Current Federal Tax Developments January 8, 2024

Edward K. Zollars, CPA (Arizona)

Brief Extension Granted to Clean Vehicle Dealers and Sellers to Submit Time-of-Sale Reports

In News Release IR-2024-02, dated January 5, 2024, the IRS declared a temporary extension for clean vehicle dealers to submit time-of-sale reports, as stipulated in Revenue Procedure 2023-38. These reports must be submitted through the IRS Energy Credits Online (IRS ECO) website.

The news release provides:

> Seller reporting in IRS Energy Credits Online (IRS ECO) became available on Jan. 1, 2024. To provide dealers and the IRS more time to submit and intake seller reports into this new system, the IRS is temporarily extending the 3-day time period to submit time-of-sale reports provided in Revenue Procedure 2023-38 through Jan. 16.
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> This means dealers and sellers have until Jan. 19 to submit a time-of-sale report for vehicles sold Jan. 1 through Jan. 16. [News Release IR-2024-02]

However, the IRS advises that dealers and sellers should utilize this extension only if they encounter difficulties in successfully submitting the report.

> While the IRS fine-tunes this new system and the intake of time-of-sale reports, dealers and sellers should continue to submit time-of-sale reports using IRS ECO. The IRS encourages sellers to use this extension only if they are unable to successfully submit a time-of-sale report when the vehicle is for a customer who intends to claim the tax credit on their tax return. [News Release IR-2024-02]

Additionally, the IRS disclosed in the same News Release that it will conduct "office hours" between 2:00 and 2:30 PM EST on January 9, 10, 11, 16, 17, and 18. These sessions are designed to address questions and assist dealers and sellers with their time-of-sale reports. Registration links are found on the web page containing the news release. [News Release IR-2024-02]

IRS Reverses Position Previously Taken in 2016 Letter Ruling Regarding Gift Tax Treatment of Adding a Tax Reimbursement Clause to an IDGT

In Chief Counsel Advice 202352018, dated December 29, 2023, the IRS issued guidance explicitly stating that it no longer upholds the stance outlined in Private Letter Ruling (PLR) 201647001. The focal issue is the determination of gift (and possible subsequent estate) tax consequences arising from the modification of an intentionally defective grantor trust. This modification entails adding a provision that permits the trust to reimburse the grantor for taxes paid on the trust's income.

Intentionally Defective Grantor Trust

An Intentionally Defective Grantor Trust (IDGT) is a strategic tool frequently employed in estate planning. Its purpose is to transfer assets out of the grantor's estate, while the grantor remains responsible for paying income tax on the trust's earnings. Notably, these tax payments are not considered additional gifts by the grantor. This approach leverages the income tax grantor trust rules (outlined in IRC §§671-679), treating the assets as though they are owned by the grantor for income tax purposes. This is achieved through various powers retained by the grantor, yet structured in a way that does not impede the completion of the gift for estate tax purposes.

However, there are instances where grantors may reconsider this arrangement, particularly when faced with income tax obligations exceeding their comfort level. In response to these concerns, some advisers have recommended modifying the trust. Such modifications could include granting the independent trustee discretion to distribute assets to the grantor for income tax payments. This suggestion was previously underpinned by the IRS's conclusions in Private Letter Ruling 201647001, which indicated that these modifications would not trigger gift or income tax consequences.

The Issue Addressed in the Chief Counsel Advice

The specific issue addressed in Chief Counsel Advice (CCA) 202352018 is as follows:

> What are the gift tax consequences to the beneficiaries when the trustee of an irrevocable trust, with respect to which the grantor is treated as the owner under subpart E, part I, subchapter J, chapter 1 (subpart E) of the Internal Revenue Code (Code), modifies the trust, with the beneficiaries' consent, to add a tax reimbursement clause that provides the trustee the discretionary power to make distributions of income or principal from the trust in an amount sufficient to reimburse the grantor for the income tax attributable to the inclusion of the trust's income in the grantor's taxable income? [CCA 202352018]

The illustrative facts forming the basis of the ruling are as follows:

> In Year 1, A establishes and funds Trust, an irrevocable inter vivos trust, for the benefit of A's Child and Child's descendants. Trustee is the current trustee of Trust and satisfies the

