

GUTTER CHAVES JOSEPHER RUBIN FORMAN FLEISHER P.A.

TAX AND BUSINESS UPDATE

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An Electronic Newsletter of Gutter Chaves Josepher Rubin
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CONTENTS

[1. TEMPORARY VISA DID NOT BAR HOMESTEAD STATUS
\[FLORIDA\]](#)

[2. PURCHASE PRICE ALLOCATIONS ARE BINDING ON THE
BUYER](#)

[3. RELIANCE ON COUNSEL DEFENSE WAIVES WORK
PRODUCT AND ATTORNEY-CLIENT PRIVILEGE
PROTECTION](#)

[4. REPORTING OF TAX INFORMATION WITH YOUR
PASSPORT APPLICATION](#)

[5. APPLICABLE FEDERAL RATES—FEBRUARY 2012](#)

[6. FOREVER IS A LONG TIME](#)

[7. REPORTING OF SPECIFIED FOREIGN FINANCIAL ASSETS
— TRUSTS & ESTATES](#)

[8. FIRM ANNOUNCEMENTS](#)

ABOUT OUR FIRM

We are a boutique law firm that seeks to protect and enhance the individual, family and business wealth of our clients in the following principal practice areas: Planning to Minimize Taxes (U.S. & International) - Probate & Trust Litigation - Estate Planning, Charitable, Marital & Succession Planning - Business Structuring & Transactions - Trusts & Estates Administration - Tax Controversies - Creditor Protection.

1. TEMPORARY VISA DID NOT BAR HOMESTEAD STATUS [FLORIDA]

Favio came to the U.S. in 2005 after a kidnapping attempt against his son in Venezuela. He rented an apartment, and lived there with his son (a U.S. citizen), and his wife. He then purchased an apartment in 2006 and lived there with his family until his death in 2009.

Favio had borrowed \$500,000 from Eric and Carla. When Favio died, they filed a claim against Favio's estate to be repaid. Favio's estate claimed the apartment was homestead property, and thus could not be reached by Eric and Carla to repay the debt. Presumably, Favio did not have other assets to fully satisfy the debt.

The probate court reviewed numerous cases that provided that an individual in Florida on a temporary visa could not form the requisite intent to make a residence a "permanent residence" so as to qualify for homestead protection against creditors. The court found that since Favio did not have the right to stay here on a permanent basis (he did not have a green card admitting him as a lawful permanent residence nor was he a U.S. citizen), the property was not homestead property.

The 3rd DCA reversed, and held the property was protected homestead. In doing so, they made a number of interesting observations and statements:

a. That the son was a U.S. citizen was an important fact. The court noted that the Florida Constitution does not require the owner to reside on the property – it is enough that the owner's family reside on the property. Thus, the father could in effect piggyback on the son's permanent status.

b. The intent question is to be answered based on the intent of the homesteader and not that of the U.S. Citizenship and Immigration Services. Thus, while Favio did not have the right to remain in the U.S. permanently, that was not controlling.

c. Precedent and rules in the ad valorem tax homestead exemption area do not control in regard to the exemption from forced sale. There is strong precedent in the tax area that temporary immigration status is not sufficient to obtain the ad valorem homestead exemption. That precedent is not controlling because for tax exemption purposes, the statute is to be strictly construed against the taxpayers. However, in the forced sale arena, the rules are to be liberally construed for the benefit of those that the rules are designed to protect.

d. That Favio and his wife had applied for permanent residence status before Favio's death was an important fact that supported homestead status.

In the end, the court noted that based on (a) continued residence at the property since its purchase, (b) possession of a visa that permitted residence here (albeit not on a permanent basis), and (c) the application that had been made for permanent resident status, homestead protection against forced sale was appropriate.

MORE ABOUT OUR FIRM

The firm and its attorneys have been recognized in numerous peer rating guides, such as U.S. News & World Report law firm rankings, Best Lawyers, Martindale-Hubbell, Chambers, Who's Who in American Law, Florida Trend's Legal Elite, Superlawyers, and South Florida Legal Guide Top Lawyers.

