commit to long term aid to Ukraine with no strings attached.

Senator Majority Leader Schumer praised the Administration's proposed budget, which he says will help upstate families while responsibly managing the country's finances. Mr. Schumer noted the proposal increases funding to many federal programs in New York, and cuts the federal spending deficit by $3 trillion over the next decade.

Congresswoman Elise Stefanik (R-NY21), who has recently gained influence in Congress expressed disapproval with the budget proposal. Ms. Stefanik, an ardent supporter of Mr. Trump, represents New York's rural 21st Congressional District, running from Glens Falls north through the Adirondacks to the Canadian border, and west to the outskirts of Watertown. The district is bordered on the east by Vermont and Lake Champlain. It comprises about one-third of New York State by area. Its estimated population was 707,224 in 2021.

Ms. Stefanik issued a joint statement with House Speaker McCarthy, Majority Leader Scalise, and Majority Whip Emmer, which criticized Mr. Biden's budget proposal:

> President Joe Biden's budget is a reckless proposal doubling down on the same Far Left spending policies that have led to record inflation and our current debt crisis...In the next ten years, the federal government will spend over $10 trillion on interest alone. We must cut wasteful government spending. Our debt is one of the greatest threats to America and the time to address this crisis is now. Yet, President Biden is proposing out of control spending and delaying debt negotiations. . .Despite the federal government collecting as much in taxes from American families as at any point in our history, federal spending is rising even faster and our debt is soaring...President Biden's unserious budget proposal includes trillions in new taxes that families will pay directly or through higher costs.

II. Funding The Budget Proposal

In his proposed budget, the President took aim at corporations and the extremely wealthy:

> We found that in 2020 when I took office, that 55 major corporations, Fortune 500 companies, paid zero in federal income tax on $40 billion in profit," Biden said during remarks Thursday. "When I got elected, there were roughly 650 billionaires in America. Now there's over 1,000. You know how much tax they pay? Three percent...No billionaire should be paying less than a schoolteacher or a firefighter.

The principal revenue generator would be $5 trillion in proposed tax increases on corporations and high income taxpayers over the next decade. Despite his call for higher taxes on international and domestic corporations and high income Americans, Mr. Biden seeks to extend the Trump-era tax cuts for households earning less than $400,000 per year. Those cuts are set to expire at the end of 2025 unless Congress acts. Under the proposal, taxpayers earning more than $400,000 per year would again be taxed at 39.6 percent, up from 37 percent. The threat of letting those cuts expire may be a bargaining chip which the President utilizes to achieve passage of some of his programs.

The corporate income tax rate would increase to 28%, which is above the current 21%, but well below the pre-2017 level of 35%. A new 15 percent minimum corporate tax would be imposed on billion-dollar companies, some of whom paid little or no tax operating abroad. The proposal would also raise the tax imposed on stock redemptions from 1% to 4%. This would reduce the gap between the rate at which qualifying dividends and stock redemptions are taxed. The stated intention of this proposal is to stimulate corporate investment rather than increase company earnings.

The budget extends the reach of the 3.8% Obamacare surtax. Currently the surtax applies to investment income of couples earning more than $250,000. Under the proposal, active business income would become subject to the surtax. For couples whose income exceeds $400,000, the budget proposal would impose a surtax of 5% on investment and business income.

The proposal also raises the top Medicare payroll tax on wages to 5% for those earning more than $400,000. Thus, the marginal 44.6% rate (i.e., 39.6% + 3.8%) would apply to business, investment and wage income.

If New York taxes are added, the combined rate could reach 51.45% for New Yorkers living outside the

(Please turn to page 5)

From Washington & Albany, Cont.

(Continued from page 4)

City, and just over 55% for those living in the City. These rates are higher than in many western European countries. In Germany, the highest rate is 47.5%, in the U.K. 45%, in France, 45%, in Spain 54%, and in Sweden, 52.3%. Short-term capital gains are taxed as ordinary income, so the rate for short-term gains would also increase.

The proposal also seeks to impose a higher capital gains tax on taxpayers earning more than $1 million. For those taxpayers, all capital gains, not only short-term gains, would be taxed at 39.6%, plus a 5% surtax.

The budget plan would also impose a 25 percent minimum tax on people and families whose net worth exceeds $100 million, which the administration states would apply to "the wealthiest 0.01 percent." The tax would be imposed on income and on unrealized gains from capital assets such as stocks.

Tax has never before been imposed on unrealized capital gains. The concept of realization as a prerequisite to the imposition of tax has always been sacrosanct. Norway, Spain, and Switzerland impose a pure wealth tax. France, Italy and Belgium impose a wealth tax on selected assets, but not on an individual's wealth *per se*. No other European countries impose a wealth tax.

The President's proposal would also eliminate the basis step up at death. It would be replaced by a provision that would tax unrealized gains above $5 million as capital gains as if the asset were sold. The exclusion amount would be $10 million for a married couple. An exclusion would apply to the primary residence. Tax owed on non-publicly traded assets would be payable over 15 years.

The budget would eliminate fossil fuel tax preferences that encourage development of oil, gas, and other fossil fuels. Tax credits relating to some expensive production methods would be eliminated. Accelerated cost recovery would be curtailed, and favorable tax treatment for some income and losses would be eliminated.

The proposal also seeks to further limit Section 1031 like-kind exchanges, which Mr. Biden characterized as an interest-free loan from the federal government. Under the proposal, a maximum of $500,000 could be deferred annually. Gains excess of $500,000 (or $1 million in the case of married individuals filing a joint return) a year would be recognized by the taxpayer in the year the taxpayer transfers the real property subject to the exchange. (Replacement property could be acquired in the following tax year). The proposal is intended to produce $19 billion in revenue.

Medicare would also be allowed to negotiate drug prices with large pharmaceutical manufacturers.

III. Medicare & Social Security

Most would agree that Social Security, signed into law by FDR in 1935, and Medicare, signed into law by President Johnson 1965 are basic rights Americans have come to expect and rely upon. The problem facing these programs today is one of cost: As Americans continue to live longer, and new expensive treatments and medicines become available which will improve both the qualify of life and the longevity of Americans, the cost of the programs will inexorably rise, and require a larger percentage of the federal budget.

President Obama suggested indirectly reducing benefits by using a slower-growing inflation index. President Trump departed from the view of other Republicans and refused to consider changes to either program that would reduce benefits. President Biden has also agreed that changes to Social Security and Medicare are off the table. Any Republican challenging Mr. Biden in 2024 would likely not openly disagree the positions taken by Mr. Biden and Mr. Trump.

Yet the problem remains: While Mr. Biden's budget proposal retains current benefits under these programs, it does not address the long-term solvency problem. An interim solution which Mr. Biden proposes, increasing the Medicare tax on high-income taxpayers, would help, but until Congress recognizes the looming financial problems faced by these two enshrined programs, the greater the danger that deferring the problem indefinitely will lead to greater problems in the future.

Just as carbon dioxide emissions were known to cause global warming since the 1980's but for the most part debated and ignored, we are now facing a costly and unsure battle to reign in climate change. While some aspects of global warming are beneficial, others such as coastal flooding, more severe and frequent storms, and intolerable heat in some areas of the world are already being felt.

Ignoring the problem of rising Social Security and Medicare costs today may make it exponentially more difficult to resolve the problem in the future. France resolved its problem recently by increasing the retirement age to 62. Few Americans would agree to raise the current retirement age of 67.

From The Courts, Cont.

(Continued from page 1)

standing, which may be problematic.

Standing refers to the right to have a court rule upon the merits of particular claims seeking judicial relief. To establish Article III standing, one must have genuine stake in the outcome of the case, a concrete and particularized injury that redressable by a judicial decision. If the petitioners bringing the action have no personal interest in the outcome, then they may succeed in establishing only what Justice Scalia termed "purely psychological displeasure." Justice Kagan acknowledged the significance of the loan authority itself not commencing the action and not bringing suit over the debt forgiveness program: "Usually we don't allow one person to step into another's shoes and say, 'I think that that person suffered a harm,' even if the harm is very great."

In oral argument, members of the conservative majority invoked the "major questions doctrine," which requires government actions with major political and economic consequences to be clearly authorized by Congress. Even Justice Sotomayor noted that the sums involved "seems to favor the argument that this is a major question."

The statute relied upon by the administration, the HEROES Act, grants the Secretary of Education power to "waive or modify any statutory or regulatory provision" to borrowers affected by "war or other military or national emergency." President Trump invoked the act during the pandemic to pause student loan repayments and to suspend the accrual of interest. President Biden has followed in that path. According to the Government Accounting Office, the payment relief has cost the government more than $100 billion.

The Court may well get past the standing issue and reach the merits. There, it will need to convince either Justice Roberts or Justice Barrett or another conservative Justice, that the growing number of Executive Orders, and the increasing power of the Executive Branch, has not effectively usurped the power of the Congress, and upset the separation of powers, which under the Constitution establishes three separate but equal branches of government.

* * *

In *Boechler, P.C. v, CIR*, No. 20-1472 (2022), on appeal from the Eighth Circuit affirming the Tax Court, the Supreme Court in a unanimous opinion reversed, taking issue with the dismissal by the Tax Court of a petition filed one day late.

This dispute commenced when the IRS contacted *Boechler*, a law firm, regarding a discrepancy in its tax filings. When *Boechler* failed to respond the IRS assessed an "intentional disregard" penalty and notified *Boechler* of its intent to levy on its property to satisfy the penalty. *Boechler* requested a "collection due process hearing" before the IRS Independent Office of Appeals, which sustained the proposed levy. Under IRC §6330(d)(1), *Boechler* had 30 days to file a Tax Court petition. *Boechler* filed one day late, and the Tax Court dismissed the petition for lack of jurisdiction. The Eighth Circuit affirmed, holding that the 30-day period is jurisdictional and cannot be equitably tolled. The language in question provides that a

> person may, within 30 days of a determination under this section, petition the Tax Court for review of such determination (and the Tax Court shall have jurisdiction with respect to such matter.)

Boechler argued, and the Court agreed, that the term "such matter" does not have a clear antecedent, and that the text does not "mandate" a jurisdictional reading. The Court, while conceding that the Commissioner's interpretation of the statute was "plausible," and that "some might even think it is better than *Boechler's*," that is insufficient. To satisfy the "clear-statement" rule, the Court stated that the interpretation must be clear, and it was not. It also noted that other tax provisions enacted around the same time "much more clearly" link their jurisdictional grants to a filing deadline.

The case was remanded to determine whether *Boechler* was entitled to equitable tolling on the facts of the case.

* * *

The government fared equally poorly in *Bittner v. U.S.*, No. 21-1195 (2023). Interestingly, the opinion by Justice Gorsuch was joined by Justices Roberts, Alito, Kavanaugh, and Jackson. Justice Barrett's dissent was joined by Justices Thomas, Sotomayor, and Kagan.

The Bank Secrecy Act requires persons with financial interests in foreign accounts to file FBAR reports annually. *Bittner*, a dual citizen of the U.S. and Romania, ran afoul of reporting requirements. The statute imposes a maximum $10,000 penalty for nonwillful violations.

Bittner learned of his reporting requirements after returning to the U.S. from Romania in 2011 and filed reports covering five years. The government found the reports deficient because they did not address all accounts as to which *Bittner* had either signatory authority or a qualifying interest. *Bittner* subsequently filed corrected FBARs for each of his accounts, which totaled 272. The government calculated the penalty due as $2.72 million, or $10,000 per violation. *Bittner* challenged the penalty, claiming that the Bank Secrecy Act authorizes a $10,000 penalty per report, not per account.

The Court found that the "nonwillful" penalty provision does not reference accounts, but rather speaks of "violations." While multiple deficient reports may result in multiple $10,000 penalties and even a seemingly simple deficiency in a single report may result in a $10,000 penalty, penalties accrue on a per-report, not a per-account, basis.

The government argued that because Congress explicitly authorized per-account penalties for some willful violations, the Court should infer that Congress meant to do so for analogous nonwillful violations. Rejecting the argument, the Court tersely noted that "the government's interpretation defies a traditional rule of statutory construction: When Congress includes particular language in one section of a statute and omits it from a neighbor, the Court normally understands that

(Please turn to page 7)

From The Courts, Cont.

(Continued from page 5)

difference in language to convey a difference in meaning (*expression unius est exclusion alterius*)."

The Court added that the statute twice provides evidence that when Congress wished to tie sanctions to account-level information, it "knew exactly how to do so," and that Congress also provided that a person may invoke a reasonable cause exception only on a showing of per-account accuracy. The Court found that "Congress did not say that the government may impose nonwillful penalties on a per-account basis," and concluded by remarking "[b]est read, the BSA treats the failure to file a legally compliant report as one violation carrying a maximum penalty of $10,000."

The case was reversed and remanded.

New York Decisions

On June 30, the Appellate Division, First Department held that a vacation home owned in upstate New York did not qualify as a "permanent place of abode" and did not trigger statutory residency for the petitioners in New York State. [*Matter of Obus v. Tax Appeals Tribunal* (2022; NY Slip Op. 04206)] The case was a substantial victory for taxpayers, and provided needed clarity on the issue of whether and under what circumstances a taxpayer who maintains a vacation home in New York could qualify as a resident under the statutory residency test. It was undisputed that the taxpayer commuted daily to New York from New Jersey for employment purposes.

New York tax law provides that a taxpayer is a resident of the state for income tax purposes if he or she is either (1) domiciled in New York or (2) considered a "statutory resident" of New York. To qualify as a statutory resident, one must "maintain a permanent place of abode" for substantially all of the year and spend "more than 183 days of the taxable year in the state."

In a rare unanimous reversal of the New York City Tax Appeals Tribunal, the Appellate Division found that a taxpayer must have actually used a dwelling as his residence in order to establish statutory residency. The mere fact that the taxpayer's vacation home had the physical attributes sufficient to make it suitable for year-round living was insufficient. The Court found that the Tax Appeals Tribunal had unreasonably focused on the objective characteristics of the vacation home rather than conducting a subjective analysis of the taxpayer's use of the dwelling. The Court noted that the Court of Appeals had "explained that the legislative intent underlying Tax Law §605 is to discourage tax evasion by residents of this state."

