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A potpourri of estate & tax planning opportunities & traps

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"For every Tax Problem there is a Solution which is Straightforward, Uncomplicated and Wrong"

A *potpourri* is defined as *"a collection of different things."* This article will provide its readers with some interesting and often unexpected tax and estate planning opportunities and potential traps.

FLPs & Retained Control. One result of the American Taxpayer Relief Act of 2012 (ATRA) is a major shift in how clients and their advisors approach estate planning. The Congressional Budget Office has noted that roughly 0.2% of all decedent estates will be taxable. Tax planning has shifted to increasing the tax basis of assets. Old cases can provide new tax planning opportunities in this new environment. In *Estate of Schauerhamer v. Commissioner,* 73 T.C.M. (CCH) 2855 (1997), the Tax Court ruled that when the creator of a general partnership retained effective control over the partnership assets by "implied" consent with the donees of 66 annual exclusion gifts, a completed gift had not occurred, and the value of the "gifted" assets was included in the donor's taxable estate. See also: *Estate of Strangi v. Commissioner*, 85 T.C.M. (CCH) 1331 (2003), and *Estate of Turner v. Commissioner,* 102 T.C.M. (CCH) 214 (2011).

Opportunity: A client created a Family Limited Partnership (FLP) 20 years ago. For years the client has gifted limited partnership units of the FLP to family members. The FLP assets have substantially appreciated over the years. Unfortunately, the client's control over the FLP clearly violates the above rulings and could result in the gifted assets being included in the donor's taxable estate pursuant to Code §2036. Assume the client's estate is not subject to an estate tax. The Personal Representatives could argue that the retained control violated §2036 and pull the gifted FLP units into the taxable estate. Why? The basis of the gifted FLP units will step up to their fair market value, and the tax basis of assets in the FLP can also step up. If the FLP assets are depreciable, the FLP partners can obtain an increased income tax basis to support deductions for depreciation.

Using Grantor Trusts to Reduce Income Taxes. The combined state and federal income tax rate on trusts and estates can push the top tax rate over 50% when the taxable income exceeds as little as $12,300 (in 2015).

Opportunity: If a trust is being created and the grantor is in a lower tax bracket than the trust is expected to be in (i.e., the trust is expected to accumulate income), then consider creating the trust as an Intentionally Defective Grantor Trust (IDGT). The IDGT is not depleted by paying income taxes during the grantor's life, and the effective tax rate may be reduced. If the grantor is married, consider making the spouse a beneficiary of the trust to permit distributions to cover all or a part of the income taxes paid by the grantor.

Caution: The IRS is closely examining sales to defective grantor trusts. See: *Estate of Mario Woelbing v. Commissioner,* No. 30260-13, 2013 WL 7045356 (T.C. Dec. 26, 2013), and *Estate of Jack Williams v. Commissioner,* No. 29736-13, (T.C. Dec. 19, 2013).

Travel Perks. The rules and limits governing the transfer at death or divorce of airline miles, hotel points, rental car perks and other similar travel programs vary significantly from company to company. For example, the Delta Air Lines website reads: "*Miles are not the property of any member. … miles may not be sold, attached, seized, levied upon, pledged, or transferred under any circumstances, including, without limitation, by operation of law, upon death, or in connection with any domestic relations dispute and/or legal proceeding*." See: *SkyMiles Membership Guide and Program Rules*, DELTA, http://www.delta.com/content/www/en_US/skymiles/program-rules-conditions.html.

Gifting to the Terminally Ill. With the right fact pattern, gifting to a terminally ill family member can make sense.

Opportunity: Assume a client owns a tract of land that has a fair market value of $2.1 million, a basis of $200,000 and secured debt of $1.5 million. If the client sells the property, the recognized gain is $1.9 million. The first $1.5 million of sales proceeds pays off the mortgage. Assuming a state and federal effective income tax rate of 30%, the taxes on the sale are $570,000, leaving the client with $30,000 before any sales commission is paid.

However, assume the client's husband was terminally ill. The client gifts the property directly to the husband, with his will specifically passing the real property to a trust for the benefit of the couple's children. Not giving any interest in the trust to the donor/wife avoids any possible application of Code §1014(e). Pursuant to Code §1041(e), the direct gift to the husband does not create an income taxable event to the wife, even though the liability on the asset exceeded its basis. When the husband passes away, the tax basis increases to $2.1 million. If the property is promptly sold, the net proceeds would be $600,000 (less closing costs and commissions) for the children's trust.