WHERE'S THE VALUE HERE? The court opens the door to homestead protection against forced sale, even when the owner does not have the right to permanently reside in Florida. However, the special facts discussed above in (a)-(c) were key – absent similar compelling facts in other situations, the lack of the ability to permanently reside is still likely to be a significant bar to forced sale homestead protection based on the other cases in this area.

Estate of Favio Jose Grisolia Sanchez v. Pfeffer, 36 Fla.L.Weekly D2554 (3rd DCA (November 23, 2011))

2. PURCHASE PRICE ALLOCATIONS ARE BINDING ON THE BUYER

Purchasers and sellers of businesses will often allocate the purchase price among the assets sold. Under Code §1060, the buyer and seller must make an allocation with their tax returns.

When the allocation is made in a written agreement, the parties are bound by it for tax purposes, except under the *Danielson* rule. Code §1060(a). That rule allows a party to contradict an unambiguous contractual term by offering proof that would alter that construction or to show its unenforceability because of mistake, undue influence, fraud, or duress.

Peco Foods purchased two processing plants. Portions of the purchase price were allocated to "Processing Plant Building" and "Real Property: Improvements." Instead of capitalizing the purchase price into real property only (Code §1250 property), Peco conducted a post-closing study that broke these allocations into component parts, including allocations to specialized mechanical systems and other personal property assets (Code §1245 property). By doing this, Peco was able to increase its depreciation deductions through the use of faster write-off methods that are allowable under Code §1245.

The IRS objected, and the matter ended up in the Tax Court. The Tax Court sided with the government, and determined that a subdivision of the allocations to real property assets between real property and nonreal tangible personal property rule was an impermissible modification of the allocation in the purchase agreement.

WHERE'S THE VALUE HERE? Buyers of businesses should conduct their cost segregation analysis before the closing and conduct any refinements in the allocation in the purchase agreement, instead of doing these things after the agreement is finalized.

Peco Foods Inc. et al., TC Memo 2012-18

3. RELIANCE ON COUNSEL DEFENSE WAIVES WORK PRODUCT AND ATTORNEY-CLIENT PRIVILEGE PROTECTION

In litigation, the work-product doctrine and the attorney-client privilege protect materials and communications from discovery by an adversary in litigation. The work-product doctrine excludes from discovery materials prepared in anticipation of litigation because discovery of such materials would

hamper the orderly prosecution and defense of legal claims in adversary proceedings. The attorney-client privilege extends to communication between a taxpayer and a "federally authorized tax practitioner" with respect to tax advice, to the extent the communication would be privileged if it were between a taxpayer and an attorney.

Many tax penalties will not apply if the taxpayer had reasonable cause for its tax position. At times, reliance on the advice of counsel in adopting a tax position constitutes reasonable cause.

Reliance on counsel, the work-product doctrine, and the attorney-client privilege, do not play well together, as Salem Financial, Inc. learned in a recent Court of Claims case. Salem is a successor to Branch Investments LLC, a subsidiary of BB&T. In tax litigation, Salem raised reliance on counsel to defend itself against asserted penalties. The Government used that defense to claim access to documents and communications that would otherwise have been protected under the work-product doctrine and attorney-client privilege. The Claims Court sided with the Government, and authorized the release of the contested items since they related to the reliance on counsel defense.

The reliance on counsel defense has saved many a taxpayer from penalties. It is unknown if the taxpayer in this case knew that by using that defense it would be forfeiting the above evidence protections – perhaps the benefits of the defense outweighed the negatives relating to the disclosure of the subject items and thus was intentional.

WHERE'S THE VALUE HERE? A reminder to litigating taxpayers that a reliance on counsel "reasonable cause" defense may result in a waiver of protections otherwise available under the work-product doctrine and the attorney-client privilege.

SALEM FINANCIAL, INC v. U.S., 109 AFTR 2d 2012-XXXX, (Ct Fed Cl 01/18/2012)

4. REPORTING OF TAX INFORMATION WITH YOUR PASSPORT APPLICATION

Passports are not under the purview of the IRS, and generally do not involve tax administration issues. However, since 1986, U.S. passport applicants have to report certain information when they make their application. Code §6039E.