Note on Litigating Outside NYS Administrative Tribunals

Administrative Law Judges in the Division of Tax Appeals are unquestionably fair and extremely competent, and are dedicated to upholding the tax laws in a manner that is both fair to the taxpayer and to New York. However, a major objective in disputes involving the Tax Department is to avoid litigation in the New York tax administrative tribunal system. Once there, the taxpayer can easily get mired in legal quicksand, since the statutory presumption greatly favors the collection of tax revenue. Administrative agencies must presume statutes to be constitutional and therefore have no authority to avoid statutory requirements on constitutional grounds. The New York Court of Appeals made clear that

> [l]egislative enactments enjoy a strong presumption of constitutionality . . . parties challenging a duly enacted statute face the initial burden of demonstrating the statute's invalidity `beyond a reasonable doubt'" (*LaValle v Hayden, 98 NY2d 155, 161* (2002); [citations omitted]).

If litigation appears a foregone conclusion, the taxpayer might attempt to litigate in State Supreme Court. The problem is getting there. While the tax law attempts to preclude actions outside of the administrative tax tribunals, there are more than a few exceptions to this rule, and the objective of the taxpayer's attorney is to find a meritorious claim that confers jurisdiction on a New York Supreme Court.

It will then be the Justice of the Supreme Court who decides whether the court has jurisdiction and whether the taxpayer has met the burden of proof imposed upon him. In equitable circumstances — and many tax disputes do possess equitable overtones — a judge might have greater latitude to exercise discretion in finding such jurisdiction, and suggesting that the litigants resolve the matter. It is no secret that in practice judges will often strongly urge litigants to settle a matter and suggest returning to court without a settlement will be inauspicious.

Once a Petition and Complaint in NYS Supreme Court is filed by the taxpayer, counsel for the Department of Taxation is required to transfer the entire file to the Office of the NYS Attorney General. Experience shows that counsel for the Attorney General has far less institutional loyalty to the Department of Taxation than does inside counsel for the Department itself.

Counsel for the Attorney General is more likely to take a pragmatic approach and acknowledge any weaknesses in the Department's case. So too, the Attorney General's counsel is more likely to attempt to resolve the matter, especially if the taxpayer's case has merit and possesses equitable appeal.

While the tax law attempts to divert most disputes into the administrative tax tribunals, there is nothing in the law which precludes the taxpayer from pursuing remedies in other venues and courts after exhausting administrative remedies. The challenge is to bring such actions while administrative remedies are pending, or in lieu of administrative remedies.

The taxpayer might thus attempt to bring an ancillary action in State Supreme Court via a Declaratory Judgment Action under CPLR Article 30 or a "hybrid" action under CPLR Articles 30 and 78. A declaratory judgment is not subject to a motion to dismiss. The tangible and intangible benefit of removing a dispute from the tax administrative tribunal vortex and seeking resolution in a Supreme Court of general jurisdiction simply cannot be overstated.

(Continued from page 1)

negotiate prescription drug prices; and (v) encourage tax reform by closing tax loopholes and increasing tax enforcement.

The investment in addressing climate change is the largest in history, and is projected by its sponsors to reduce 2030 U.S. greenhouse gas emissions to 40% below 2005 levels. The projected impact of the bill on inflation is disputed. The $738 of revenue raised by the bill will come from a 15% minimum corporate tax ($313 billion), prescription drug pricing reform ($288 billion), IRS tax enforcement ($124 billion) and the carried interest loophole ($14 billion). According to the administration, families with income of $400,000 or less will not see increases in taxes, nor will small businesses.

The minimum 15% corporate minimum tax applies to corporations with financial accounting profits over $1 million. The new law also imposes a 1% excise tax on certain stock redemptions.

Senate Examines Biden Nominee For IRS Commissioner

Daniel I. Werfel, President Biden's choice to run the IRS, told the Senate Finance Committee at a confirmation hearing on February 15, 2023 that he would audit large partnerships more frequently than low income taxpayers. He added that any imbalance of enforcement methods that had a disproportionate effect on low income people degrading public trust in the IRS.

Mr. Werfel's comments were in response questions relating to how the IRS would use the $124 billion allocated to the IRS under the Act. Chair Senator Ron Wyden (D-OR) stated he believes the main benefits of the IRS funding are (1) an increase in audits of wealthy taxpayers; (2) an increase in enforcement against large multinational corporations; and (3) an improvement in staffing and technology. Senator Wyden emphasized that the IRS would not use its resources to target Americans who earn less than $400,000.

With Debt Ceiling in Sight, Treasury Considers 'Extraordinary Measures'

Congress must raise the debt limit, currently set at roughly $31.4 trillion, or risk defaulting on debt payments and other government obligations such as Social Security. As the U.S. nears the debt ceiling, President Biden and Democrats want to raise the debt ceiling without any conditions. Republicans insist on spending cuts if the debt ceiling is to be raised. The impasse has raised interest in possible alternatives that could help the U.S. avoid a default.

Treasury has begun discussing extraordinary measures. However, Michael Strain, director of Economic Policy Studies at the American Enterprise Institute, warned that the proposed workarounds "would communicate to investors and communicate to global markets and communicate to foreign governments that the United States is dysfunctional to the point that there's real doubt about our ability to pay our bills. And that's what matters."

Alternatives to addressing the borrowing limit range from ignoring it entirely to prioritizing certain payments. However, it is doubtful that the administration or financial markets would seem those solutions as legitimate. Treasury Secretary Janet Yellen dismissed the idea of issuing a trillion dollar coin as a "gimmick," and has warned of dire consequences should the U.S. default. Federal Reserve Chair Jerome Powell, normally taciturn on political subjects, has also stated emphatically that default is not an option.

Any resolution would require a consensus between Democrats and Republicans. There do appear to be a sufficient number of Democrats and Republicans in the House such that a consensus is likely to emerge, even if the path is uncertain. If past history is a guide, a resolution will be achieved, but perhaps not until the last moment. Game theory would suggest that neither Republicans nor Democrats gain significantly by making early concessions, but would both suffer egregiously if the nation were to default. Therefore, default appears to be a remote outcome under that theory.

Secure 2.0 Act of 2022

Delay in Starting Date for
<u>Required Minimum Distributions</u>

Effective January 1, 2023, the threshold age to begin RMDs will increase by one year, to age 73. It will increase to age 75 on January 1, 2033.

<u>Notices to Unenrolled Employees</u>

Under previous law, if an employee is eligible to participate in a defined contribution plan, all legally required notices must be provided to that employee on an ongoing basis, even if the employee never enrolls or receives a contribution.

For Plan years beginning after December 31, 2022, if a new employee receives a summary plan description and any other notices related to initial eligibility under the plan, but does not enroll or receive a contribution, the plan need only provide that employee with a single annual reminder notice about the plan. All other notices must be available to the employee, but need only be provided upon request.

Required Automatic
<u>Enrollment and Escalation</u>

Under existing law, §401(k) and §403(b) plans may, but are not required to, use automatic enrollment and escalation features. For Plan years beginning after December 31, 2024, new §401(k) and salary reduction §403(b) plans – meaning those adopted on or after December 29, 2022 – must include automatic enrollment (of at least 3%) and automatic escalation (of at least 1% per year, up to a minimum of 10% and a maximum of 15%). Participants who are automatically enrolled will have 90 days to elect to withdraw those automatic deferrals.

Participation Requirements
<u>For Part-Time Employees</u>

For Plan years beginning after December 31, 2024, The SECURE 2.0 Act introduced a new requirement

(Please turn to page 9)

IRS & NYS-DTF MATTERS, CONT.

(Continued from page 7)

that part-time employees with at least 500 hours of service for three consecutive years be permitted to make elective deferrals to an employer's §401(k) plan.

SECURE 2.0 shortens the eligibility service requirement for part time employees from 3 years to 2 years. The eligibility requirements for part-time employees now also apply to salary reduction §403(b) plans that are subject to ERISA.

Early Withdrawal Rules Relaxed

SECURE 2.0 allows plan participants to withdraw up to $1,000 annually for unforeseeable or immediate family needs or family emergencies. The distributions are not subject to the 10% penalty for early withdrawal for those who have not reached 59½ Provisions were included in the bill allowing for some early withdrawals (prior to age 59½) for terminally-ill individuals, victims of domestic abuse, and to cover the costs of certain long term care premiums.

Those affected by a federally-declared disaster will be allowed to take up to $22,000 penalty free, with the option to pay the income tax liability over three years.

Late Estate Tax Portability Election Allowed After Death of First Spouse

Effective July 8, 2022, the IRS issued Rev. Proc. 2022-32 which supersedes Rev. Proc. 2017-34 and now allows for a late estate tax exemption portability election to be made up to 5 years from a deceased spouse's death. The previous late election period was 2 years. A surviving spouse may have been unaware of the ability to transfer ("port") the deceased spouse's unused estate tax exemption ("DSUE"). The surviving spouse now has more time to file the estate tax return on which the election is made.

IRS Approves Test Program to Fast Track Private Letter Rulings

Rev. Proc. 2022-10 established an 18-month pilot program to provide for "fast track" processing of certain private letter ruling (PLR) requests solely or primarily under the jurisdiction of IRS Associate Chief Counsel. Rev. Proc. 2022-10 modifies Rev. Proc. 2022-1, which includes the general procedures for PLR requests. If fast track processing is granted, the IRS will attempt to complete processing and issue the PLR within 12 weeks. With PLR requests generally taking six to nine months from the time the IRS receives the request to the time the PLR is issued, the 12 week processing period will help taxpayers who require determinations for the current tax year.

Cryptocurrency Not Publicly Traded Security And Thus Not Exempt From Qualified Appraisal Requirement For Charitable Deduction

Chief Counsel Memorandum (CCM) 202302012 states that digital assets are defined in IRC §6045(g)(3)(D) as digital representations of value that are recorded on a cryptographically secured distributed ledger. Such assets include, but are not limited to, property that the IRS has described as convertible virtual currency and cryptocurrency. IRC §170 allows a deduction for charitable contributions defined in §170(c) for the taxable year the contribution is made but such contribution must be verified under regulations prescribed by the Secretary.

To claim the charitable contribution deduction the taxpayer must satisfy substantiation requirements. Where the taxpayer claims a deduction of more than $5,000 for property contributed, the taxpayer must obtain a "qualified appraisal" of such property for the taxable year in which the contribution is claimed and provide such information regarding the property and the appraisal as is required by the Secretary.

However, there are exceptions to the requirement of obtaining a qualified appraisal. For example, donations of readily valued property such as cash, stock in trade, inventory, property primarily held for sale to customers in the ordinary course of business, publicly traded securities, intellectual property, and certain vehicles do not require a qualified appraisal.

The term publicly traded securities is defined in Treas. Reg. §1.170A-13(c)(7)(xi) by reference to §165(g)(2) which defines it as a share of stock in a corporation; a right to subscribe for, or to receive, a share of stock in a corporation; or a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or a government or political subdivision thereof, with interest coupons or in registered form. CCM 202302012 states that the cryptocurrency at issue was none of the items listed in the definition of publicly traded securities in §165(g)(2).

No exception to the qualified appraisal requirements of 170(f)(11) applied because the cryptocurrency at issue was not cash, a publicly traded security, or any of the other types of property listed in §170(f)(11)(A)(ii)(I) and Treas. Reg. §1.170A-16(d)(2)(i). Since the taxpayer's claimed charitable contribution deduction exceeded $5,000, the taxpayer was required to obtain a qualified appraisal.

Mere Decline in Value of Digital Assets Does Not Produce Taxable Loss

CCM 202302011 stated that a mere decline in the value of cryptocurrency owned by the taxpayer will not produce a loss under IRC §165 because the taxpayer had not abandoned or otherwise disposed of the cryptocurrency. There must be a sale, exchange, or other disposition of digital assets in order to recognize gain or loss.

Filing Paper Returns When Electronic Filing Required May Result in Penalties Barring Reasonable Cause

CCM POSTN-107995-22 stated that penalties may be imposed on a taxpayer that submits specified returns on paper when required to file electronically. The Memorandum stated Courts "have long recognized the necessity for taxpayers to meticulously comply with filing requirements." Therefore, unless the taxpayer establishes reasonable cause, the IRS may impose penalties in this situation.

Notable Criminal Investigations Division (CID) Convictions

Debtors' prisons were extant in

(Please turn to page 10)

IRS & NYS-DTF Matters, Cont.

(Continued from page 8)

the U.S. until the early 1800's. However, public disfavor and the advent of bankruptcy laws eventually led most states to abolish them. New York abolished debtors' prisons in 1832. While debtors' prisons themselves were abolished in the states, indigent persons unable to pay fines were in effect forced into a type of debtors' prison.

In 1970, the Supreme Court, in *Williams v. Illinois,* 399 U.S. 235 (1970) held that imposing a maximum prison term because of a persons' indigence violated the Equal Protection clause of the Fourteenth Amendment. Even today one can be jailed for nonpayment of debt, one case being the failure to pay child support. These imprisonments are justified under the guise of civil contempt of court, but in essence are just a modern version of debtors' prison.

Returning to the subject of the IRS and its ability to imprison taxpayers, the fact is that the IRS cannot jail any taxpayer simply because the taxpayer has a tax debt in any amount. No one can go to jail for a tax delinquency. Only tax crimes can land someone in jail.

The IRS Criminal Investigations Division (CID) examines potential criminal activity that is specifically related to tax crimes and makes recommendations for prosecution to the Department of Justice – Tax Division. Year 2022 saw multiple convictions for tax related crimes, some relating to Covid fraud, others to tax evasion, and still others relating to Ponzi schemes.

By way of comparison only, NY Penal Law § 125.15 defines Manslaughter in the second degree, usually involving recklessness, negligence or heat of passion, as "recklessly causing the death of another person," while being aware that one's actions present a substantial risk that someone could be killed, while disregarding that risk. A Class C felony, a person could be sentenced for to up to 15 years if convicted of second degree manslaughter.