> governing instrument requirement that a trustee of Trust must be a person not related or subordinate to A within the meaning of §672(c) of the Code. Under the governing instrument of Trust, a trustee of Trust may distribute income and principal to or for the benefit of Child in the trustee's absolute discretion. Upon Child's death, Trust's remainder is to be distributed to Child's issue, per stirpes.
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> Under the governing instrument of Trust, A retains a power that causes A to be the deemed owner of Trust under §671 of the Code, and, accordingly, all items of income, deductions, and credits attributable to Trust are included in A's taxable income.
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> Neither State law nor the governing instrument of Trust requires or provides authority to a trustee of Trust to distribute to A amounts sufficient to satisfy A's income tax liability attributable to the inclusion of Trust's income in A's taxable income.
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> In Year 2, when Child has no living grandchildren or more remote descendants, Trustee petitions State Court to modify the terms of Trust. Pursuant to State Statute, Child and Child's issue consent to the modification. Later that year, State Court grants the petition and issues an Order modifying Trust to provide a trustee of Trust the discretionary power to reimburse A for any income taxes A pays as a result of the inclusion of Trust's income in A's taxable income. [CCA 202352018]

Analysis of the Case

Revenue Ruling 2004-64 offers guidance for scenarios where a reimbursement clause is included from the inception of the trust. The Chief Counsel Advice (CCA) summarizes this ruling as follows:

> In Rev. Rul. 2004-64, 2004-2 C.B. 7, a grantor created an irrevocable inter vivos trust for the benefit of the grantor's descendants and retained sufficient powers with respect to the trust so that the grantor is treated as the owner of the trust under subpart E of the Code. In relevant part, the ruling considers two situations in which the trustee reimburses the grantor for taxes paid by the grantor that are attributable to the inclusion of all or part of the trust's income in the grantor's income. In Situation 2 of Rev. Rul. 2004-64, the distribution reimbursing the grantor is mandated under the terms of the governing instrument. In Situation 3 of Rev. Rul. 2004-64, the governing instrument provides the trustee with the discretionary authority to make a reimbursing distribution. In both of these situations, when the trustee of the trust reimburses the grantor for the income tax paid by the grantor, the ruling concludes that the payment does not constitute a gift by the trust beneficiaries because the distribution was either mandated by the terms of the governing instrument or made pursuant to the exercise of the trustee's discretionary authority granted under the terms of the governing instrument. [CCA 202352018]

In Private Letter Ruling (PLR) 201647001, the IRS previously determined that adding a reimbursement clause to an intentionally defective grantor trust (IDGT) after its initial formation did not result in a transfer tax issue. However, the IRS has since revised its stance, no longer considering this interpretation as the correct application of law to the given facts. The IRS's current analysis is outlined as follows:

> Under the governing instrument of Trust, Child and Child's issue each have an interest in the trust property. As a result of the Year 2 modification of Trust, A acquires a beneficial interest in the trust property in that A becomes entitled to discretionary distributions of income or principal from Trust in an amount sufficient to reimburse A for any taxes A pays as a result of inclusion of Trust's income in A's gross taxable income. In substance, the modification constitutes a transfer by Child and Child's issue for the benefit of A. This is distinguishable from the situations in Rev. Rul. 2004-64 where the original governing instrument provided for a mandatory or discretionary right to reimbursement for the grantor's payment of the income tax. Thus, as a result of the Year 2 modification, Child and Child's issue each have made a gift of a portion of their respective interest in income and/or principal.1 See §25.2511-1(e) and §25.2511-2(b). See also *Robinette v. Helvering*, 318 U.S. 184 (1943). The result would be the same if the modification was pursuant to a state statute that provides beneficiaries with a right to notice and a right to object to the modification and a beneficiary fails to exercise their right to object.
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> The gift from Child and Child's issue of a portion of their interests in trust should be valued in accordance with the general rule for valuing interests in property for gift tax purposes in accordance with the regulations under §2512 and any other relevant valuation principles under subtitle B of the Code. [CCA 202352018]

Within this Chief Counsel Advice, there are two footnotes of significance. The first footnote acknowledges the Office of the Chief Counsel's shift in position, specifically refuting the analysis previously presented in Private Letter Ruling (PLR) 201647001.

> PLR 201647001 concludes that the modification of a trust to add a discretionary trustee power to reimburse the grantor for the income tax paid attributable to the trust income is administrative in nature and does not result in a change of beneficial interests in the trust. These conclusions no longer reflect the position of this office. [CCA 202352018, Note 1]

The second footnote concedes that significant practical challenges arise in valuing the gift, as concluded by the Chief Counsel Advice (CCA).