Proposed Regulations on what must be reported were issued in 1992, but never finalized. Treasury has now issued new proposed Regulations. Under these, the items to be reported are:

- (1) the applicant's full name and, if applicable, previous name;
- (2) address of regular or principal place of residence within the country of residence and, if different, mailing address;

(3) taxpayer identifying number (TIN); and

(4) date of birth.

Not a burdensome filing, but an additional filing for taxpayers to deal with, nonetheless. The changes from the 1992 proposed Regulations are minor.

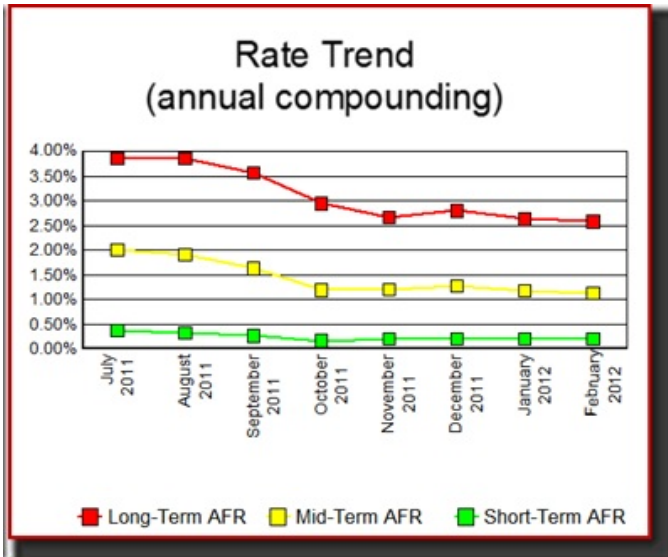
Code § 6039E also requires reporting for individuals applying for lawful permanent resident status (green card). The items to be reported are more broad. However, while the 1992 proposed Regulations included these items, the new proposed Regulation does not address such applicants.

Most people think the income tax is all about tax. What often goes unrealized is that the income tax provides legal justification for the gathering of reams of data on taxpayers, including marital status, business and investment activities, and asset holding that might otherwise be beyond the interest of government.

Proposed Treas. Regs. §301.6039E-1

5. APPLICABLE FEDERAL RATES—FEBRUARY 2012

APPLICABLE FEDERAL RATES				
Short-Term AFR	<i>Annual</i>	<i>Semi annual</i>	<i>Quarterly</i>	<i>Monthly</i>
July 2011	0.37%			
August 2011	0.32%			
September 2011	0.26%			
October 2011	0.16%			
November 2011	0.19%			
December 2011	0.20%			
January 2012	0.19%			
February 2012	0.19%	0.19%	0.19%	0.19%
Mid-Term AFR	<i>Annual</i>	<i>Semi annual</i>	<i>Quarterly</i>	<i>Monthly</i>
July 2011	2.00%			
August 2011	1.90%			
September 2011	1.63%			
October 2011	1.19%			
November 2011	1.20%			
December 2011	1.27%			
January 2012	1.17%			
February 2012	1.12%	1.12%	1.12%	1.12%
Long-Term AFR	<i>Annual</i>	<i>Semi annual</i>	<i>Quarterly</i>	<i>Monthly</i>
July 2011	3.86%			
August 2011	3.86%			
September 2011	3.57%			
October 2011	2.95%			
November 2011	2.67%			
December 2011	2.80%			
January 2012	2.63%			
February 2012	2.58%	2.56%	2.55%	2.55%



6. FOREVER IS A LONG TIME

Usually, a taxpayer cannot obtain a charitable income tax deduction for a contribution of property if the taxpayer transfers less than his or her entire interest in the property. However, Code §170(h) does allow for a charitable deduction for a conservation easement granted in property owned by a taxpayer. To qualify, the easement must be granted "in perpetuity" (among other requirements).