Plan for Loss Carryforwards & Deductions. A pivotal part of the tax planning for any terminally ill client includes examining the most recent federal income tax returns and other documents. Look for tax carryforwards, because a decedent's unused tax carryforwards are not carried over to the estate or to heirs. See: Rev. Rul. 74-175, 1974-1 C.B. 52.

Opportunity: There are at least three ways that expiring losses and carryforwards could be used (but always run the math):

- The client could take actions to use any expiring losses (e.g., accelerating taxable income to offset the expiring carryforwards) before the client dies.
- In the case of a married client who files a joint return, the spouse might take premortem actions to create taxable income to offset the soon-to-expire losses.
- Pursuant to Code §6013(a), a surviving spouse is entitled to file a joint return in the decedent's year of death and could take year-of-death, postmortem steps to offset the losses. For example, assume the deceased Husband left a $400,000 net operating loss (NOL) from his failing business. In the year of the Husband's death, the Wife could convert $400,000 of her IRA to a Roth IRA to take advantage of the expiring NOL.

Filial Support Laws. According to the Statute of Frauds, an individual cannot generally be held liable for the debts of another person without agreeing to such liability. However, as many as 30 states have adopted Filial Support statutes, in which family members can be held legally liable for the support obligations of spouses, parents and other family members. These costs can include health care and long-term care costs, even if the family member has not signed a document guaranteeing those liabilities or received any assets from the needy family member. According to a 2011 MetLife Survey, an average private room in a nursing home costs $87,235 per year.

Trap: Studies consistently show that baby boomers have not been saving for their retirement. Moreover, their parents are living longer than expected and, as a consequence, are outliving their assets. The increased life expectancy of Americans, combined with their lack of adequate financial preparation for their long-term care, will cause increased enforcement of Filial Support Laws against family members. This right may prove to be particularly problematic in second and third marriages, even when there is a prenuptial agreement in place.

Opportunity: If you represent an impoverished elder or incapacitated client, do you raise the specter of Filial Support Laws to family members?

Opportunity: If the client's state of residency has a strong Filial Support statute, consider obtaining a Long-term Care policy to insure against the cost.

General Powers of Attorney. As Americans live longer, incapacity is becoming a growing issue. Guardianship is an expensive and time-consuming process that can normally be avoided by a well-drafted General Power of Attorney (GPOA).

Trap: A January 26, 2015, article in *The New York Times* noted that it has become "routine" for nursing homes to attempt to gain guardianship over residents and to use that power to pay bills of the nursing home. Moreover, other family members may attempt to gain control of an incapacitated person if they disagree with the actions of the person holding the GPOA. In a number of states, appointment of a guardian revokes or limits the agent holding the GPOA (e.g., Florida, Texas, Virginia and Washington). To minimize this risk, provide in the GPOA the identity of the person who should be named as guardian over the person and assets of the maker of the GPOA.

Medical Directives. Terri Schiavo, Karen Ann Quinlan, Nancy Cruzan—all were women in their late 20s and early 30s whose incapacity and life support issues created tremendous cost and pain to their families. No matter the age, every adult should have a Medical Directive providing for how life support should be withdrawn and who will make medical decisions upon incapacity. Always name two to three successor decision-makers.

NOLs for Estates and Trusts. The timing of payment of deductible expenses is a critical income tax planning issue. Most deductible estate administration expenses are not considered business expenses. Therefore, they cannot generate an NOL for the estate. Consequently, to the extent that such deductions exceed income, they are not carried over to future years.

Opportunity: If an estate anticipates having large income tax deductions early in its first year, the estate might consider using a longer fiscal year to allow the estate to earn sufficient income to offset the early deductions or take actions to accelerate income into the current tax year to offset the deductions.

Opportunity: Code §642(h) provides that, to the extent estate deductions exceed the estate's income in the final year of the estate, the excess deductions can be carried over to the estate beneficiaries. Personal Representatives of cash basis estates with substantial deductible expenses (such as commissions and legal fees) should consider delaying the payment of non-business deductions until the final year of the estate, so that heirs can receive the benefit of the pass-through of any excess deduction.

Trap: Personal Representatives should also be careful about paying too many non-business expenses in any year in which the estate has insufficient income to offset the deduction of such expenses.

Postmortem Estimated Income Taxes. Treasury Regulation §1.6153-1(a)(4) provides that estimated income tax payments are not required after a taxpayer's death. Code §6654(l)(2) provides that estates and certain trusts do not have to pay estimated income taxes for two tax years after a decedent's passing.