> Although the determination of the values of the gifts requires complex calculations, Child and Child's issue cannot escape gift tax on the basis that the value of the gift is difficult to calculate. See *Smith v. Shaughnessy*, 318 U.S. 176, 180 (1943) ("The language of the gift tax statute, 'property . . . real or personal, tangible or intangible,' is broad enough to include property, however conceptual or contingent.") [CCA 202352018, Note 2]

Taxpayer Allowed to Rely on Notice of Deficiency Statement of Last Day to FIle a Tax Court Petition Even When the Date Was More than a Year After the Notice Was Issued

What are the implications when the Internal Revenue Service (IRS) erroneously states the filing deadline for a petition in the Tax Court to contest a notice of deficiency? In a situation where this error significantly favored the taxpayer, the Tax Court determined that the taxpayer was entitled to rely on the date specified in the initial notice, despite the IRS issuing a corrected notice the following day. (*Dodson v. Commissioner*, 162 TC No. 1)

The Notices the IRS Mailed

The IRS issued the original notice of deficiency to the taxpayers on October 7, 2021, concerning their 2017 tax return. The Tax Court details this notice as follows:

> On October 7, 2021, respondent mailed the first notice to petitioners for their 2017 taxable year. Tracking information for two copies of the first notice reflects the delivery of both copies in Alamogordo, New Mexico, on October 12, 2021, by the U.S. Postal Service (USPS). The first notice bears a stamped date specifying December 5, 2022, as the last day to file a petition. Petitioners filed their Petition on March 3, 2022. The Petition attached a copy of the first notice and no other notice of deficiency.

However, upon recognizing the error, the IRS, a day later, dispatched a corrected notice of deficiency to the taxpayers. The Tax Court opinion further elaborates on the circumstances pertaining to this subsequent notice.

> Respondent has also produced the second notice, which he mailed to petitioners on October 8, 2021, and which purports to be a corrected version of the first notice. The second notice bears a stamped date specifying January 6, 2022, as the last day to file a petition. The second notice is accompanied by a cover sheet stating: "PREVIOUS NOTICE SENT WITH INCORRECT DATE. CORRECTED NOTICE WITH CORRECT DATES." The second notice does not differ from the first notice in any other material respect.

The taxpayers contend that they did not receive this subsequent notice. The Tax Court observes that, in contrast to the original notice, the tracking information provided by the IRS fails to indicate delivery of the document to the taxpayers.

> Petitioners state that they did not receive the second notice. Petitioners have produced tracking information for two copies of the second notice reflecting the departure of the notice copies from USPS's El Paso, Texas, distribution center on October 13, 2021, without any indication that USPS ever delivered them to petitioners.

The opinion states that the taxpayers submitted their petition considerably before the due date indicated on the original notice of deficiency. However, this submission occurred significantly beyond the standard 90-day period following the issuance of either notice.

> Petitioners filed their Petition in this case on March 3, 2022, which is 147 days after respondent mailed the first notice and 146 days after respondent mailed the second notice.

So the question facing the Court is whether the taxpayers had timely filed their petition in these circumstances.

The Law

The Tax Court begins by noting that they are a court of limited jurisdiction, and so must make their own determination of whether they have jurisdiction in this case:

> Our jurisdiction in a case for the redetermination of a deficiency depends on the issuance of a valid notice of deficiency to the taxpayer and the timely filing of a petition by the taxpayer. See *Monge v. Commissioner*, 93 T.C. 22, 27 (1989); *Normac, Inc. v. Commissioner*, 90 T.C. 142, 147 (1988); see also *Sanders v. Commissioner*, No. 15143-22, 161 T.C. (Nov. 2, 2023); *Hallmark Rsch. Collective v. Commissioner*, 159 T.C. 126 (2022). Generally, the petition must be filed within 90 days after the notice is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day). See *Sanders v. Commissioner*, No. 25868-22, 160 T.C., slip op. at 5 (June 20, 2023). This filing deadline is jurisdictional, and equitable tolling does not apply. See *Hallmark Rsch. Collective*, 159 T.C. at 166–67.