In a recent Tax Court case, the taxpayers conveyed a conservation easement in their Colorado property to a charitable organization. The deeds restricted the charity's use of the gift to "preserve and protect in perpetuity the Conservation Values of the Property for the benefit of this generation and generations to come." The deeds also provided for the extinguishment of the easement under certain circumstances:

"Extinguishment—If circumstances arise in the future such that render the purpose of this Conservation Easement impossible to accomplish, this Conservation Easement can be terminated or extinguished, whether in whole or in part, by judicial proceedings, or by mutual written agreement of both parties, provided no other parties will be impacted and no laws or regulations are violated by such termination." (emphasis added)

The IRS sought to deny the deduction since the conservation could be terminated by mutual agreement of the parties, and thus violated the perpetuity requirement (even though the purposes of the easement first had to be rendered impossible to accomplish). The Tax Court agreed with the IRS. Forever means forever, so the retention of a mutual right to terminate violated the perpetuity requirement.

Treas. Regs. §1.170A-14(g)(3) provides that a charitable deduction will not be disallowed merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible. The taxpayers argued that the likelihood of a mutual termination of the easement was so remote that this regulation should save the charitable deduction. The Court held that this "remoteness" exception was something separate and apart from the perpetuity/extinguishment requirements, and thus could not be applied to override the perpetuity/extinguishment requirements.

So what happens if circumstances change so that the easement no longer makes sense? Does tax law nonetheless require the easement to still go on forever? Treas. Regs. §1.170A-14(g)(6)(i) provide an out:

"If a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation under this paragraph can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds *** from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution..." (emphasis added)

Thus, a judicial termination under these conditions is allowed, without that violating the perpetuity requirements. Forever is a long time, but under the appropriate circumstances, it need not go on, well, forever.

Kayln M. Carpenter, et al., TC Memo 2012-1

7. REPORTING OF SPECIFIED FOREIGN FINANCIAL ASSETS – TRUSTS & ESTATES

[The following was also published on Leimberg Information Services on January 9, 2012]

EXECUTIVE SUMMARY. Taxpayers with non-U.S. financial assets are subject to new and extensive reporting, commencing with the 2011 tax year filings. The IRS has recently issued guidance, which includes specific rules relating to grantor trusts and interests in foreign trusts and estates. All return preparers should have some familiarity with these new rules.

FACTS. Code §6038D, enacted as part of the Hiring Incentives to Restore Employment (HIRE) Act, will result in the first foreign asset disclosure filings in 2012. Form 8938 will be used to report. In recent weeks, Treasury has released a final version of the Form 8938, Instructions under the form, and temporary and proposed regulations relating to this reporting. Before addressing the specific provisions relating to estates and trusts, a short overview of the filing requirements is helpful.

WHO MUST FILE? (a) A “specified person,” (b) with an “interest,” (c) in “specified foreign financial assets (SFFAs),” (d) that meet stated filing thresholds, and (e) that otherwise has to file an income tax return, is required to prepare the Form 8938. Generally, a “specified person” at this time is an individual that is a U.S. citizen or resident alien. An “interest” means ownership of a subject asset in such a manner that income, gain, loss, expense from that item would be reported on an annual return of the taxpayer (regardless of whether there is income, gain, loss or expense for the current year). The filing threshold for a U.S. resident is SFFAs in excess of \$50,000 on the last day of the tax year or \$75,000 at any time during the year. Higher thresholds exist for married persons, and persons residing abroad.

WHAT IS AN SFFA? There are two types of assets that are a “specified foreign financial asset.” The first is a financial account of the taxpayer maintained by a foreign financial institution. The second is an asset not held in such an account, if held for investment, and that is: (a) stock or securities issued by a non-U.S. person, (b) a financial instrument or contract with a non-U.S. issuer or counterparty, or (c) an interest in a non-U.S. entity.

VALUATION. Values of SFFAs must be determined, both to determine if the filing threshold has been met, and to report the value on the Form 8938. Reasonable estimates of value are (thankfully) allowed.

PENALTIES. Failure to fully disclose will result in monetary penalties of \$10,000 (up to a maximum of \$50,000), absent reasonable cause. Failure to report will also result in statute of limitations extensions on income, both relating to the unreported SFFAs and potentially to all income of the taxpayer.

DUPLICATIVE REPORTING. For FSSAs reported on other tax forms, reporting may not be necessary under the Form 8938. However, those filings must be referenced on the Form 8938.

TRUST AND ESTATE ISSUES. There are some specific rules and aspects that relate to trusts and estates.