Deathbed Gifting. Only Connecticut has a state gift tax.

Opportunity: For clients facing a tax gap between the state and federal death tax exemptions, making lifetime gifts may be a way to reduce a state death tax.

Trap: If the donor dies proximate to the time of the gift, with a non-taxable estate, the donees may question the loss of a step-up in basis that would have occurred at the donor's death.

Trap: In Revenue Ruling 96-56, 1996-2 C.B. 161, the IRS ruled that if the donor dies before a gift check clears his or her account, then the gift is not removed from the estate. In *Estate of Newman v. Commissioner,* 111 T.C. 81 (1998), the Tax Court agreed with the IRS' position.

Gifts in Contemplation of Death. Most tax practitioners have a decent understanding of the few "contemplation of death" rules that remain in the federal estate tax code. Some states have rules that provide that certain "*gifts in contemplation of death*" are subject to a state death tax. As of January 1, 2016, these states will include Iowa, Kentucky, Maryland, Nebraska, New Jersey, and Pennsylvania. The rules vary widely (e.g., the period of "contemplation") and in some cases are rebuttable (e.g., an unexpected death).

Business Opportunity. There have been a number of recent cases in this area that give us some guidance. Recent cases on business goodwill versus personal goodwill have helped define the impact of goodwill on business values. See: *Bross Trucking, Inc. v. Commissioner,* 107 T.C.M. (CCH) 1528 (2014); *Estate of Adell v. Commissioner,* 108 T.C.M. (CCH) 107 (2014); *Cavallaro v. Commissioner*, 108 T.C.M. (CCH) 189 (2014).

Trap: The recent taxpayer success in providing that personal goodwill of an owner or employee of a business cannot be included in the value of the business has the risk that the IRS will use that argument when tax practitioners are trying to get a larger step-up in basis for a decedent's business (e.g., the IRS argues that the goodwill rested with the decedent or a key employee, not the business entity, and the value of the goodwill does not increase the value of the business).

Right of Publicity. In 2014 *Forbes* magazine reported that Michael Jackson was the top annual income earner among deceased celebrities, earning $140 million. *Forbes* reported that the next four deceased top income-earning celebrities were: Elvis Presley ($55 million), Charles Schulz ($40 million) Elizabeth Taylor ($25 million) and Bob Marley ($20 million).

During their life, individuals generally have a right to control their publicity, personal image and persona (commonly called a "Right of Publicity" or ROP). A number of states (e.g., California, Florida, Indiana, Kentucky, Nevada, Oklahoma, Tennessee, and Virginia) have statutes that permit a deceased celebrity's right of publicity to be inherited. The period for which heirs can control the ROP varies widely.

An inheritable ROP can create a significant estate tax liability. For example, the Estate of Michael Jackson and the IRS were reported to have significant disagreements over the deemed value of his ROP. The Estate gave a value of $2,105, while the IRS thought the value was closer to $434 million.

Opportunity: Advisors of celebrities need to be cognizant of the differences in state laws governing ROP and the resulting state and federal estate tax cost. Establishing the state of domicile of the decedent is critical to whether the celebrity's heirs can inherit the persona and how long that inheritance will last.

Intestacy and a Deceased Spouse's Family. Although the general rule is that stepchildren (or other blood relatives of a deceased spouse) cannot inherit from a stepparent, a few states permit such an inheritance by intestacy if the decedent's remaining statutory intestate heirs are more remote. For example, Florida Statute §732.103(5) provides: "If there is no kindred of either part [i.e., lineal descendants of the blood line of the maternal and paternal grandparents of the deceased], the whole of the property shall go to the *kindred* of the last deceased spouse of the decedent as if the deceased spouse had survived the decedent and then died intestate entitled to the estate." Note that the use of the word "kindred" would appear to include all intestate heirs of the predeceased spouse, not just the spouse's lineal descendants.

Trap: Wills always should have a common disaster provision that dictates how the assets will pass. However, in the above states, a final passage "to my intestate heirs" might result in kindred of a deceased spouse inheriting. Clients should be advised of this fact and consider adding a will provision that overrides the local intestate inheritance law. For example, "Notwithstanding applicable state law, under no condition shall my deceased spouse's blood family members be considered to be my intestate heirs."

ABA State Attorney List. The ABA has created a listing of attorneys who will help out-of-state attorneys prepare local deeds (i.e., generally for estate planning purposes). See: List for Out of State Deed Preparation, at http://www.americanbar.org/groups/real_property_trust_estate/resources/deeds_preparation_list.html.

