

# GUTTER CHAVES JOSEPHER RUBIN FORMAN FLEISHER P.A.

## TAX AND BUSINESS UPDATE

November 14, 2011

An Electronic Newsletter of Gutter Chaves Josepher Rubin

Forman Fleisher P.A.

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## 1. IRS ADDS GST TAX AVOIDANCE TO TAX SHELTER REPORTING & DISCLOSURE – DO WE CARE?

The IRS has issued final regulations that add generation-skipping tax avoidance as reportable under the tax shelter reporting and disclosure rules. Do we care?

The short answer is "not yet."

Promoting, advising taxpayers about, or participating in a transaction that is the same as or substantially similar to a transactions determined by IRS to be a tax avoidance transaction and a "listed transaction" triggers numerous disclosure and penalty rules. Taxpayers may need to disclose their participation and

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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.

material advisors may need to disclose these transactions. Material advisors also must maintain lists of advisees and other information with respect to these listed transactions. "Transactions of interest" are included in reportable transactions. These are transactions that IRS believes have potential for tax avoidance or evasion, but for which it lacks enough information to determine whether they should be identified specifically as tax avoidance transactions.

The final regulations finalize proposed regulations that include GST taxes as coming under this rules. It is the position of the Dept. of the Treasury that the changes were "corrective," not "expansive."

The reason we don't care yet is that there are no transactions on the IRS "listed transaction" list or the "transactions of interest" list that involve generation-skipping taxes. Therefore, the rules will only be relevant if the lists are expanded to include transactions involving GST taxes in the future.

Objections to the expansion were raised by persons representing corporate fiduciaries – that they would be subject to reporting as a material advisor simply by being a trustee or a personal representative when a reportable transaction was undertaken by a trust or estate. In response to those comments, Treasury noted that a "fiduciary will not be treated as a material advisor merely by acting as an executor or trustee with respect to an estate or trust that is incidental to a transaction. A fiduciary will be treated as a material advisor only if the fiduciary provides material aid, assistance or advice as described in § 301.6111-3(b)(2), the fiduciary directly or indirectly derives gross income in excess of the threshold amount as described in § 301.6111-3(b)(3), and the transaction is entered into by the taxpayer."

*T.D. 9556, 11/10/2011; Reg. § 26.6011-4, Reg. § 301.6111-3, Reg. § 301.6112-2*

## 2. POST-NUPTIAL AGREEMENT TRAP

A recent Florida appellate court decision bears review by practitioners drafting post-nuptial agreements.

The case involved a husband who provided for assets to pass to his wife in his Last Will. After the Will was signed, the spouses entered into a post-nuptial agreement. The husband then died while the parties were still married. The probate court determined that the gift to the wife was waived by the wife under the

### 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.

agreement, and thus she could not inherit the gifted property. It appears that the husband had children from a prior marriage, and it was the husband's prior wife who challenged the gift to the surviving spouse in favor of her minor children with the decedent.

Let's assume that the terms of the agreement, in conjunction with Fla.Stats. §732.702(1), constituted a waiver of rights by the surviving spouse of her rights under the Will - this is what the probate court and the appellate court found. This is an interpretative issue.

The more interesting part of this case was the effect of the following common clause that was in the post-nuptial agreement:

Notwithstanding the terms of this Agreement, either party shall have the right to voluntarily transfer or convey to the other party any property or interest therein, whether Separate Property or other property, which may be lawfully conveyed or transferred during his or her lifetime, or by will or otherwise upon death. Neither party intends by this Agreement to limit or restrict in any way the right and power of the other to receive any such voluntary transfer or conveyance. Such gifts shall not constitute an amendment to or other change in this Agreement, regardless of the extent or frequency of such gifts. Any gifts given by one party to the other hereafter shall constitute the receiving party's separate property.

The first two sentences of this clause clearly authorized the husband to make a valid and effective gift to the wife in his Last Will. However, the courts found that the term "hereafter" in the last sentence meant that only a Will signed AFTER the post-nuptial agreement would be given effect.

This is a strained reading of that clause. The purpose of such clauses is to establish the property rights of the spouses in various property, but to allow for the parties to make their own voluntary transfers to the other spouse if they want. Whether those transfers are set out in a Will that predated the agreement seems irrelevant, and a trap for unwary spouses (and their counsel). That the Will doesn't take effect until the post-agreement death of the spouse further suggests that the date of the Will should not matter.

Further, all the last sentence appears to be doing here is characterizing gifts as "separate property" under the Agreement. This makes sense – if an inter vivos gift was made, it would be appropriate to treat that as the separate property of the recipient spouse that cannot be reached by the other spouse per the terms of the agreement relating to separate property. It does not appear to be designed to address any testamentary transfer issues – how would the label "separate property" in the hands of a surviving spouse have any relevance to anything?

How would this principle be applied to other testamentary transfers, such as a revocable trust or beneficiary designation made before the marital agreement? Would a post-agreement codicil addressing other dispositions or Will terms eliminate the pre-agreement character of the gift? Is this a narrow case that is dependent on the "hereafter" wording in the above clause, or is it of broader import that may have precedential value in all prenuptial and postnuptial situations?

Of course, in the future, agreements can be drafted with terms that specifically address pre-existing dispositions between the spouses. Alternatively, pre-existing dispositions can be redone post-agreement. However, such technical solutions are apt to be overlooked in many circumstances.