Notable cases in 2022 involve the persons convicted of tax fraud whose sentences were comparable and to the length of time one could be sentenced in New York for manslaughter. Evidenced by sentencing statutes for tax crimes, Congress takes tax fraud very seriously and compels courts to impose harsh penalties for transgressors. Some cases of note:

(1) Elias Eldabbagh received 10 years for attempting to steal $31 million in Covid-19 relief funds. He used the money to buy a Tesla, and to pay for hotels and attorneys' fees.

(2) Christopher Burnell, a former sheriff's deputy, was sentenced to 14 years for deceiving investors, and promising annual returns as high as 100%. He spend the money on gambling, luxury items and luxury cars.

(3) Michael Little received 19 years and was ordered to forfeit $12.3 million. He filed a series of false returns in his name and in the name of co-conspirators, claiming nonexistent fuel tax credits. He then attempted to launder the money in real estate investments.

(4) Television personalities Todd and Julie Chrisley were sentenced to 12 and seven years, respectively. To evade taxes, they opened and operated corporate bank accounts in Julie's name.

(5) A former decathlete from the Philippines, David Bunevacz, was sentenced to 17½ years for fraudulently raising more than $45 million from investors to fund a cannabis vaping business.

(6) Paulette Carpoff received 11 years for a Ponzi scheme relating to DC Solar. She caused false engineering reports for mobile solar generator trailers (MSGs) that were sold but never built.

(7) Michael J. DaCorta was sentenced to 23 years for conspiracy to commit wire and mail fraud, money laundering, and filing a false return. He was charged with running a Ponzi FOREX scheme that persuaded investors to invest through promissory notes and other means.

(8) Attorney Michael Avenatti was sentenced to 14 years for stealing millions from clients and for committing tax fraud. The 14-year sentence will be served consecutively with a prison sentence for stealing money from Stormy Daniels in her legal dispute with Donald Trump.

New York State

Beginning April 1, 2022, a tax is imposed on the sale or transfer of adult-use cannabis products by a distributor to a retail dispensary. In addition, tax is imposed on the sale or transfer of adult-use cannabis products to an adult-use customer. The tax is imposed on the person who sells or transfers adult-use cannabis at retail at the time of sale or transfer.

All distributors and retailers of adult-use cannabis products in New York must first obtain the applicable license from the Office of Cannabis Management. After doing so, they must apply online for an Adult-Use Cannabis Certificate of Registration with the Department of Taxation before engaging in business. There is a $600 application fee for registration.

Matter of the Petition of Dynamic Logic, Inc., NY Tax Appeals Tribunal, Docket No. 828619 (January 20, 2022) addressed the application of sales tax to the petitioner's provision of services involving the collection of information regarding the effectiveness of clients' advertising by conducting surveys, analyzing the information and furnishing the information and analysis to clients in reports that present the results and offer recommendations intended to improve the effectiveness of the clients' advertising.

The Tax Appeals Tribunal determined that the petitioner's services "consist entirely of the evaluation of advertising campaigns through the collection and analysis of information and thus plainly fall within the statutory definition of an information service" and were thus subject to sales tax.

Odds Are Heavily Against
Litigating Taxpayers in
NYS Administrative Tax Tribunals

The presumption in taxing statutes places the burden of proof squarely on the taxpayer, which in substantial part accounts for the difficulty tax-

(Please turn to page 11)

IRS & NYS-DTF MATTERS, CONT.

(Continued from page 9)

payers encounter in litigating cases involving the Department of Taxation.

Taxpayers who find themselves in the administrative tax tribunals rarely emerge victorious. During the 2021-2022 year, Administrative Law Judges issued 122 determinations. Of those, 105 sustained the deficiency, 7 were cancelled, and 10 were modified.

The chance of winning a case in 2021-2022 was 7/122, or 5.7377%, or slightly more than 17/1 odds. The chance of losing was 86.07%, yielding odd of slightly less than 1/5. Unless the taxpayer manages to overcome 17/1 odds and wins at the administrative level, the only recourse is to continue on with an appeal from the Tax Appeals Tribunal to the Appellate Division, Third Department (First Department in NYC), by a CPLR Article 78 proceeding, where the taxpayer must show the Tax Appeals Tribunal Decision was “arbitrary and capricious,” an exceedingly difficult standard to meet.

If the taxpayer does decide to take an appeal to the Appellate Division, the Department may continue collection efforts during the appeal. Although bond is not required for income tax cases involving individuals, if the appeal is brought by a corporation and involves sales or withholding tax, a bond is required.

INSTALLMENT SALES, CONT.

(Continued from page 1)

With the lifetime estate tax exemption set to revert to $6.8 million at the end of 2025, and the New York State estate tax currently being imposed on estates exceeding $6.58 million, it may be prudent for some persons to consider locking in the federal higher exemption amount, especially if capital gains tax can be deferred.

The New York exemption operates in a somewhat unusual manner. If and when the exemption amount is breached, the entire estate, not just the excess over the exemption, is subject to estate tax. Once the estate becomes subject to New York estate tax, the rate will be north of 12% (for the excess) and can reach as high as 16%. The rate below the excess will be taxed at between 3.06% to 12%. The "cliff" feature is also discussed "Essential Tax Provisions For 2023 Reviewed" in this issue.

IRC Section 453 Allows
Deferral Of Capital Gains

IRC Section 453 allows capital gains to be reported on a deferred basis, spreading the gain over periods during which payments are actually received. It thus alleviates possible liquidity problems which might arise from the bunching of gain in the year of sale when most of the selling price has not actually been received. The problem with structuring a sale using Section 453 is that the buyer may be averse to the added complexity of the transaction since the buyer must remain obligated on the promissory note. The seller, on the other hand, will be required to rely on the buyer's creditworthiness, and may insist on terms of the promissory note which the buyer might find burdensome both from a practical and substantive standpoint. Furthermore, the buyer's promise cannot be secured by cash or a cash equivalent, as that will be considered constructive receipt of the entire purchase price, and will take the transaction out of Section 453 entirely.

Like Kind Exchanges Compared

Like kind exchanges under §1031 now apply only to exchanges of real property. In a §1031 exchange, gain is realized, but gain recognition is deferred. The mechanism used to defer gain is a carryover of basis in the replacement property. Gain will ultimately be recognized when the replacement property sold (or gain is again deferred in another exchange) or when the taxpayer dies, at which time the basis of the asset will be stepped-up to fair market value. Installment sales also provide for a deferral of gain recognition, but through a different concept: the amount of installment gain is determined on the date of sale. However, the gain is not taxed until payments are received.

While like kind exchanges are more elegant, deferrals under Section 453 are more practical for some taxpayers. Congress also has reserved its greatest scorn for §1031 exchanges, which it views as a vast and unjustified tax expenditure. Its demise is often predicted, but never occurs. While the type of assets eligible for like kind exchange treatment has been narrowed to now include only real estate, it appears that Section 1031 will live to see another day. For taxpayers owning appreciated real estate, the like kind exchange continues to make sense if tax deferral is a principal objective.

The provisions for a like kind exchange have been codified, and an ample amount of judicial and legislative authority exists. A like kind exchange possesses transactional qualities, whereas the installment sale described herein is less transactional. Though deferral of gain is a common thread in both transactions, the sale to a trust described in this paper has different objectives which cannot be achieved in an exchange. Those objectives include federal and NYS estate tax planning, providing a trust for the taxpayer's desired beneficiaries, providing income to the taxpayer through the note, and protecting the assets by virtue of placing them in an irrevocable trust.

Operation of IRC Section 453

An installment sale is a disposition of property in which at least one payment is to be received after the close of the taxable year in which the disposition occurs. IRC §453(b)(1). The "installment method" is the default method prescribed by the Code to report income from installment transactions unless the taxpayer elects not to use the installment method. This election must be made no later than the due date of the tax return (including extensions) for the taxable year in which the disposition occurs. §453(d)(1). Under the installment method, a portion of each installment payment constitutes a return of capital and a portion constitutes capital gain. The "gross profit" equals the contract price minus the adjusted basis. The "gross profit percentage" equals the gross profit over the selling price.

If a property whose adjusted basis is $200,000 is sold for $1 million, then the gross profit percentage is 80%. 20 percent of each installment payment received is a return of capital, and 80 percent is capital gain subject to tax.

The total contract price is the total consideration to be paid, reduced by the amount of any "qualifying indebtedness" assumed or taken subject to by the buyer, to the extent of the seller's basis in the property. IRC §453(c); Temp. Treas. Reg. §15A.453-1(b)(2)(ii).

Deferral occurs because even though the sale is complete, the consideration received is deferred, and the incidence of taxation is correlated with the receipt of consideration. The lower the taxpayer's basis in the property, the greater the amount of gain subject to deferral. Thus, low basis property is best for deferral under §453.

Providing for an initial period of interest-only payments, total deferral of capital gain may be achieved during that initial period. During that period, the seller will report only interest income. Following the initial period of interest-only payments, and depending on the amortization schedule and whether the promissory note employs a balloon payment, the deferral period and the total amount of tax deferred will vary.

Gain from ordinary income property and personal property depreciation are not eligible for deferral under §453. When property is sold under the installment method, all recapture income must be recognized in the year of a sale, up to the total amount of gain realized. Straight-line deprecia-

(Please turn to page 13)

INSTALLMENT SALES, CONT.

(Continued from page 12)

tion must be reported before installment gain under §453.

Deferral is also greatest where the amount of principal remaining on the note is highest. Therefore, the longer the note, and the longer the period of interest-only payments, the greater the deferral and tax benefit. The amortization schedule may be the greater of 30 months or the remaining mortality of the seller. To the extent there has been depreciation taken on the asset, §453 will not permit deferral. Since most depreciation today reflects only straight-line depreciation, depreciation recapture will generally be taxed at 25 percent.

A taxpayer may dispose of one or more installments of an installment obligation in advance of having received all payments thereunder. Certain dispositions of an installment note may trigger a taxable event. In general, under §453B(a), the transfer, distribution, sale, or other disposition of an installment obligation is a taxable event, triggering gain or loss, the amount of which depends on the type of disposition and the basis of the note. Some dispositions of a installment obligation that would not otherwise trigger a taxable event, such as the gift of a note, will trigger a taxable disposition. §453B(a).

Gain or loss recognized on the disposition equals the difference between the fair market value of the obligation and its adjusted basis. The adjusted basis of an installment obligation is the face amount of the obligation reduced by the gross profit that would be realized if the holder collected the face amount of the obligation. In the case of a gift, gain recognized equals the face amount of the obligation less its adjusted basis.

Taxpayers should always be wary of unintentionally triggering a taxable disposition; §453 is known as having a "hair trigger." Nevertheless, some common dispositions of installment obligations will not result in a disposition and acceleration of gain or loss. Those dispositions include (a) certain corporate reorganizations and liquidations; (b) §351 transactions; (c) transfers incident to death or divorce; (d) distributions by a partnership; and (e) contributions to capital of a partnership. §453B.

Property not qualifying for installment sale treatment includes (i) inventory, (ii) depreciable property to the extent of depreciation recapture, (iii) depreciable property if the buyer and seller are related, and (iv) publicly traded stock.

Annual Interest Charge If
Obligation Exceeds $5M

Section 453A(a)(1) imposes an interest charge on nondealer installment obligations where the sales price of the property exceeds $150,000 and the total amount of all installment sale obligations that arose during the tax year and were outstanding at the end of the tax year exceed $5 million. However, in TAM 9853002, the IRS stated that married individuals are not treated as one person in calculating the $5 million threshold. The interest charge is assessed in exchange for the taxpayer's right to use the installment method. The interest charge may be assessed annually, and is based on the "applicable percentage" of the deferred tax liability at the end of each year.

The deferred tax liability is calculated on the installment obligation in excess of $5 million outstanding at the end of the tax year. Section 453A(c)(2) provides that the interest charge is based on the then prevailing §6621(a)(2) underpayment rate. §453A(c)(5) further states that any amount paid is taken into account in computing the amount of the taxpayer's interest deduction for the tax year. The interest is subject to the rules concerning deductibility of tax underpayments. Several cases, as well as §163 and Temp. Regs. §1.163-9T(b)(2)(i)(A), take the position that interest on an individual underpayment of federal income tax is a nondeductible personal interest expense even if the tax liability arose from a business or investment activity.

Therefore, for individual taxpayers, the §453A interest charge would be considered nondeductible personal interest. The 1987 Conference Committee Report on the Omnibus Budget Reconciliation Act of 1987 also states that §453A interest is considered interest on an underpayment of tax subject to the rules in §163. For large installment sale transactions, the additional cost could be prohibitive. Finally, if a taxpayer dies before receiving payment on the installment obligation, the IRS will have collected a nondeductible interest charge on an outstanding deferred tax liability that the taxpayer no longer owes. The installment gain would be income in respect of a decedent to the recipient of the note. The after-tax benefit of the installment sale will be reduced by the annual "toll" charge imposed by IRC §453A(a)(1).

Permissible Modifications
To Installment Notes

In general, if the terms of a debt instrument are significantly modified, the result is a deemed disposition of the old debt instrument for the new, modified debt instrument. Under IRC §1001 and the Regulations, a "significant modification" of the note, such as the alteration of a legal right, would result in a deemed disposition. Whether a modification is significant is determined pursuant to Treas. Reg. §1.1001-3(e).

The deemed disposition of an installment obligation issued in connection with installment sales are governed by more lenient rules. Whether a deemed disposition of an installment obligation occurs by reason of a modification to the note is governed by §453B under a more liberal standard than that which §1001 applies to other debt obligations. Preamble to T.D. 8675, 61 Fed. Reg. 32926 (June 26, 1996).

For a deemed disposition to result from the modification of an installment obligation, the modification must be substantial and result in a material change in, or elimination of, the rights of the seller so that the need to postpone recognition ceases. The IRS has found that the following modifications to an installment obligation did not result in a deemed disposition: (i) extension of maturity date; (ii) suspension of principal payments; (iii) change in interest rate; (iv) substitution of one obligor for another; (v) change in nature of interest (i.e. variable versus flat rate); and (vi) modification of original purchase price.