1. At this point in time, domestic trusts are not reporting taxpayers – only individuals need to report. At some point in the future, domestic entities that are availed of to avoid reporting will also need to report.
2. In counting SFFAs to see if the filing threshold is exceeded, or in actually reporting SFFAs, a beneficiary is not treated as owning the assets of a trust or estate. However, owners of an interest in a grantor trust will report the SFFAs of the trust attributed to them, subject to some exceptions.
3. An interest of a beneficiary in a foreign trust or a foreign estate is itself an SFFA. However, the beneficiary needs to know or have reason to know about the foreign trust or estate based on readily accessible information before it will be considered an SFFA. A receipt of a distribution from the estate or trust constitutes knowledge for this purpose.
4. In determining the “maximum value” of a beneficial interest in a foreign trust, the maximum value is the sum of (a) the fair market value on the last day of the year of all cash and property distributed to the beneficiary, and (b) the actuarial value on the last day of the year of the beneficiary’s rights to receive mandatory distributions. If the beneficiary cannot obtain information to calculate (b), they can use only the value under (a).
5. In determining the value of a beneficial interest in an estate, the taxpayer can limit the computation to that described in 4.(a) above, if it cannot obtain the information needed to value the beneficial interest.

COMMENT. Tax preparers are now obligated to inquire about the foreign assets of their clients so that proper reporting can be made. This will require preparers to be familiar with the foregoing rules, including what constitutes an SFFA and the application of the rules to interests in trusts and estates. Note that the Form 8938 instructions and accompanying regulations provide additional detail and exceptions beyond the general overview provided above.

Importantly, reporting of foreign accounts on an FBAR does NOT relieve taxpayers of reporting SFFAs on the Form 8938.

As noted above, a mere beneficial interest in a foreign trust or a foreign estate is an SFFA that is subject to reporting if the filing thresholds are met. There is no guidance that limits this to current beneficiaries or vested remainder beneficiaries. Thus, contingent beneficiaries at this point should report to avoid a risk of penalty, although an argument can be made that such persons do not have the requisite “interest.”

The valuation aspects are interesting. As to interests in a foreign trust, a beneficiary is not generally required to obtain valuation of the trust assets, since he or she needs only to report the value of distributed property. However, if the beneficiary has a mandatory distribution right, an actuarial computation is required. To compute this, the value of the underlying trust assets in that situation will be needed. For foreign estates, some effort will need to be undertaken to obtain the value of the beneficiary’s interest. Helpfully for beneficiaries of foreign trusts and foreign estates, if readily accessible value information is not available, valuation can be limited to the value of distributed property that is received.

The question arises whether values reported on the Form 8938 can be used by the IRS to challenge asset values for other purposes, such as estate or gift tax transfer values for transfers occurring in the tax year or in the future. There is nothing that prohibits the IRS from using the reported values, although the probative value of such reporting is arguably limited since the form only requires "reasonable estimates" of value. Nonetheless, to avoid issues if there are somewhat contemporaneous transfers subject to estate or transfer taxes, some coordination of reporting is advisable to avoid creating inconsistent reporting problems to the extent workable within the confines of the Form 8938 reporting rules.

CITES: Code § 6038D; Form 8938 and Instructions; TD 9567, Reporting of Specified Foreign Financial Assets (12/14/11); Treas.Reg. § 1.6038D-1T, -2T, -3T, -4T, -5T, -7T, & -8T

8. FIRM ANNOUNCEMENTS

Jenna G. Rubin has joined the firm as an associate. Jenna attended college at Northwestern University, and obtain her law degree from Harvard University. She will be practicing principally in the areas of estate planning, and litigation involving trusts, estates, and guardianships.

Charles (Chuck) Rubin has posted the materials from his recent seminars on the new Form 8938 filing requirements for taxpayers with foreign financial assets on our website.

Our attorneys are available for speaking engagements at Bar, accountant, and other professional organization meetings and seminars (schedules permitting). Feel free to contact us with any requests.

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information is condensed from, and a general summary of, legislation, court decisions, administrative rulings and other information, and should not be construed as legal advice or opinion, and is not a substitute for the advice of counsel.

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