*Steffens v. Evans*, 4th DCA (Case No. 4D10-2467), October 5, 2011

### 3. TICK, TOCK, WILL CONGRESS SPEED UP THE GIFT TAX CLOCK?

As part of the 2010 budget showdown, the unified credit equivalent for federal gift taxes was bumped up to \$5 million for 2011 and 2012. In 2013, the amount will be reduced down to \$1 million with the expiration of the Bush tax cuts, unless Congress and the President act to modify that amount. What this means is that high net worth taxpayers only have until the end of 2012 to take advantage of the \$5 million exemption.

Or do they? About a month ago, rumors started that the Congressional budget "Super Committee" that is tasked with producing budget cuts to Congress by November 23 was considering a reduction in the exemption to \$1 million. What was once a trickle is now becoming a torrent of newsletters and warnings regarding the possible reduction with an effective date of November 23.

So far, we have not seen anything from official sources on this. Personally, it is difficult to believe that the Republicans on the Super Committee would accept this, but of course, anything is possible in Washington D.C. Even if a change is contemplated, there is no certainty that the effective date would be on November 23 – it could be before or after that.

UPDATE: The above item was initially published on November 9. Since then, while nothing definitive has been issued, news reports suggest that the likelihood of any such reduction occurring on or before November 23 is fairly small. But all in all, there still is no clear information on what will be coming out of the Super Committee, if anything. The most recent rumor is that the Super Committee may announce tax hikes, but leave the details of those hikes for Congress to address at a later date.

## 4. AT THE INTERSECTION OF MEDICINE AND TAX LAW

Medicine and tax law are two distinct fields. However, when tax law allows a deduction for expenditures relating to disease, tax lawyers and courts have to apply medical concepts.

Code §213 allows a deduction for medical expenses if paid for the diagnosis, cure, mitigation, treatment or prevention of disease. Cosmetic surgery doesn't come under this unless related to a congenital abnormality, personal injury, or a disfiguring disease.

Do expenses for hormone therapy and sex reassignment surgery relate to a disease, so that they are deductible?

In *O'Donnabhain*, 134 TC 34 (2010), the Tax Court allowed the deduction for some of these items. It was able to do this by locating a disease – here, “sever gender identity disorder.” What likely tipped the scale was that such an order is listed in the Diagnostic and Statistical Manual of Mental Disorders. That is published by the American Psychiatric Association. In other words, it had enough scientific recognition to be a “disease.”

The Tax Court allowed deductions for expenses of hormone therapy and sex reassignment surgery. However, expenses relating to breast augmentation surgery were found to be cosmetic only and therefore nondeductible. For some reason, below the belt surgery was deemed noncosmetic and above the belt surgery was cosmetic. We won't dwell on the legitimacy of that distinction, nor the applicable mental images – the opinion does have something of an involved discussion of this issue.

The IRS initially opposed the Tax Court's determination. However, it has now acquiesced and says it will follow the decision.

*AOD 2011-03, 11/2/11*

## 5. DISREGARDED ENTITIES AND EMPLOYMENT TAXES—FURTHER REFINEMENTS

Our last newsletter noted that disregarded entities are not treated as disregarded for employment tax purposes, but are instead treated as corporations. This special treatment came into effect in 2009, and the treatment as a corporation was specifically provided for recently.

Some wage payments are exempt from FICA and FUTA taxes. For example, services performed by a child under the age of 18 in the employ of his father or mother is not considered employment for FICA

purposes. Code §3121(b)(3)(A). Services performed by an individual under the age of 21 who is employed by his father or mother, or performed by an individual employed by his spouse or son or daughter (subject to certain conditions) for domestic service in a private home of the employer is not considered employment for FICA purposes. Code §3121(b)(3)(B). Services performed by an individual in the employ of his son, daughter, or spouse, and service performed by a child under the age of 21 in the employ of his father or mother, are not considered employment for FUTA purposes. Code §3306(c)(5).

If the employer is a disregarded entity owned by an employer described in one of the preceding exemptions, the treatment of the employer as a corporation and not a disregarded entity for employment tax purposes acts to convert exempt wages to taxable wages for FICA and FUTA taxes. In recognition of this problem, the IRS has issued temporary Treasury Regulations that will allow the exemptions to continue to apply in this circumstance. Essentially, they provide a partial exception to the nondisregarded entity treatment applied to otherwise disregarded entities for employment tax purposes – yes, quite a mouthful.

The new regulations also confirm that information reporting and backup withholding is applied to the owners of disregarded entities, and more specifically, that the disregarded entities themselves are relieved of such obligations.

Treas. Regs. §§31.3121(b)(3)-1T(e) , 31.3127-1T(d) , 31.3306(c)(5)-1T(e) , and 301.7701-2T(e)(5)

## 6. FIRM ANNOUNCEMENTS

Charles (Chuck) Rubin presented on the topic of Business Succession Planning to the Gold Coast Chapter of the Alpha Kappa Psi business fraternity.

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.

We are migrating this newsletter to a new service. Please pardon any errors while we work the bugs out. If you have any problems receiving the messages, please send a note to [crubin@floridatax.com](mailto:crubin@floridatax.com). As you can tell, we are experimenting with adding the newsletter as an attachment to the circulation email, instead of putting the newsletter in the body of the email.

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