PLR 9506018 permitted modi-

(Please turn to page 14)

Installment Sales, Cont.

(Continued from page 13)

fication of the maturity date of the Note to defer payments of principal "due to valid business reasons, stating that such modification "will not constitute a disposition or satisfaction of the Note within the meaning of Section 453B." The PLR cited Rev. Rul. 68-419 in which a buyer purchased stock with a note providing for five equal annual payments. Due to financial difficulties, the seller agreed to modify the Note by deferring each payment for five years, and in return the buyer agreed to increase the interest rate from 6 to 7 percent.

The Ruling, citing *Rhombar Co. v. Com'r*., 47 T.C. 75 (1966) acq., 1967-2 C.B. 3 *aff'd* on other grounds, 386 F2d 510 (2d Cir. 1967) opined that the proposed modifications of the note "are not considered a disposition or satisfaction of the installment obligation within the meaning of section 453(d) (the predecessor of current 453B). The Court in *Rhombar* held that the taxpayer corporation was not in constructive receipt of payments when the corporation agreed to postpone due dates of payments and take a higher rate of interest on the amounts owed. The Court found that the parties had dealt at arm's length, the modifications benefitted both parties, the deferral was for a valid business purpose, and there was not a tax avoidance motive on the part of the taxpayer.

In TAM 9238005 the IRS ruled that the substitution of obligors as well as the change in form of the collateral did not result in a taxable disposition of an installment obligation. *See also Affiliated Capital Corp. v. Comr*., 88 T.C. 1157 (1987); and Rev. Rul. 75-457.

However, as lenient as the rules appear to be with respect to modifications of an installment note, Rev. Rul. 82-188 found an increase in the value of the stock substantially changed the taxpayer's economic position: "The substantial increase in the face amount of the note, which reflected the taxpayer's change in position, exchanged for the waiver of the right to convert was a material change in the rights of the taxpayer that, in effect, caused the cancellation of the original obligation and the issuance of a new obligation."

In *Kutsunai v. Com'r*., the Tax Court noted that "[t]he general purpose of section 453(d) is to require a taxpayer to report any deferred profits when those profits are realized. Economically speaking, the seller herein is in no better position than before. He still holds an obligation from the same creditor. Under these circumstances, we find the issuance by Buyer of a new note does not constitute a "disposition" of the original installment obligation. Accordingly, DH is entitled to report payments made on the $1,500,000 note on the installment basis.

* * *

ANALYSIS OF TRANSACTION

II. Overview of Transaction

The taxpayer's objective is not simply to sell the property, but to sell it in sale qualifying for deferral of gain under §453, and to receive a promissory note from a creditworthy obligor. The taxpayer also wishes to create a trust which will benefit the taxpayer's children or other persons the taxpayer chooses. A sale to a trust would also accomplish the taxpayer's federal and New York estate planning objectives since the sale would remove the asset from the taxpayer's estate. The trust would provide asset protection which would enhance the likelihood of the taxpayer receiving payments under the promissory note.

Only a sale by the taxpayer to a trust can accomplish these objectives. The trust would sooner or later — preferably sooner — find a suitable cash buyer for the asset and dispose of it in a second disposition; but that cash buyer is not the buyer to whom the taxpayer wishes to sell asset directly for myriad reasons. The remainder of this paper will delve into the tax law and attempt to analyze whether the various components of this plan are consistent with the requirements of federal tax law.

The related trust would be settled by the taxpayer. The trustee would be a reputable trust company. The trust would be a nongrantor trust. The taxpayer and trust would be related, but only under the rules of attribution in IRC §267. After having made the sale to the trust, the taxpayer would have no economic interest in trust property, nor would the taxpayer have retained any more than extremely limited rights with respect the trust itself.

The trustee of the trust and the taxpayer would agree to a sales price for the asset. Since the trustee would owe a fiduciary obligation to trust beneficiaries, any agreement as to price would impliedly reflect an arm's length relationship between the trustee and taxpayer. True, the trust would also be obligated to pay the promissory note according to its terms, and would thus also have an obligation to the taxpayer. However, the relationship between the trustee and taxpayer would be contractual, whereas the trustee would owe a fiduciary obligation to the beneficiaries. It does not seem there is a conflict of interest, since the trustee, although having a fiduciary obligation to the beneficiaries, will also have an interest in agreeing to a fair price with the taxpayer. The trustee will not agree to a lower price because that would not be in the best interest of the beneficiaries. The taxpayer will also not agree to a price he believes is not fair.

The taxpayer will not enter into any trust agreement unless the agreement achieves the objectives sought by the taxpayer, the primary one being that payments under the note are paid, and that the trust remain a creditworthy obligor thereunder. If the note is not sufficient in amount, that jeopardizes the taxpayer right to be paid under the installment obligation. The taxpayer will not enter into such an agreement. It seems that any price agreed upon would reflect an arm's length, bargained-for agreement.

The attorney for the taxpayer would prepare a draft for review by the trustee. The trustee will ensure that the interests of the trust beneficiaries are protected, but will also recognize that the right to payment on the promissory note issued to the taxpayer be respected. Therefore, the trust and installment note would both provide that prior to any beneficiary distributions being made, the trust must have sufficient assets to certify that payments on the promissory note are secure. A default on the note would be detrimental

(Please turn to page 15)

INSTALLMENT SALES, CONT.

(Continued from page 14)

not only to the taxpayer, but to trust beneficiaries as well.

The taxpayer would not under any circumstance be made a beneficiary of the trust or derive benefits, directly or indirectly, from the trust. Doing so would risk not only estate inclusion under Section 2036, but could also create grantor trust issues. Accordingly, the taxpayer must know and accept the fact that the only cash he or she will receive from the trust will consist of principal and interest payments on the note. If the taxpayer requires more income for retirement or other purposes, that income must come from other sources.

At closing, the taxpayer will transfer title of the asset to the trust, and take back a nonrecourse promissory obligation, the terms of which have been previously agreed upon. The parties will also execute the trust agreement at closing if they have not already done so.

The nonrecourse nature of the promissory note imbues the transaction with economic risk to the taxpayer, which in turn strengthens the *bona fides* of the transaction for tax purposes. By making the trust nonrecourse, the taxpayer has made an economic concession. If the trust fails to make a payment under the promissory note, the taxpayer can look no further than trust assets for payment.

The trustee will coordinate the second disposition of the property, which may occur at any time after the first disposition. A delay in the second disposition would increase the likelihood of the property's value rising or falling during the interim, which would complicate matters for the trustee. The taxpayer may have already identified one or more potential purchasers for the trust. However, the trustee would be under no obligation to follow any recommendation made by the taxpayer with respect to either to whom the second disposition will be, or when the second disposition will take place.

A decision to wait two years before the second disposition will be one which carefully examines the facts and legal risks involved in making an earlier second disposition. There is no question that waiting two years will strengthen the transaction for tax purposes, for reasons discussed *infra*, but the decision to wait is one which the trustee will make, perhaps with the knowledge of the taxpayer's preference. The subtle contours of this issue will be more clear later. If the risk reduction in waiting is only marginal, and the benefit of selling sooner than two years is great, then the trustee may decide that the added risk of an earlier sale is worth the amount of tax risk an earlier sale would entail.

If the nature of the property is such that the taxpayer's continued active involvement must continue until the second disposition such as might be the case if the property consisted of a farm or ranch, the taxpayer may receive fair compensation from the trust for the period during which his or her involvement remains necessary. This does not appear to post a tax risk, but may be something which the taxpayer finds unappealing.

The purchase price which the trust and taxpayer agree upon will not be modified even if the trustee eventually makes the second disposition at a price above or below that which the trust purchased the asset from the taxpayer. The taxpayer-seller will have no legal recourse or right to object to not receiving the benefit of the higher price; nor will the taxpayer be subject to additional tax based on the appreciation of the asset during the interval.

Should the property decline in value and not command a price equal to what the trust paid for the asset, the trustee must decide whether it is in the best interests of the beneficiaries and the taxpayer-obligee to make the sale at the lower price. In making that judgment, the trustee must also consider whether making a sale at a lower price will jeopardize payments under the note; or whether a further delay in time will only result in making matters worse.

Since a sale for a lower price will negatively impact both the taxpayer and the trust beneficiaries, and increase the risk of a default on the note, a resale at a significantly lower price presents a dilemma for the trustee. For this reason, a prompt second disposition seems a prudent course for the trustee, provided tax risk is acceptable. If the taxpayer's asset is illiquid, this factor would be reflected in the initial purchase price.

The trust will authorize and will likely require the trustee to engage an advisor to invest trust assets. The taxpayer may wish to convey to the trustee the taxpayer's broad investment objectives for the trust when drafting the trust. This appears permissible under Rev. Rul. 82054, which addressed investor control of assets in a variable annuity contract issued by an insurance company. The ruling stated "the ability to choose among broad, general investment strategies, such as stocks, bonds, or money market instruments . . .does not constitute sufficient control" to change tax ownership. Care must be taken not to exceed the limited powers which the seller may retain. Any input of the taxpayer with respect to broad investment decisions should be made only in consultation with the taxpayer's attorney and should require the approval of the trustee.

Amendments to the promissory note may become necessary due to changed circumstances. Any changes must be of the type and nature of those which would not cause an disposition of the note triggering the entire remaining gain. (See *supra,* Part I)

The trustee would most likely be given broad discretion to make distributions to beneficiaries, but as noted, only after the trust has shown a history of reliably meeting its contractual commitments to the taxpayer under the installment obligation, and only after all tax liabilities arising under state and federal law have been satisfied. If the trust were to default on the note, then the taxpayer would be entitled to immediate payment of the remaining principal on the note. The note being nonrecourse, the taxpayer could look only to trust assets for payment. The taxpayer would also lose the benefit of tax deferral under §453 on remaining note payments, so the result for the taxpayer would be inauspicious, to say the least.

Since the prospect of the trust not having sufficient liquidity to keep current with note payments would ultimately work to the detriment of not only the taxpayer, but to the beneficiaries as well, it is in the best interest of the trustee to make only those payments to beneficiaries as can safely be

(Please turn to page 16)

Installment Sales, Cont.

(Continued from page 15)

made without risking default on the note. The trustee would not have legal liability unless it breached its fiduciary obligations by acting negligently or recklessly with respect to trust assets.

The trust would in general grant the trustee broad discretionary powers since evolving circumstances may require flexibility to meet the dual needs of the taxpayer, who holds the promise of payment, and the beneficiaries of the trust. The job the trustee, as is often the case with trustees, would not be easy.

The interest of trust beneficiaries must not be remote, uncertain or inconsequential. For the transaction to be respected, it is not enough that the trustee owe a fiduciary obligation to beneficiaries whose likelihood of receiving benefits is insignificant or distant. The beneficiaries must have a real prospect of receiving benefits from the trust when economic realities permit distributions. At the same time, those distributions must not impair the right of the taxpayer to be secure in receiving payments under the installment obligation.

Taxes on trust income must also be reported and paid by the trust, since the trust is a taxable entity taxed at high marginal rates. The trust will not be allowed a deduction until each installment payment on the note is paid. See *Helvering v. Price,* 309 U.S. 409 (1940).

Constructive Receipt

Constructive receipt occurs when money or other property is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it. §446; Treas. Regs. §1.446-1(c). However, the taxpayer is not in constructive receipt of money or other property if the taxpayer's control over its receipt is subject to substantial limitations. *Nixon v. Com'r*, T.C. Memo, 1987-318, held that the taxpayer was in constructive receipt of a check payable to taxpayer which the taxpayer did not cash, but later endorsed to a third party. To avoid constructive receipt, the trust must not be viewed as an "agent" of the seller for tax purposes. If the IRS were successfully in arguing constructive receipt, the taxpayer would be taxed immediately on the entire sale proceeds. *See Amend v. Com'r*, 13 T.C. 178 (1949), *acq*. 1050-1 C.B. 1.

However, the taxpayer will have relinquished virtually all rights with respect to the property sold to the trust. The trust is entirely independent. The trust is "related" to the taxpayer only for some purposes specifically enumerated in the Code. Here, only cause §453 references the attribution rules in §267(b)(6). The tenuous connection implied by §267(b)(6) which find a relationship by attribution between a fiduciary and a grantor "of any trust" seems insufficient to assert that the trust is the "agent" of the taxpayer. For all practical purposes, the trust and taxpayer have no relationship after the sale: the trust owns property over which the taxpayer has virtually no control, and the taxpayer derives no benefits from the trust. The receipt of payments under the installment obligation is clearly not a "benefit," but rather a contractual right of a seller in a taxable transaction. The distinction is important. The taxpayer is merely the obligee on a promissory note issued by the trust. Such would be the case in any deferred sale under §453.

III. Importance of Avoiding Grantor Trust Status

Installment sales involving related parties or controlled business entities as intermediaries have fared considerably less well than trusts as intermediaries. However, grantor trusts cannot serve as intermediaries in the contemplated transaction, since all income would then be taxed to the grantor, making qualification under §453 impossible.

That the trust may not be a grantor trust follows axiomatically from Rev. Rul. 83-15, which treats the grantor as owner for income tax purposes of sales made to a grantor trust. The grantor is treated as having made a sale to himself, resulting in no income tax consequences. If the trust were a grantor trust, there would be no sale at all for income tax purposes — the seller would be considered as still owning the asset transferred to the trust. The presence of stray trust provisions or note powers that would give credibility to an argument that the taxpayer had retained powers or rights enumerated grantor trust rules §§671-677 should be avoided.

It is of course paramount that the trust itself not contain any provision that could be interpreted as causing the trust to be a grantor trust with respect to the taxpayer-seller. However, rights or powers lurking even in the installment obligation reflecting some impermissible benefit that the taxpayer has or might receive from the trust should be avoided.

In *SEC v. Wyly*, 56 F. Supp. 3d 394 (S.D.N.Y. 2014), no intermediary trust was involved. However, the court found the prohibited relationship under the grantor trust provisions, thus attributing tax ownership of trust assets to the seller, defeating the purpose of the trust. The importance of avoiding the grantor trust provisions was again evidenced in *Wyly*.