Private Inurnment. Making contributions for the benefit of a deceased police officer's family or providing aid to a neighbor is a common practice in most communities. Churches and other charities often set up funds for that particular purpose. The earmarking of the gift to a particular person is not generally entitled to a charitable deduction and, in fact, may be a taxable gift (though it is generally covered by the gift tax annual exclusion). See: I.R.S. Info. Ltr. 20120042 (Jun. 29, 2012); Rev. Rul. 62-113, 1962-2 C.B. 10; *Tripp v. Commissioner*, 337 F.2d 432 (7th Cir. 1964); *Peace v. Commissioner*, 43 T.C. 1 (1964).

Charitable Deductions Versus Advertising/Marketing. Charitable deductions by individuals and businesses are subject to numerous limitations and deduction requirements (e.g., aggregated gross income [AGI] limits on the amount of the deductions, phaseout of itemized deduction, etc.).

Opportunity: Business owners should consider having their business make payments that qualify as marketing and advertising, rather than taking a deduction as a business or personal charitable deduction. The central issue in distinguishing the two is the financial value that the payer expects to receive from the payment. See: Treasury Regulation §1.162-15(b).

Charitable Information. If a client is considering making a gift to a public charity that you and the client do not have much knowledge about, then pull the charity's Form 990. See: 990 Finder, Foundation Center, http://foundationcenter.org/findfunders/990finder/. Determine whether the IRS has recognized the charity as tax exempt. See: Search for Charities, Internal Revenue Serv., http://www.irs.gov/Charities-&-Non-Profits/Search-for-Charities. In addition, there are a number of web-based sources that evaluate public charities, including:

- http://www.charitynavigator.org/
- https://www.charitywatch.org/
- http://www.guidestar.org/
- http://www.bbb.org/

Adopting Your Significant Other. Divorce can throw a wrench into planning expectations, particularly pre-divorce irrevocable trusts.

Opportunity: However, there can be creative opportunities. For example, in *Goodman v. Goodman*, 126 So. 3d 310 (Fla. Ct. App. 2013), a Florida resident and creator of a 1991 irrevocable trust for the benefit of "my children" adopted his 42-year-old girlfriend so she could gain access to a portion of the $300 million in trust funds. The ex-wife, as legal guardian of the two current trust beneficiaries, objected. The court terminated the adoption on a procedural basis (i.e., lack of notice to the other trust beneficiaries), but it did not rule on the core issue of whether the adoption was legal and entitled the girlfriend to benefit from the trust. It is not clear what Mr. Goodman did next. Or: like many states, Florida, specifically permits the adoption of adults. Florida statute §63.042(1) provides: "Any person, a minor or an adult, may be adopted."

Dependency Deduction. Most people assume that the dependency deduction is limited to family members, but this is not the case. A non-blood member of the household can be a dependent. The definition of a "qualifying relative" in Code §152(d)(2)(H) includes *"[a]n individual . . . who, for the taxable year of the taxpayer, has the same principal place of abode as the taxpayer and is a member of the taxpayer's household."* Treasury Regulation §1.152-1(b) provides that the person must be a member of the taxpayer's household for the entire year, with partial year residency disqualifying the deduction.

Dad's New Girlfriend. As married couples age, one of them will pass first. According to a 1996 University of California study, 61% of widowers are engaged in a new romantic relationship within 25 months of their wife's death, while only 19% of the widows have a new relationship. The Census Bureau reports that over 10 times as many widowers as widows over age 65 remarry. According to an AARP report, at age 70, men are twice as likely to have a current or recent sexual partner as women. Dad's marriage to a woman 20 years his junior has created heartburn for a lot of children who have been anticipating a larger and quicker inheritance. The children may attempt to aggressively insert themselves into their parent's estate planning process, creating new ethical and legal complexities for estate planning attorneys.

Caution: Having watched their friends' experiences, ex-wives increasingly are raising the issue of how to prevent their husband's new spouse from obtaining the family assets when the ex-wife dies first.

Alimony is Earned Income. Code §219(f)(1) provides that alimony is considered earned income for IRA purposes.

Opportunity: Assume a non-working 51-year-old spouse is getting divorced. Allocating a portion of any "property" settlement to long-term alimony (e.g., $6,500 per year) would create an income tax deduction for the payer and allow the payee to fund a tax-deductible IRA contribution.

Interestingly, Code §219(f)(7) provides that non-taxable combat pay is also treated as earned income for IRA contribution purposes. Is there a theme here?