The concluding sentence reiterates that the Tax Court has not adopted the Third Circuit's stance on equitable tolling being applicable to this deadline, as established in *Culp v. Commissioner of Internal Revenue*, No. 22-1789 (3d Cir. July 19, 2023). The opinion highlights that any appeals in this case would fall under the jurisdiction of the Tenth Circuit Court of Appeals. Consequently, the Tax Court will not apply the precedent set in the *Culp* decision, given that the Tenth Circuit has yet to endorse the Third Circuit's position.

The Tax Court turns to the last sentence of IRC §6213(a) which reads "Any petition filed with the Tax Court on or before the last date specified for filing such petition by the Secretary in the notice of deficiency shall be treated as timely filed."

The Court observes that the date indicated on the initial notice sent to the taxpayer precedes the date on which the taxpayer filed their petition.

> The Petition in this case attached the first notice. The first notice unambiguously determines a deficiency against petitioners and is therefore valid. See *Dees v. Commissioner*, 148 T.C. 1, 6 (2017) ("[I]f the notice is sufficient to inform a reasonable taxpayer that the Commissioner has determined a deficiency, our inquiry [as to the notice's validity] ends there; the notice is valid."). Petitioners filed their Petition before December 5, 2022, the last day specified in the

> first notice for filing a petition in this Court. This is sufficient to comply with the last sentence of section 6213(a), which in the words of the Tenth Circuit means that "if a notice indicates a petition date that is more than 90 days after the date of mailing, that date controls." *Smith v. Commissioner*, 275 F.3d at 916.

However, consideration must also be given to the second notice, which was dispatched a day later. In this context, the Tax Court references Internal Revenue Code (IRC) §6212(d), Revenue Procedure 98-54, and Form 8626, stating:

> The record discloses no consent by petitioners to a rescission of the first notice in any manner, let alone in a form complying with Rev. Proc. 98-54. Absent a rescission with petitioners' consent, the first notice continued to "be treated as a notice of deficiency for purposes of . . . section 6213(a)," see §6212(d), including for purposes of the last sentence of section 6213(a). Accordingly, respondent's issuance of the second notice without petitioners' consent did not have the effect of rescinding the first notice, either in whole or in part. See *Hanashiro v. Commissioner*, T.C. Memo. 1999-78, slip op. at 10 ("The rescission of a notice of deficiency requires mutual consent by the Commissioner and the taxpayer, and such mutual consent must be objectively apparent."); *Slattery v. Commissioner*, T.C. Memo. 1995-274, 69 T.C.M. (CCH) 2953, 2956 ("Clearly, the statute requires mutual consent by the Secretary and the taxpayer to effect a rescission of a notice of deficiency. We know of no authority deeming a notice of deficiency rescinded in absence of a formal rescission." (Footnote omitted.)). As soon as respondent mailed the first notice to petitioners on October 7, 2021, respondent could no longer unilaterally rescind the first notice.
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> The restriction on nonconsensual rescissions found in section 6212(d), unlike the restriction on further deficiency letters found in section 6212(c), is not limited to situations where the Secretary determines an additional deficiency of income tax (or certain other taxes) for the same taxable year. Our straightforward conclusion, derived from the plain text of sections 6213(a) and 6212(d), is that we are required to treat the Petition as timely filed. Accordingly, we will do so. This is not a case where a taxpayer petitions us for redetermination of a deficiency in a notice that purports to correct a prior notice of deficiency, a circumstance for which we express no view on the application of the last sentence of section 6213(a)."

The Tax Court dismissed several arguments presented by the IRS, referencing prior instances where the deadline for filing a petition was not included in notices issued by the IRS. Additionally, the Court rejected the notion that the discrepancy constituted an 'obvious error' that the taxpayer should have identified:

> Respondent repeatedly characterizes the petition filing date on the first notice as an "obvious mistake," but this characterization is misleading. As recognized by the Tenth Circuit, a taxpayer may timely file a deficiency petition by meeting the requirements of the first sentence of section 6213(a) or, alternatively, the last sentence of section 6213(a). See *Smith v. Commissioner*, 275 F.3d at 916 ("[I]f a notice indicates a petition date that is more than 90 days

after the date of mailing, that date controls.”). Here, the petition filing date on the first notice had independent legal effect, and petitioners were permitted to rely on it regardless of whether they retained counsel and regardless of whether prejudice would result from applying another deadline. Respondent’s position in this case attempts to create uncertainty about the meaning of the last sentence of section 6213(a) where there is none.