Justice Douglas, writing for the Court in the landmark case of *Clifford v. Helvering*, 309 U.S. 331 at 335-336 noted factors which inexorably led to the conclusion that the grantor remained the tax owner:

> In this case, we cannot conclude as a matter of law that respondent ceased to be the owner of the corpus after the trust was created. Rather, the short duration of the trust . . . and the retention of control over the corpus by respondent all lead irresistibly to the conclusion that respondent continued to be the owner for [income tax] purposes. . . .In substance, his control over the corpus was in all essential respects the same after the trust was created as before. The wide powers which he retained, included, for all practical purposes, most of the control which he as an individual would have. . . It is hard to imagine that respondent felt himself the poorer after his trust had been executed, or, if he did, that it had any rational foundation in fact. For, as a result of the terms of the trust and the intimacy of the familial relationship, respondent retained the

(Please turn to page 17)

INSTALLMENT SALES, CONT.

(Continued from page 16)

> substance of full enjoyment of all of the rights which previously he had in the property. 309 U.S. 331 at 335-336.

The trek through Sections 673 through 679 in search of such powers that cause the grantor to be taxed on the trust income therefore have as guideposts benefits, both direct and indirect, retained by the grantor, as well as legal rights so retained. The legal obligation for the trust to make payments on the promissory note cannot even colorably be described as a retained "benefit" by the taxpayer. By carefully ensuring that the trust is independent and that taxpayer has retained no benefits, the risk of the taxpayer being considered the "tax owner" trust assets appears very low.

[Note on terminology: Some confusion arises because even a nongrantor trust has a "grantor" in a non-tax sense: The term "grantor" is often used interchangeably to describe the settlor of both grantor and nongrantor trusts.]

IV. Rev. Rul. 73-157 & *Wrenn v. Commissioner*

Several early Revenue Rulings disapproved of the taxpayer's use of a related party to consummate an installment sale. Rev. Rul. 73-157 found a prearranged plan lacked economic reality where the taxpayer's son or the taxpayer's controlled corporation resold property to a third party. The objection to this plan was that the end result allowed the family, as an economic unit, to obtain all of the cash consideration for the property, while also reporting the gain under the installment method. The taxpayer would receive an installment note from the son (or a controlled corporation) initially. Then, in a separate transaction, son or controlled corporation would sell the property to a new buyer. Since son or controlled corporation paid fair market value for the property, the resale to a new buyer would generate little or no gain given the cost basis of son or controlled corporation.

A negative result also obtained in *Wrenn v. Com'r*, 67 T.C. 576 (1976), where the taxpayer engaged in an installment sale to his wife, who then immediately resold the property. The Tax Court agreed with the IRS that the transaction lacked any legitimate business purpose, legitimate estate planning purpose, and any other legitimate non-tax purpose. The Tax Court found that the parties had not only availed themselves of the benefits of a §453 installment sale, but had further accelerated receipt of all the cash that the installment sale would have eventually produced. Since wife had a cost basis, her resale yielded no capital gain. Thus the family "unit" had all of the cash from the sale, but was reporting the gain on an installment basis.

As bad as *Wrenn* was, the Tax Court declined to invalidate an intrafamily transactions based upon a prohibited agency relationship. Rather, the Court held that such sales are subject to close scrutiny, and an intrafamily sale should be evaluated by the degree of independence of the parties, and the presence of a substantive or business purpose.

A different problem arose in Rev. Rul. 77-414, where a Long Island seller negotiated the sale of property to Suffolk County for a lump sum. Since local law did not allow Suffolk to utilize an installment sale, a bank bought the property from the seller issuing an installment note, and then proceeded to immediately sell the property to Suffolk County for cash. The IRS disallowed installment sale treatment to the taxpayer, arguing that the taxpayer had inserted an "unnecessary intermediary," into the transaction. Rev. Rul. 77-414 cited *Wrenn v. Com'r.* in finding that a resale by a related party under a prearranged plan lacked a legitimate business or estate planning purpose.

The transaction upon which the Service opined negatively in Rev. Rul. 77-414 might today be decided differently, since the transaction in which unrelated bank served as intermediary did not appear to evidence tax avoidance, but merely a desire to report the transaction on the installment method, a legitimate tax objective. *Wrenn* would likely be decided today as it was in 1976, for the same reasons.

V. <u>Enactment of IRC §453(e)</u>

Section 453(e), enacted in 1980, established a bright-line rule permitting second dispositions by related parties if a two-year holding period is met. §453(e) is entitled "Second Dispositions by Related Persons." §453(e)(1) provides that a second disposition within two years will be treated as having been received at the first disposition. If more than two years elapses until the second disposition, §453(e)(2) provides deferral under §453 will be unaffected. Section 453(e)(7) provides that in some circumstances, the two-year holding period may not be required:

> [Section 453(e)] shall not apply to a second disposition (and any transfer thereafter) if it is established to the satisfaction of the Secretary that neither the first disposition nor the second disposition had as one of its principal purposes the avoidance of Federal income tax.

Establishing that the second disposition within two years was not motivated by tax avoidance requires satisfying the economic substance doctrine which was codified in 1990. Moreover, the legislative history of §§ 453(e) and 453(f)(1) offer a cautionary warning:

> The definition of related party relationships is not intended to preclude the Internal Revenue Service from asserting the proper tax treatment of transactions that are shams.

H. Rep. 96-1000, 96th Cong., 2d. Sess. 17 (1980).

<u>Taxpayer to Trust Attribution Exists Under §267(b)</u>

For purposes of determining the applicability of the two-year holding period required for "related" parties in §453(e)(1) and (e)(2), reference is made to §453(f)(1)(B) which states that a "related intermediary" includes a person who bears a relationship to the seller under §267(b). Under §267 (b)(6), "[a] grantor and a fiduciary of

(Please turn to page 18)

INSTALLMENT SALES, CONT.

(Continued from page 17)

any trust" are related by attribution.

Section 453(e) applies literally to second dispositions by related parties. Does Section 453(e) have any effect on second dispositions by unrelated parties within two years? The question is not merely academic.

While it is true that the parties in the contemplated transaction are related through attribution, the taxpayer has no economic interest in the intermediary nongrantor trust to which the asset is sold. Were it not for the relationship attributed to the taxpayer under §267(b)(4), the taxpayer and trust would be unrelated. For that reason, it is worth analyzing whether §453(e) has any effect on second dispositions by unrelated parties.

Private Letter Ruling 200937007

In PLR 200937007, the IRS found §453(e) had no application to a second disposition by an unrelated party. The seller and intermediary were unrelated under §453(f)(1), and the unrelated party would dispose of the property within two years. The PLR concluded that

> the related party provisions described in §453(e)(1) of the Code do not apply. Therefore, the taxpayer will not recognize gain on a second disposition.

However, PLR 200937007 was revoked after its issuance due to the seller's "misstatement or omission of controlling facts on which the earlier ruling was based." Private Letter Rulings are taxpayer-specific and other taxpayers may not rely on them, though in practice taxpayers do.

Nevertheless, the reasoning behind the revoked ruling is no less cogent by virtue of its revocation, and certainly the taxpayer argue that §453 (e)(1) has no application to second dispositions by related parties where it is established that tax avoidance was not a principal purpose of the transaction pursuant to §453(e)(7); especially in situations where the trust is related only by reason of the attribution rule in §267(b)(4), but when viewed in all other legal contexts, the trust and taxpayer are entirely unrelated.

The taxpayer in the contemplated transaction would have no ownership interest in trust assets, would have retained no rights to those assets under the trust, except the rights of a creditor, and would have retained no benefits under the trust. Being a creditor-oblige under an installment note is not a "benefit" but rather a legal right emanating from a legitimate sale to the trust. If challenged, the taxpayer might succeed in arguing the applicability of the §453(e)(7) "no principal purpose of tax avoidance" to the second disposition within two years.

If faced with that issue, it seems a court would most likely find what the revoked PLR did: that §453(e) literally applies to dispositions made by related parties within two years because so states, but that the exception in §453(e)(7) might apply to a disposition by an unrelated party if under established case law, the transaction was clearly not one in which tax avoidance was a principal purpose, and further, that the transaction met the more stringent test imposed by the economic substance doctrine. There is nothing in §453(e)(7) that expressly limits its application to related party transactions.

VI. Business Purpose Requirement: Prelude To Economic Substance Doctrine

Dispositions by related parties (i) after two years and (ii) prior to two years if the §453(e)(7) no tax avoidance exception is met, must both have a legitimate business purpose. As noted, the use of trusts as intermediaries appears to be the most reliable means of achieving installment sale treatment with an intermediary.

In *Rushing v. Com'r.*, 441 F.2d 593 (5th Cir. 1971), aff'g, 52 T.C. 888 (1969), the Fifth Circuit held in favor of the taxpayer. At issue in *Rushing* was the legitimacy of an intrafamily installment sale involving the use of trusts. Citing the economic independence of each spouse, and the lack of control by the selling spouse over the resale proceeds, the court opined that the "prearranged plan" argument loses currency unless a straw conduit is interposed. The Court concluded tersely:

> Certainly the IRS cannot be contending that any time an installment purchaser makes it known to the installment seller that he . . . plans to resell at some future date the installment seller immediately loses his . . . right to report gain pursuant to section 453(b)."

One commentator citing *Rushing*, summarized the tolerant view of courts regarding installment sales to irrevocable trusts:

> The courts have consistently recognized the legitimacy of installment sales to irrevocable trusts managed by independent trustees. It is interesting to note that the courts have been unreceptive to the Commissioner's reliance upon a prearranged, or intended, resale as the indicia of a "sham" installment sale. Instead, the courts have demonstrated a willingness to look beyond such arrangements to the more fundamental issue of trust independence. One of the indicia of such independence is the trustee's ability to void such prearranged plans. In addition, the courts have relied heavily upon the fiduciary's duty to act exclusively for the benefit of the beneficiaries. The interaction of these two elements presents strong evidence in support of a claim to independent, economic significance by any trust. *Section 453: Installment Sales Involving Related Parties or Trusts*; *John L. Rupert, DePaul Law Review*, Volume 29, Fall 1979.

In *Nye v. United States*, 407 F. Supp. 1345 (MDNC 1975), one spouse sold securities to the other under the installment method, as in *Wrenn*. The IRS challenged the transaction alleging the existence of an agency relationship. Citing *Rushing*, the court ruled in favor of the taxpayer. The proper test was whether the seller directly or indirectly controlled the proceeds of the resale or derived any economic benefit from the transaction. The court dismissed the IRS argument that seller's knowledge of the related

(Please turn to page 19)

INSTALLMENT SALES, CONT.

(Continued from page 18)

party's intention to resell precluded the seller from reporting gain on the installment method.

In *Oman Construction Co. v Com'r*., 37 T.C.M. (CCH) 1849-57, decided in 1978, the IRS alleged the transaction lacked economic substance because of a prearranged sale. The court examined each transaction and determined that the sellers neither directory nor indirectly controlled the sale proceeds nor benefitted economically. The court rejected IRS reliance on Rev. Rul. 73-536 and the prearranged resale argument.

The IRS again challenged the use of a trust intermediary engaged to accomplish a sale in *Roberts v. Com'r*., 1 T.C. 311 (1978). *Rushing* was again critical in the Tax Court's conclusion. The Court observed that the primary purpose of the *Rushing* test was to determine the independent significance of the intermediary. The court stated that "[t]he fact that the [taxpayer] may have opted . . . to put the proceeds beyond his legal control does not vitiate . . . the transaction once it was consummated."

The Tax Court examined the independent significance of the trust, and found that the trust (i) was irrevocable; (ii) was a valid and distinct entity under state law; and (iii) despite the fact that family trustees were employed, the taxpayer had provided evidence of their economic independence. The Court also noted that the lack of security for the obligations of the trust instilled economic risk to the seller.

* * *

Factors probative of a *bona fide* sale to an independent trustee include the following: (i) whether the trust is irrevocable; (ii) whether the seller can amend the trust; (iii) whether the seller is a beneficiary of the trust; (iv) whether the trustee is independent; (v) whether the trustee may void any prearranged sale; (vi) whether the trust is subject to economic risk of appreciation or depreciation in the trust corpus; (vii) whether the trust's obligations may be accelerated; (viii) whether the seller is limited solely to the installment obligations of the trust for investment recovery; (ix) whether the trust's obligations are secured; (x) whether the trustee owes fiduciary obligations to the beneficiaries; (xi) whether the trust agreement impairs the trustee's independence; and (xii) whether the trustee is a close family member. *Installment Sales Involving Related Parties or Trusts, DePaul Law Review*, *supra*, at pp. 64-65.

Application of these criteria to the present analysis yields auspicious results. In fact, each factor analyzed is probative of a *bona fide* sale to an independent trustee:

(i) The trust is irrevocable;

(ii), the taxpayer has no right to amend the trust;

(iii), the taxpayer is not a beneficiary of the trust;

(iv), the trustee is independent;

(v), the trustee makes a determination when, how, and to whom the second disposition of the asset shall occur;

(vi), the trust bears the entire economic risk of appreciation or depreciation in the trust assets;

(vii), the obligation of the trust may be accelerated in the event of a default;

(viii), the trust is nonrecourse with respect to the taxpayer;

(ix), the obligations of the trust are unsecured;

(x), the trustee owes a fiduciary obligation to the beneficiaries;

(xi), the trust agreement grants the trustee broad discretionary rights and powers; and

(xii), no family member is a trustee.

VII. Economic Substance Doctrine And Its Codification in 2010

The economic substance doctrine is a common law doctrine whereby the tax benefits of a transaction are disallowed if the transaction does not have economic substance or lacks a business purpose. Prior to 2010 there was a split among various Circuit Courts with respect to whether the doctrine consisted of a two-prong test, or whether the test involved an objective inquiry into whether the transaction had economic effect.