Divorce Tax Basis Records. Pursuant to Code §1041, a spouse who receives assets in a divorce obtains the transferor spouse's tax basis in the assets. The divorce decree should also require that the transferor spouse provide the transferee spouse with sufficient records to support both the basis of transferred property and its holding period. Without such information, the IRS could challenge the client's tax filings, and an ex-spouse may not be cooperative in providing the necessary information. Although Temporary Regulation 1.1041-1T, Q&A-14 requires that such information be provided at the time of any transfer, there are no penalties for failing to provide the information.

Checklist: See: www.scrogginlaw.com for a Practical Post-Divorce Checklist.

Long-Haul Trucker. The Tax Court in *Jacobs v. Commissioner*, T.C. Summ. Op. 2015-3 (2015), ruled that a long-haul trucker who did not have a personal residence (he used a friend's guest room when he was not on the road) was not entitled to deduct his costs on the road, because his permanent home was the back of his cab.

Residency and Liquidity Events. The state of tax domicile is particularly important for clients who are anticipating a major taxable liquidity event (e.g., sale of a low-basis stock portfolio).

Opportunity: Before the liquidity event occurs, consider moving the client's tax domicile to a state where there is no tax cost or a lower tax cost. Among the elements to be considered in this change are:

• If possible, make the change of residency in the year before the event. Therefore, the client does not have to file a partial year state income tax return in his former state, with a copy of the federal income tax return being attached and showing the liquidity event, but with no payment to the state.

• If the taxpayer has localized income that requires filing a non-resident state income tax return, see if the state permits the business entity that generated the income to pay state income taxes on behalf of non-residents. This can eliminate the requirement that non-residents attach their federal income tax return to the state income tax return.

• Do not have the taxpayer's federal income tax return address be in the former state. The state and federal governments share that information.

• Do not have the client sign any sales agreements or letters of intent before the change in residency has been completed.

Checklist: See: www.scrogginlaw.com for a Checklist for Transferring your Tax Domicile to Florida.

Eliminating ERISA Rights. Changes in beneficiary designations of an ERISA retirement plan generally require written approval of a spouse if the participant is married. However, IRAs do not have a similar requirement. In *Charles Schwab v. Debickero*, 593 F.3d 916 (9th Cir. 2010), a husband rolled a 401(k) into an IRA after retirement. The husband named his children as the IRA beneficiaries. When the IRA owner passed away, his wife argued that because her husband had rolled his 401(k) into the IRA, she should receive the same protections that his ERISA qualified retirement plan had provided to her. The Ninth Circuit ruled in favor of the children.

Opportunity: Clients should consider rolling their retirement assets out of an ERISA plan if they want to limit their surviving spouse's control over and/or benefit from the funds.

Withdrawal Penalty. Be careful in recommending to a surviving spouse who is below age 59½ to roll over a deceased spouse's IRA to the surviving spouse's IRA account.

Trap: If the spouse needs the funds before age

59½, the distribution may be subject to a 10% early withdrawal penalty. Better to maintain the IRA as an inherited IRA of the deceased spouse, which is not subject to the early withdrawal penalty.

Self-Directed IRAs and Business Investments. There seems to have been growth in the number of advisors recommending that IRA owners invest their IRA funds in closely held business interests. The promoters sometimes brush over the complicated rules and risks that clients should be aware of.

Trap: Not only are small businesses with their financial risks a bad choice for most retirement assets like IRAs, but it is easy to inadvertently stumble into major problems. A prime example is *Peek v. Commissioner*, 140 T.C. 216 (2013). The taxpayer invested funds from his IRA in a small business and then personally guaranteed the loans of the small business. The Tax Court ruled: "*Each of [taxpayers'] personal guaranties of the . . . loan was an indirect extension of credit to the IRAs, which is a prohibited transaction; and under I.R.C. sec. 408(e), the accounts that held . . . stock ceased to be IRAs. Held, further, the gains realized on the sale of the . . . stock are included in [taxpayers'] income. Held, further, [taxpayers] are liable for the accuracy-related penalty under I.R.C. sec. 6662*." In *Ellis v. Commissioner* No. 14-1310 (8th Cir. 2015), the Court provided that when an IRA owner received a salary from a business owned by his IRA, the IRA was terminated by the prohibited transaction.

Inherited IRAs & Bankruptcy. In the *Clark v. Rameker* decision, 134 S. Ct. 2242 (2014), the U.S. Supreme Court unanimously ruled that an inherited IRA did not have the bankruptcy protection of an ERISA retirement account or a taxpayer's own IRA. Some state statutes offer partial protections from creditors for IRAs and other retirement benefits.