Codification of Doctrine

To resolve a split in the Circuits, the economic substance doctrine was codified in the *Health Care and Education Reconciliation Act of 2010*, Pub. L. No. 111-152, §1409, by adding new §7701(o) to the Code. The doctrine is the convergence of statutory interpretation and common law into a rule of law which provides that even if a taxpayer meets all Code requirements and all relevant common law doctrines, the taxpayer will not prevail unless the taxpayer can satisfy the subjective and objective standards applied by the courts. The determination of whether the economic substance doctrine applies to a transaction is made "in the same manner as if [the] subsection had never been enacted." §7701 (o)(5)(C).

Under §7701(o), a transaction entered into for profit will have economic substance only if

(i) the transaction changes in a meaningful way (apart from federal income consequences) the seller's economic position;

and

(ii) the seller has a substantial purpose (other than tax) for entering into the transaction.

In Notice 2010-62, the IRS stated it would continue to rely on relevant case law under the common law economic substance doctrine in applying the two-prong conjunctive test in §7701(o); but will challenge taxpayers who seek to rely on earlier case law for the proposition that a transaction will be treated as having economic substance because it satisfies either prong of the two-prong test. The Service views the economic substance

(Please turn to page 20)

INSTALLMENT SALES, CONT.

(Continued from page 19)

doctrine as applying to tax benefits it perceives as not being consistent with purposes of the particular Code provision that the taxpayer relies on for tax benefits.

Notice 2010-62 does not contain an "angel list" of transactions to which the economic substance doctrine is not relevant. The notice also states that the IRS will not issue a private letter ruling regarding whether the economic substance doctrine is relevant to any transaction, or whether any transaction complies with the requirements of §7701(o). As a result, taxpayers will apparently be foreclosed from seeking IRS pre-approval of transactions to avoid the strict liability penalty imposed by the statute.

A prominent tax treatise finds the economic substance doctrine "exquisitely uncertain," and notes that it emanates from a "coalesce[nce]" of the substance over form and business purpose concepts which are "closely related." *Bittker & Lokken*, *Federal Taxation of Income, Estates, and Gifts* ¶ 4.3.1 & n.8; and ¶ 4.3.4A (2013).

Notice 2014-58 states that the use of an intermediary employed for tax benefits whose involvement was unnecessary to accomplish an "overarching" non-tax objective could be tested as a separate transaction for purposes of determining the existence of economic substance. If found to lack economic substance, the IRS could assert a 20% negligence penalty under IRC §6662 on transactions lacking economic substance, or 40% on transactions lacking economic substance that are not adequately disclosed on the seller's return or on a statement attached to the return.

Feldman v. Com'r, 779 F.3d 448 (7th Cir. 2015), decided five years after codification of the economic substance doctrine, did little to clarify the when the economic substance doctrine applies. The Court found the economic substance doctrine "similar but not identical" to the substance-over-form doctrine, noting it "borrows heavily from both." A transaction will have economic substance and will be respected for tax purposes if it "changes in a meaningful way. . .the taxpayer's economic position" and the taxpayer has a valid nontax business purpose for entering into it. However, the Court cautioned that "even when a transaction has some degree of nontax economic substance, the substance-over-form principle may provide an independent justification for recharacterizing it."

Affirming the Tax Court decision holding for the IRS, the Court of Appeals for the 7th Circuit concluded that the IRS appears to take the position that although the substance-over-form and economic-substance doctrines are similar, they can be applied independently, and envisions reserving the economic substance analysis for "situations where the economic realities of a transaction are insignificant in relation to the tax benefits of the transaction." [Citations omitted].

Exceptions to Application of
<u>Economic Substance Doctrine</u>

The Joint Committee of Taxation Report which accompanied legislation codifying the economic substance doctrine states

> The provision is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages.

Thus, two exceptions to the application of the doctrine appear to apply:

> First, whether the benefits claimed are consistent with a Congressional purpose or plan; and
>
> Second, whether the transaction has been respected under longstanding judicial and administrative practice.

New York University 70th Institution on Federal Taxation, "Economic Substance," New York, NY October 23-28, 2011; San Francisco, CA November 13-18.

Reasonable Cause Exception
<u>Inapplicable if Penalties Imposed</u>

Section §7701(o)(1)(B) imposes strict liability penalty under §6662 for an underpayment attributable to any disallowance of claimed tax benefits by reason of a transaction lacking economic substance. The penalty is 20% percent (increased to 40% if the taxpayer does not adequately disclose the relevant facts affecting the tax treatment in the return or a statement attached to the return). The reasonable cause and good faith exception of present law §6664(c)(1) are inapplicable to any portion of an underpayment that is attributable to a transaction lacking economic substance. An amended return is not taken into account if filed after the taxpayer has been contacted for audit. No exceptions to the penalty are available.

Thus, outside opinions or inhouse analysis would not protect a taxpayer from the imposition of a penalty if it was determined that the transaction lacked economic substance or failed to meet the requirements of any similar rule of law. If a transaction is a reportable transaction, the adequate disclosure requirement will be met only if the taxpayer files a Form 8886 (Reportable Transaction), and not merely Form 8275 (Disclosure Statement).

VIII. "Monetized Installment Sales" <u>Transactions Distinguished</u>

"Monetized installment sales," have attracted the disapproved of the Service. In Chief Counsel Memorandum (CCA) 202118016. The "MIS" transaction attempts to achieve what *Wrenn* sought: to receive cash from the sale and report gain on the installment method. In contrast to the MIS transaction, in the arm's length sale to the trust contemplated, no "monetization" of the installment obligation note occurs. The note will, by its very terms, prohibit pledging, hypothecating, or creating any collateral escrow arrangements with respect to the note.

CCA 202118016 enumerates six separate bases for concluding that IRS counsel "generally agree[s] that

(Please turn to page 21)

INSTALLMENT SALES, CONT.

(Continued from page 20)

the theory on which promoters base the arrangements is flawed." The advisory enumerates six "common features that make the transactions problematic."

> Those consist of
>
> (i) there being no genuine indebtedness;
>
> (ii) the debt being secured by escrow;
>
> (iii) the debt being secured by a dealer note;
>
> (iv) the intermediary does not appearing to be the true buyer of the asset sold by taxpayer;
>
> (v) the note being secured by a cash escrow; and
>
> (vi) the loans being to a disregarded entity wholly owned by seller which were secured by the buyer's installment notes.

The transaction described in this paper appears to posses none of the "features" that caused IRS counsel to take a dim view of the monetized installment sale in CCA 202118016. The absence of those characteristics should be addressed sequentially:

> With respect to objection (i) there is genuine indebtedness, represented by a nonrecourse note with respect to which the taxpayer bears real economic risk;
>
> With respect to objection (ii), the debt is not secured by escrow;
>
> With respect to objection (iii), there is no dealer note. The note is given by an independent and unrelated nongrantor trust, over which the taxpayer has no control;
>
> With respect to objection (iv), the trust is the "true" buyer in an arm's length transaction with the taxpayer. The trustee owes a fiduciary obligation to the beneficiaries not to engage in any sale which is not for fair market value. The obligation of the trustee to beneficiaries is fiduciary, a higher obligation than that owed to the taxpayer on the installment note, which is a contractual obligation.
>
> With respect to objection (v), not only is the note not secured by a cash escrow, it is a nonrecourse in nature. The only recourse the taxpayer has is to proceed against trust assets in the event of a default. Furthermore, in the event of a default by the trust, the "full payment" clause will be triggered, which will accelerate the taxpayer's deferred capital gain under Section 453.
>
> Finally, with respect to objection (vi), the trust is not a disregarded entity, but a separate taxable entity.

With respect to objection (iv), CCA 202118016 states:

> Under section 453(f), only debt instruments from an "acquirer" can be excluded from the definition of payment and thus not constitute payment for purposes of section 453. Debt instruments issued by a party that is not the "acquirer" would be considered payment, requiring recognition of gain. See Rev. Rul. 77-414, 1977-2 C.B. 299; Rev. Rul. 73-157, 1973-1 C.B. 213; and *Wrenn v. CIR*, 67 T.C. 576 (1976) (intermediaries ignored in a back-to-back sale situation).

The citations refer to *Wrenn*, Rev. Rul. 73-157, and Rev. Rul. 77-414. Of the three, the transaction described in this paper bears no resemblance whatsoever to *Wrenn* or to Rev. Rul. 73-157, which both illustrated situations where the taxpayer sought deferral under §453 and the receipt of cash by accelerating payment through a related intermediary. Rev. Rul. 77-414 would likely be decided differently today, since the bank involved was unrelated to the taxpayer. The preservation of installment gain treatment is result of an economic transaction which at every level appears to exhibit non-tax avoidance characteristics. The economic result which the taxpayer seeks to achieve does not appear to violate either the business purpose doctrine. It cannot be fairly said that the taxpayer should be forced relinquish legitimate and substantial nontax benefits sought in order to achieve deferral under §453.

The sale to the trust contemplated does not remotely resemble the "monetized installment sale" which has received the disapprobation of the Service. Furthermore, even if it were the case that the two year holding period required under §453(f)(3) would normally be required, the contemplated transaction bears all of the hallmarks of one which would qualify under the §453(e)(7) exception, which applies to second dispositions with respect to which "neither the first disposition nor the second disposition had as one of its principle purposes the avoidance of tax."

IX. Application of Economic Substance to Transaction

Trust intermediaries were present in several cases decided favorably in the 1970's. No known cases have reversed or criticized the holdings of any of those decisions, the most important of which is *Rushing.* The JCT Report which accompanied the legislation codifying the economic substance doctrine clearly provides that §7701(o)

> is not intended to alter the tax treatment of longstanding business transactions. . . Among those . . . are the choice to utilize a related-party entity in a transaction, provided that the arm's length standard of Section 482 and other concepts are satisfied.

In the transaction at issue, there is an arm's length sale in the first disposition between the independent trust and the taxpayer. In the second disposition, an arm's length sale occurs between the trust and the ultimate purchaser. The terms of the Note may be

(Please turn to page 22)

INSTALLMENT SALES, CONT.

(Continued from page 21)

modified, in accordance with legal precedent, for various legitimate reasons, most of which would relate to the avoiding default on the note.

The risk of nonpayment is of course not helpful to the taxpayer in an economic sense, yet that same economic risk imbues the transaction with a legitimacy from a tax standpoint, and would contradict an assertion that the transaction lacks economic substance. So too, the nonrecourse nature of the promissory note also increases the risk assumed by the taxpayer, which again refutes the notion that a principal purpose of the transaction was to avoid tax.

Since the codification of the economic substance doctrine, the IRS asserts that it will require compliance with both prongs of the doctrine. The substance-over-form argument seems weak, because the trust intermediary serves a crucial non-tax objective: It will serve a vehicle to both to ensure payment on the installment obligation and also to make distributions to trust beneficiaries. Only the trustee could provide the essential elements of the installment obligation and trust which the taxpayer's economic objectives.

The use of the intermediary trust will also vanquish the difficult problem of finding that rare creditworthy buyer willing to both provide a promissory note with terms the taxpayer requires, and who will also remain involved as a obligee for the term of the installment obligation.

The trust intermediary will provide the terms of the note required, ensure that the interests of the beneficiaries are protected, and administer the trust in such a manner that maximizes the probability that the taxpayer will timely receive payments called for under the terms of the note. The trustee will also ensure that beneficiaries' interests are protected, and that once the trust achieves financial strength, distributions will be made.

The terms of the promissory note will also reflect the contractual obligation of the trust to make payments on the promissory note. The trust and promissory note will together establish the relationship that will enable the taxpayer to achieve the legitimate tax and economic objectives of selling the asset, reporting gain on the installment method, planning for estate tax, and planning engage in estate planning, removing the assets from the federal and New York taxable estates.

Judge Learned Hand, who sat on the Second Circuit Court of Appeals from 1924 to 1951 famously noted:

> Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. *Helvering v. Gregory*, 69 F.2d 809, 810-11 (2d Cir. 1934).

The argument that the trust is not the "true buyer" is unpersuasive. The trust would be independent, controls the asset which it purchases and the destiny of the asset. The taxpayer will have relinquished all rights to the asset and in exchange received an unsecured nonrecourse promissory note. The taxpayer would have no control over decisions made by the trustee, including the timing and extent beneficiary distributions. The trust and terms of the promissory note will inform the trustee as to when beneficiary distributions should be made. The taxpayer will also have made his broad investment objectives clear in the trust instrument. Whether the taxpayer could later inform the trustee of a changed investment risk profile for trust assets would require the consent of the trustee, and a legal opinion that the taxpayer's counsel.

The trust will be unrelated except under the attributions rule of §267 (b)(4), a tenuous basis for claiming that the trust is related. In most litigated cases, the lynchpin of objections has been a relationship among family members, not one of trustee-taxpayer) such as would occur if the taxpayer retained benefits in the trust), and certainly not one of trustee-taxpayer under merely a rule of attribution in §267.

All of the factors analyzed, both by Courts, and by legal authorities, appear to suggest that the arrangement falls well within existing precedent and is not violative of important tax doctrines. The "monetized installment sale," to which the IRS has objected, has in common with the instant transaction only that both involve deferred sales under §453.

As noted, the use of the trust will have enabled the taxpayer to avoid the near-impossible task of locating a creditworthy buyer willing to enter into the transaction involving a long-term promissory note. The manner in which the taxpayer will have proceeded will arguably have been the only route which could have provided the legitimate nontax benefits sought by the taxpayer, while preserving the taxpayer's right to utilize §453. It might even be argued that no other method could have achieved those benefits, and that only the transaction in the form chosen could achieve the nontax benefits sought. In that case, an argument that the taxpayer should not be able to report the sale under the installment method appears weak.

The taxpayer is not required to choose an inferior path which results in greater tax. Trust intermediaries in transactions akin to that contemplated have long been supported by the Courts. The transaction appears to satisfy both the business purpose and both prongs of the economic substance doctrines. Whether the taxpayer decides to wait two years, or is comfortable proceeding under the §453(e)(7) exception is a matter for the trustee to decide, further burnishing the argument that the taxpayer has not violated the economic substance doctrine.

X. <u>Conclusion</u>

The foregoing analysis expresses the views of the author concerning issues of federal tax law and does not constitute legal advice. Anyone contemplating any transaction involving federal tax law should seek the advice of competent tax counsel before proceeding.

2023 TAX PROVISIONS, CONT.

(Continued from page 1)

income thresholds that apply to the top tax bracket will decline significantly. Adjusted Gross Income of single tax filers in excess of $418,400 and joint filers in excess of $470,700 would be within the 39.6% bracket. By comparison, the top income thresholds for 2023 (for the 37% bracket) are higher, at $578,125 for single tax filers and $693,750 for joint filers.

New York has a compressed rate structure. The vast majority of joint filers will be subject to income tax rates between 5.85% and 6.85%. Taxpayers whose income exceeds $2.155 million will pay tax at a 9.65% rate; over $5 million, at 10.3%. Most New York City residents will incur tax at rates between 3.7% and 3.85%.

Standard Deduction

The standard deduction for 2022 is $12,950 for single taxpayers, and $25,950 for joint filers. For 2023, the rates will increase to $13,850 and $27,700, respectively. Fewer taxpayers now itemize since the standard deduction was increased in 2017. Itemization is still necessary to deduct mortgage interest, state and local taxes, or charitable contributions.

Taxpayers 65 and older benefit from a slightly increased standard deduction. For single filers, $1,750 in 2022 and $1,850 in 2023. Joint filers receive a $1,400 increase for each spouse 65 and older in 2022, and $1,500 for each 65 and older in 2023.

Note that the increased standard deduction, as well as the repeal of the personal exemption, which both occurred in 2017, will expire at the end of the year in 2025.

Capital Gains Tax

Long-term capital gains rates (assets held more than a year) are taxed at 15% to 20%. For the 2023 tax year, the 20% brackets applies to joint filers whose gains exceed $0.553 million. Short term capital gains are taxed at ordinary income rates. New York taxes all capital gains as ordinary income.

Dividends

"Qualified" dividends are dividends from public companies, and are taxed as long term capital gains. Therefore, a stock purchase in advance of a dividend will benefit from a 15% or 20% tax rate even if the stock is sold immediately after receiving the dividend.

3.8 Percent Surtax

The 3.8% surtax is imposed on net investment income of taxpayers whose adjusted gross income exceeds $200,000 for single taxpayers and $250,000 for joint filers. Net investment income includes capital gains, dividends, taxable interest, rents and royalties, and passive income from activities in which the taxpayer does not actively participate. Net investment income also includes the taxable portion of nonqualified annuity payments.

Child Tax Credit

The child tax credit remains at $2,000 in 2022, but is phased out for single filers at $200,000 and joint filers at $400,000.

State & Local Tax Deduction (SALT)

The bane of wealthy coastal states, the reviled SALT limitation is set to expire at the end of 2025. The SALT provision operates to limit the deduction for state and local taxes paid, including income, property, and sales tax, to $10,000 per return. Filing separately will not help, as the limit is reduced to $5,000 per return.

New York, joined by at least 30 other states, including California and Illinois, have devised strategies to enable its residents, especially small business owners, to avoid the limitation. Treasury has approved the workarounds. See IRS Notice 2020-75. While the workaround benefits owners of pass-through entities, many other taxpayers are still adversely affected by the SALT cap.

New York's "pass-through entity tax" (PTET) works like this: Owners of pass through entities, such as LLCs, S Corps, and Partnerships, may elect to pay taxes at the entity level, reducing the income flowing out to the partner or shareholder. (See TSB-M-21(1)C,(1)I. The consequent reduction in state tax lessens the impact of the $10,000 limitation. However, New York still collects tax revenue at the entity level. *New York collected $11 billion in pass-through entity taxes by the end of 2021*.

Mortgage Interest Deduction

Fewer taxpayers are claiming the mortgage interest deduction since itemizing will not reduce taxes unless mortgage interest, state and local taxes, and charitable deductions exceed the standard deduction of $25,900 for married couples in 2022, and $27,700 in 2023.

The current limit on deducting mortgage interest is $750,000 for first and second homes purchased after December 15, 2017. A higher $1 million limit applies to first and second homes purchased before that date. The lower limits on newer homes will expire at the end of 2025.

Although relatively few homeowners would elect to refinance a mortgage today, up to $1 million in mortgage debt existing on December 15, 2017 may be refinanced, provided the refinanced amount cannot exceed the amount of the paid-down mortgage being refinanced.

Debt on home equity loans used to "buy, build, or substantially improve" a first or second home, may be deductible up to $100,000, provided the debt is secured by the home sought to be improved.

Bitcoin & Cryptocurrencies

The IRS considers Bitcoin property, not a currency. As such, gains and losses must be reported just as capital assets would be. Form 1040 now contains a question concerning the acquisition or disposition of cryptocurrency during the taxable year. Unlike purchases made with cash or a credit card, purchases of assets made with Bitcoin are taxable transactions, which will require reporting gain or loss in the transaction. For example, buying a laptop or iPhone with Bitcoin would be akin to a purchase made by selling about shares of Apple stock

(Please turn to page 24)

2023 TAX PROVISIONS, CONT.

(Continued from page 22)

and reporting the gain or loss. Even the purchase of can of Coke Zero at a gas convenience store would result in a reportable taxable sale or exchange if purchased with Bitcoin rather than with cash or credit card.

Federal Estate & Gift Tax

No changes have occurred in the federal estate tax regime, although some are imminent. The gift and estate tax exemption amount is $12.06 million per individual; twice that for a married couple.

A number of current provisions are scheduled to "sunset" on Dec. 31, 2025. With that date approaching, planning to leverage current favorable estate tax laws may be prudent for some taxpayers. Congress may act to extend the current law, or it may not. It is worth noting that the federal exemption has steadily increased over the years; a reduction in the exemption amount would be unusual.

The unified estate and gift tax deduction is $12.06 million per individual in 2022 and $12.92 million in 2023 (effectively $24 million for a married couple in 2022 and nearly $26 million in 2023). Note that the amount is increased in line with the inflation rate, resulting in a significant jump in the exemption in 2023.

The ability to utilize certain lifetime gift and estate planning strategies may be curtailed if the lifetime exemption is in fact reduced as of January 1, 2026.

Strategies to consider

Individuals with large estates may want to secure the benefits of the current enhanced exemption levels by making lifetime gifts, as the limit on gifts, as noted, will decease by about one-half as of January 1, 2026, if Congress does not act.

New York has no gift tax, but does have a "clawback" tax which operates to include the value of gifts made within 3 years of death when calculating estate tax.

Business owners may gift an ownership interest and apply a valuation discount, typically 20% or more due to the depressed value of a minority interest due to lack of control and illiquidity. These discounts will leverage the available gift tax exemption.

New York Estate Tax

New York has no plans to eliminate the estate tax. One should have an idea of the size of the estate to determine whether the allowable exemption amount would likely be exceeded. In certain situations, planning might be considered. Planning might be considered if the estate is in danger of exceeding the "cliff" by an amount that can be trimmed from the estate so that the cliff is not exceeded. Although federal estate tax exemption is $12.06 million, the comparable New York figure is $6.11 million. The tax rate New York imposes once the threshold is exceeded ranges from 5% to 16% depending on the amount of the excess.

There is one exceptionally important proviso: If the "excess" exceeds 5% of the exemption, then the entire estate – not just the "excess" – is subject to tax. This is how the "cliff" operates. To illustrate, an estate worth $6.115 million would have a small estate tax, since the "excess" over the exemption amount is only $5,000. However, if the estate were worth a single dollar more than the sum of (i) 5 percent of $6.11 million and (ii) $6.11 million, or $6,415,501 (*i.e.*, $6.11 million plus $305,500 plus $1) the entire estate would be subject to estate tax.

Determining the approximate size of the taxable estate is important if the size of the estate is likely to exceed the 105% of the exemption amount. If that were the case, gifting an amount that would reduce the likelihood of the "cliff" feature applying. On the other hand, planning to avoid the "cliff" would be unlikely if the estate were worth $10 million, since that would require an immense gift which would far outweigh the New York estate tax savings.

Charitable Deductions

Given the higher standard deduction, many fewer persons are taking itemized deductions for charitable contributions. However, if large donations are contemplated, the donor might consider making larger donations in staggered years to surmount the itemized deduction limitation. A taxpayer may also make a donation of appreciated securities. In that case, the donor will receive a deduction based on the fair market value of the stock, and avoid paying tax on the appreciation. Careful planning is required as the rules for charitable deductions are complex.

Electric Vehicle Incentives

Beginning in 2023, Tesla, GM and Toyota benefit from the removal of cap on the number of vehicles a manufacturer may sell to qualify for a credit. Fledgling electric manufacturers will find it more difficult to gain market share, but the playing field will be leveled. A credit of up to $7,500 under IRC §30D will be available to buyers of new, qualified plug-in EV or fuel cell electric vehicle (ECV). Hybrid vehicles will not qualify for the credit. To take the credit, adjusted gross income may not exceed $300,000 for joint filers and $150,000 for single filers. The AGI limitation may reference the year in which the vehicle is purchased or the previous year. Beginning in 2024, a taxpayer may receive the credit at the point of sale, rather than when the taxpayer files a return.

The vehicle must be new, must have a gross weight of less than 14,000 pounds, and be manufactured by a "qualified manufacturer," which includes the major manufacturers selling autos in the U.S. The MSRP for vans, SUVs, and pickup trucks cannot exceed $80,000; and cannot exceed $55,000 for other vehicles. As of August 16, 2022, to qualify for any credit, "final assembly" must be in North America, which includes Canada, Mexico, and Puerto Rico. The term "final assembly" appears to refer to the process of integrating batteries into EVs during vehicle production, and not manufacturing battery cell components out of critical materials, or producing battery cells and packs from cell components.

A credit of the lesser of $1,000 or 30% of the cost of installing a residential charging system is available

(Please turn to page 25)

(Continued from page 23)

retroactive to January 1, 2022. The credit is only available in certain areas of the country.

Energy Efficient Home Improvements

For 2022, a credit equal to 10% of the cost of energy-efficient home improvements, not including solar, may be taken, up to $500. For 2023 through 2032, the credit increases to 30% of the cost, with a $1,200 annual limit. Solar or wind improvements are eligible for a 30% credit against the cost of buying and installing the solar or wind system. Beginning in 2023, the 30% credit also applies to battery storage systems

Medical Expenses

The medical expense deduction is limited to eligible expenses exceeding 7.5% of adjusted gross income. Although most taxpayers will not benefit either because they do not itemize, or if they do, because they do not meet the 7.5% threshold, some taxpayers will benefit.

For example, expenses not paid for by insurance, such as nursing home or assisted-living expenses would be eligible expenses. Other unreimbursed expenses that might benefit from itemization include insurance premiums not otherwise deductible, or expensive items such as protheses. Other treatments not covered by insurance, such as acupuncture, or expenses for illnesses paid out of pocket, might also benefit from itemizing.

Flexible Spending Accounts (FSAs)

Flexible spending accounts allow employees to pay for unreimbursed healthcare expenses, such as over the counter medicine, or glasses, with pre-tax dollars. Employee contributions are not subject to payroll tax. For 2023, the limit is $3,050.

IRC Sec. 121 Exclusion For Sale of Principal Residence

Provided the taxpayer has used the home as a principal residence for two of the preceding five years, up to $250,000 gain may be excluded. The limit is $500,000 if a joint return is filed. Taxpayers utilizing this exemption must still report the gain on Schedule D of their return, or face a letter from IRS and NYS inquiring about gain reported on Form 1099-S. So, while the exclusion is not elective — the taxpayer is entitled to it the statutory requirements are met — it must still be reported or the taxpayer may face an unnecessary IRS request for documentation.

The two years of nonuse need not be consecutive. The five year period ends on the date the home is sold. There is no requirement that another home be purchased. A surviving souse may claim the full $500,000 exemption up to two years after the death of a spouse.

A vacation home is not a principal residence, and one cannot claim the exclusion for its sale. A home that was rented for part of the time would qualify for a truncated portion of the exclusion. For example, if a taxpayer rented the home for three years, and lived in it for two, then three-fifths of the could not be excluded.

The principal residence applies not only to homes sold in the U.S. but also to homes outside the U.S.

Home Offices

Business owners can still take deductions relating to offices at home. However employees cannot. Various miscellaneous itemized deductions, including deductions for meals and entertainment, tax-preparation fees, and employee travel, no longer appear on Schedule A. The repeal of these deduction is schedule to terminate at the end of 2025.

Lifetime Learning Credit

The American Opportunity Tax Credit provides a credit of $2,500 per student per year, subject to a phaseout beginning ta $80,000 for single filers, and $160,00 for joint filers. This credit is for college education, and can be applied to tuition and course-related expenses. It cannot be used for room and board. Forty percent of the credit is refundable. The credit is available for four years.

The Lifetime Learning Credit is available for undergraduate education, as well as for post-graduate education, and for persons not pursuing a degree or other recognized educational credential. The credit is $2,000 per taxpayer per year. It can also be applied to offset 20% of up to $10,000 of eligible expenses. There is no cap on the number of years the taxpayer may claim the credit, which can be for post -secondary education and for courses to acquire or improve job skills. The credit can be used to pay for tuition and fees required for enrollment or attendance.

The taxpayer can claim only one of these credits per year. The credits for either entitlements is claimed on Schedule 3 of Form 1040 and Form 8863, Education Credits.

Student Loan Interest Deduction

Up to $2,500 of student loan interest may be deducted per year per return. For 2022, the deduction is phased out beginning at $70,000 for single filers and $145,000 for joint filers. For 2023, the phaseout is increased by $10,000 for both single and joint filers. Forgiveness of debt due to death or disability is no longer taxable. Forgiveness of debt in general will not be taxable through 2025. Both of these provisions expire at the end of 2025.

RESIDENT & NONRESIDENT TRUSTS, CONT.