Trap: If a creditor seizes funds from an inherited IRA to cover the owner's debts, the owner remains responsible for the income taxes (and potential penalties) resulting from the withdrawal.

Opportunity: To provide asset protection and create a gatekeeper between the asset and the beneficiary, clients should consider using qualified trusts as designated beneficiaries of retirement accounts and IRAs, even when the retirement assets are passing to a surviving spouse.

No Rollover for Inherited IRAs. Code §408(d)(3)(C) prohibits rollover treatment in the case of an inherited IRA. There is no 60-day rollover period for inherited IRAs. Once the funds are pulled from the account, they are taxable income and cannot be repaid to the account to avoid taxation. Appropriate Trustee-to-Trustee transfers of inherited IRAs will not create current taxable income to the account holder. See: *Beech v. Commissioner*, T.C. Summ. Op. 2012-74 (2012); *Kim v. Commissioner*, 679 F.3d 623 (7th Cir. 2012).

Change in Entitlement Benefits. Contrary to the general perception, Social Security benefits are not a guaranteed contractual right. In *Flemming v. Nestor,* 363 U.S. 603 (1960), the U.S. Supreme Court ruled that Congress retains the ability to reduce or even eliminate Social Security benefits at any time. It should be expected that this ruling would apply equally to any other entitlement benefits, such as Medicaid and Medicare.

Fiduciary Earned Income. When a fiduciary receives a payment for performing fiduciary functions, the income is taxable at ordinary income tax rates. However, unless the fiduciary is in the trade or business of serving as a fiduciary, the income is not generally subject to self-employment or payroll taxes. See: Rev. Rul. 58-5, 1958-1 C.B. 322; *McDowell v. Ribicoff*, 292 F.2d 174 (3d Cir. 1961). *But see* I.R.S. P.L.R. 9107009 (Feb. 15, 1991) (finding fiduciary fees paid to an attorney who served as a fiduciary for 12 trusts were considered to be self-employment income).

Street Hustling. In *Basada v. Commissioner,* 75 T.C.M. (CCH) 2159 (1998), the Tax Court ruled that "street-hustling" can be a trade or business subject to self-employment taxes and income taxes. No one escapes the long arm of the revenue collector.

Beware the Ungrateful Tax Cheat. In *Thomas v. UBS AG*, 706 F.3d 846 (7th Cir. 2013), a proposed class of "tax cheats" tried to sue UBS for the company's failure to prevent them from evading their U.S. income taxes. The Seventh Circuit noted: "*The plaintiffs are tax cheats, and it is very odd, to say the least, for tax cheats to seek to recover their penalties . . . .*" In denying a class certification for other UBS-related tax cheats, the Court noted: *"[The three plaintiffs] argue rather that the bank should* *have prevented them from violating the law. This is like suing one's parents to recover tax penalties one has paid, on the ground that the parents had failed to bring one up to be an honest person who would not evade taxes and so would not subject himself to penalties."*

Lavish Lifestyle as Willful Tax Evasion. The Bankruptcy Code at 11 U.S.C. §523(a)(1)(C) provides that a debtor may not discharge any tax debts "*with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax*." In *Hawkins v. Franchise Tax Board of California and Internal Revenue Service,* 769 F.3d 662 (9th Cir. 2014), the government argued that living a lavish lifestyle was a willful attempt to evade applicable taxes. The Ninth Circuit Court of Appeals noted: "*The primary, but not exclusive, theory of the IRS and FTB was that the Hawkinses' <u>maintenance of a rich lifestyle after their living expenses exceeded their income constituted a willful attempt to evade taxes</u>."* The Court ruled: *"[A] mere showing of spending in excess of income is not sufficient to establish the required intent to evade tax; the government must establish that the debtor took the actions with the <u>specific intent</u> of evading taxes*."

Trap: Why is this significant? As the Court noted in *Hawkins*, the above language from the Bankruptcy Code substantially mirrors the language of Code §7201, which makes "*willfully attempt in any manner to evade or defeat any tax*" a criminal felony. Could this be a new argument for the IRS?

Interesting Audit Statistics.

- For the fiscal year ending September 30, 2012, the IRS reported that the effective audit rate for estates over $10 million was 116%. Overall, 30% of all estate tax returns were audited.
- In 2012, the IRS reported a 93% conviction rate on criminal tax fraud cases.