(Continued from page 1)

locating is avoiding disputes with the Department. Litigating against the Department in its independent tax administrative tribunal system is close to an exercise in futility, not because of any inherent defect or unfairness in the court system or administrative law judges, who are extremely competent and fair, but rather because the burden of proof in tax matters requires the taxpayer to prove by "a preponderance of the evidence, a fact or facts in dispute on an issue raised between the parties." Tax Law §3030(a)(4).

If the taxpayer should decide to appeal a decision of the Tax Appeals Tribunal to the Appellate Division in an Article 78 proceeding, the determination will be upheld unless it is "arbitrary and capricious" and has "no reasonable basis," the standard for review in such proceedings.

Not surprisingly, the odds, statistically speaking, of winning a tax dispute against the Department are similar to the odds of picking a 17-1 longshot who then wins the Kentucky Derby. The number of determinations, and a breakdown of those determinations that are cancelled, modified or reversed are published yearly by the Tax Appeals Tribunal. The odds above are based on the statistics for the 2021 administrative docket. [See Note on Alternative Litigating Strategies Involving NYS Department of Taxation, in "From Federal Courts, NYS Courts & Tax Tribunals," April 2023, this issue]

* * *

II. Residence and Domicile Distinguished

Tax Law §605(b)(3) defines a "Resident Trust" as

> (i) a trust, or portion of a trust, transferred by will of a decedent who at the time of death was domiciled in New York, or
>
> (ii) a trust, or portion thereof, consisting of the property of
>
> (a) a person domiciled in New York at the time such property was transferred to the trust, if such trust was then irrevocable, or if was then revocable, and has not subsequently become irrevocable; or
>
> (b) a person domiciled in New York at the time such trust, or portion of a trust, became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

If either (i) or (ii) is met, the trust is a resident trust and is taxed on all of its income (unless the exception for an "exempt" resident trust below applies). If neither (i) nor (ii) is met, then the trust is by default a nonresident trust and is taxed only on its New York "source" income. The vagaries of what is New York source income will be discussed later.

Note that the determination of whether a trust is a resident trust is made without regard to either the location of the trustee or the trust assets, or the source of trust income. Rather, it is a function of the domicile of the settlor or grantor, or the decedent, as the case may be.

<u>Domicile Outside NY Must Be Established by "Clear and Convincing Evidence</u>"

Residency, for New York personal income tax purposes is defined as an individual:

(A) who is domiciled in this state, unless (i) the taxpayer maintains no permanent place of abode elsewhere, and spends in the aggregate not more than thirty days of the taxable year in this state, or . . .

(B) who is not domiciled in this state but maintains a permanent place of abode in this state and spends in the aggregate more than one hundred eighty-three days of the taxable year in this state, unless such individual is in active service in the armed forced of the United States." Tax Law §605(b)(1)(A).

Domicile is not statutorily defined, but is generally considered as the place where the individual intends to have a permanent home. The Department examines five factors in determining domicile:

> (1) the maintenance of a New York residence compared with any out of state residence;
>
> (2) the taxpayer's active business involvement in New York;
>
> (3) where the taxpayer spends the most time;
>
> (4) where the taxpayer's pets, family heirlooms, or favorite artwork is located; and
>
> (5) where the immediate family is located, and where children attend school. The test is both objective and subjective.

The policy of the Department is that the taxpayer may have many residences but only one domicile.

* * *

In a recent case, *Matter of Boniface*, DTA No. 829018, the taxpayers took argued they were not subject to New York income tax because it was undisputed they were not present in New York for the number of days required to impose tax based on residency and they maintained no domicile in New York. The case therefore turned on the issue of domicile.

The taxpayers failed to report their "maintenance of living quarters in New York" on their return, claiming during the proceeding that the reason therefor was because house was unoccupied. It may not have mattered. The tribunal found other items which made the taxpayers' case untenable. The Tax Appeals Tribunal, sustaining the determination of the Division of Tax Appeals, instructed:

> As it is petitioners who are claiming a change of domicile to Florida, they bear the burden of showing by clear and con-

(Please turn to page 27)

(Continued from page 24)

vincing evidence such a change (id.; see also *Matter of -20-Bodfish v Gallman*, 50 AD2d 457 [3d Dept 1976]). Formal declarations are considered in determining a change of domicile, but more weight is accorded the informal acts that demonstrate an individual's "general habit of life" (*Matter of Silverman*, Tax Appeals Tribunal, June 8, 1989; citing Matter of Trowbridge, 266 NY 283, 289 [1935]).

The Division of Tax Appeals, whose Determination had been appealed to the Tax Appeals Tribunal, noted:

> While petitioners did take actions aimed at establishing Florida as their domicile, including purchasing a home in Florida, acquiring Florida driver's licenses, and completing a Florida homestead exemption application (see finding of fact 5), these formal declarations must be considered in conjunction with the informal acts which show an individual's "general habit of life" (see *Matter of Wechsler*, Tax Appeals Tribunal, May 16, 1991 *quoting Matter of Trowbridge*, 266 NY 283,289).

Matter of Boniface, Division of Tax Appeals, DTA No. 829018 (2021).

Summary of Distinction Between
<u>Resident and Nonresident Trust</u>

To summarize: A resident trust, which is established by domicile in New York is taxed on all income. Any trust that is not a resident trust is by default a nonresident trust, which is taxed on New York source income.

* * *

II. "Exempt" Resident Trusts

Now we welcome to the table a new animal: The "exempt" resident trust, a species of a resident trust. An exception to the general rule that resident trusts are taxed on all income, also provides that no tax may be imposed on a resident trust if

> (i) all trustees are domiciled outside of New York;
>
> (ii) the entire corpus of the trust, including real and tangible property, is located outside of New York; and
>
> (iii) all income and gains are from sources outside of New York.

Tax Law §605(b)(3)(D).

The exemption from taxation derives not from the largesse of the New York legislature; rather it derives from the Constitution. If the three requirements are met, the trust has insufficient nexus with New York for the state to impose tax.

In *Mercancile-Safe Deposit and Trust Company v. Murphy*, 15 N.Y.2d 579 (1964), the Court of Appeals agreed with the Third Department in a case involving a nonresident trustee of an *inter vivos* trust created in Maryland by a New York resident. In a unanimous memorandum decision, the Court held that

> [t]he lack of power of New York State to tax in this instance stems not from the possibility of double taxation but from the inability of a State to levy taxes beyond its border. . . [This] upon the theory that the taxing power of a state is restricted to her confines and may not be exercised in respect of subjects beyond them.

"Trustee" Includes
<u>Other Trust Fiduciaries (1st Prong)</u>

In a "directed" trust, trust powers may be invested in "trust advisors." The Department has taken the position that the domiciliary of the trust advisor or other trust fiduciaries may be considered for purposes of determining whether the first prong of the three-prong requirement is met. Guidance regarding the domicile of a corporate trustee provides circumstances where trust advisors and trust protectors may be considered trustee domiciliaries. This could imperil the exempt status of a resident trust seeking to meet the exception. See TSB-A-04(7)I (2004).

Note on real and tangible assets locat<u>ed outside of New York (2nd Prong)</u>

An amendment to Tax Law §605(b)(3) provides that intangible assets are deemed sitused at the domicile of the trustee. If all trustees are outside of New York, then placing the situs of intangible assets outside New York has no effect on satisfying the statutory requirement. If all trustees are not outside of New York, then the test is not satisfied. Therefore, for purposes of satisfying the test, the amendment appears inconsequential.

Note on New York
<u>Source Income (3rd prong)</u>

The Department has taken the position that even a <u>single dollar</u> of New York source income will cause the trust to fail to satisfy the no New York source income requirement. It appears to be arguable whether having a trace amount of New York source income would justify New York imposing tax on the entire income of a trust, the vast majority of whose source income was from sources outside of New York. Nevertheless, that is the stated position of the Department: that the trust must not have even a single dollar of New York source income to qualify as an Exempt Resident Trust. TSB-A-20(2)I.

If there were some New York source income, but also other non-New York source income, an meritorious argument could be made that only that New York source income should be subject to taxation. However, that argument is likely to be met with disapproval by the Department. It is unclear whether the position of the Department would withstand Constitutional scrutiny. However, one would not wish to be the taxpayer in the position of challenging the policy.

To illustrate the effect of the

(Please turn to page 28)

(Continued from page 25)

policy, assume the first two prongs of the test were met: the trustees were in Houston, all trust assets consisted of oil rigs located in Texas. However, the trust received a K-1 showing $100 of New York source income. Texas has no state income tax, which makes the problem worse since there would be no Texas income tax for New York to conceivably credit.

The Department often has the last word in matters such as this because the administrative tax tribunals are not courts of equity, nor are they intended to be. Equitable arguments will fall on deaf ears. Avoiding New York source income is just a red line that the trust must not cross without venturing into dangerous waters (to mix metaphors).

Few taxpayers, other than large corporations such as Altria or Exxon, will litigate these matters all the way to the Appellate Division, where they too, will likely lose most cases, but not necessarily the hypothetical case posited. As noted, taxing statutes are strictly construed and the burden of proof is placed squarely on the taxpayer. Moreover, Constitutional arguments — even those with merit — made in administrative tribunals are unlikely to succeed, unless the Department has acted truly egregiously.

<u>“Exempt” Trusts Must Still Report</u>

A trust that meets the three requirements for an “Exempt Resident Trust” must still report annually and must now pay tax on “accumulation distributions” made in later years. This allows New York to “claw back” hypothetical income from previous years in which no distribution to beneficiaries was made.

Nongrantor Trust Status
Generally — But Not Always —
<u>Determined at Federal Level</u>

Whether to draft a trust as a grantor trust or a nongrantor trust is a crucial planning decision, and the consequences can be detrimental if a the intended status is not attained. While the grantor of a grantor trust is taxed on trust income, a transfer can be made for transfer tax purposes without a transfer being made for income tax purposes. The converse is also possible. The reason for this dichotomy is that the income and transfer tax statutes provide separate requirements for a taxable transfer, and at times those requirements do not align.

With that in mind, it is assuring to note that New York will generally follow the federal classification. However, in one known instance involving perceived tax avoidance, New York (and some other states) deviate from the general rule, and ascribe grantor trust status to what for federal purposes is a nongrantor trust. Some have commented that New York’s action may violate the principle underpinning the exception to taxation for nonresident trusts having no nexus with New York.

Thus, to stem the loss of tax revenue, the Department has cut off at the pass a popular planning technique involving “incomplete gift nongrantor trusts.” New York taxes such trusts as grantor trusts for all income tax purposes, despite a contrary classification under federal tax law. The effect of the rule will result in the creation of a grantor trust. The income of a grantor trust is taxed to the grantor. Thus the trust would now have New York source income, which would be taxed to the newly ascribed grantor.

Path to Exempt Resident Trust
<u>Status is Somewhat Tortuous</u>

The path to a trust made by a resident domiciliary is somewhat tortuous: First, it must qualify by having all trustees domiciled out of New York. Second, it must have no New York source income (not even one dollar, according to the Department). Third, it must have no assets in New York. Even if the these requirements appear to be met, the grantor or executor, as the case may be, must ensure that the trust contains no trust “advisor” or “protector” in New York, nor have a corporate trustee that might sully the waters under TSB-A-04(7)I.

It must also not be the type of trust which somehow becomes a grantor trust for New York tax purposes. Finally, a trap for the unwary: the trust must not have a single dollar of New York source income, otherwise the Department, in a TSB advisory, warns that all income, not just New York source income, will be subject to income tax.

III. <u>Throwback Tax</u>

The impetus for the throwback tax, enacted into law by Governor Cuomo in 2014, was a perceived abuse of resident trust exemption. As noted earlier, Tax Law §605(b)(3)(D) provides an exemption where all trustees are domiciled outside of New York, all real and tangible property is located outside of New York, and all trust income and gains are derived from sources outside of New York.

Nongrantor trusts qualifying for the exemption could accumulate income and refrain from making distributions to beneficiaries. This would result under federal law in no distributable net income (DNI) to the beneficiary for that year. Under previous law, trust income from earlier years could later be distributed to beneficiaries without being taxed. The throwback rules operate to “look back” and impose tax on the earlier years’ undistributed income. Tax Law §612(b)(40) states that the “throwback” tax applies to income of an exempt trust which is distributed to a resident beneficiary that was not previously taxed and that has been “accumulated.”

Normally, if an exempt trust makes a distribution to a beneficiary out of distributable net income (DNI), New York will tax the resident beneficiary on the distribution. If an exempt trust makes no distributions to beneficiaries in a year where there is DNI, no tax liability will arise — either to the trust because it is an exempt trust, or to the beneficiary, because the beneficiary received no distribution. Under the amendment, if accumulated income is distributed in a later year, the statute “looks back” and imposes tax on income from the earlier tax year.

Fortunately, in computing DNI, capital gains are “backed out,” so the throwback tax does not apply to capital gains, and the effect of the throwback tax is lessened. Therefore, when a drafting a trust, it might be best not to include capital gains in DNI if the

(Please turn to page 29)

(Continued from page 25)
throwback tax may be an issue.

IV. Reporting Requirements

As noted, resident trusts not meeting the exemption are taxed on all New York taxable income, whereas nonresident trusts are taxed only on New York source income. Trustees are required to make estimated tax payments where tax liability arises. A resident trust must file if it is required to file a federal return, or if it has New York taxable income. A nonresident trust must file if it has either New York source income or New York adjusted gross income.

Source Rules

Tax Bulletin TB-IT-615 provides that a New York source income of a nonresident includes the sum of income, gains, losses, and deductions from:

(a) Real or tangible personal property located in NYS;

(b) Services performed in New York State;

(c) A business, trade, profession, or occupation carried on in NYS;

(d) The distributive share of New York State partnership income or gain;

(e) New York State estate or trust income or gain;

(f) NYS lottery winnings greater than $5,000;

(g) Any gain from the sale, transfer, or other disposition of shares in a [coop] in connection with the grantor or transfer of a proprietary leasehold, when the real property comprising the units of the [coop] is located in New York State;

(h) Any income related to a business, trade, or occupation previously carried on in NYS, including but not limited to covenants not to compete and termination agreements;

(i) a New York S corporation in which person is shareholder.