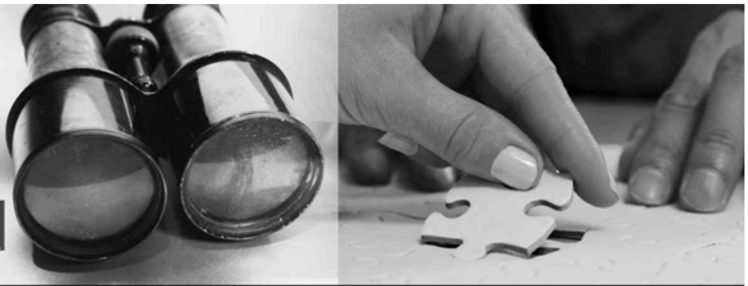
INSIGHTS & STRATEGIES

FINANCIAL AND ESTATE PLANNING



VOLUME 23, ISSUE NO. 5; May 2012

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Myron Kove, Esq., Executive Editor

GIFT TAX PLANNING

Gifts to Trust Complete Notwithstanding Donors' Retained Powers of Appointment; Withdrawal Rights are Illusory

In a recent private ruling, the IRS has concluded that transfers by the donors (husband and wife) to a trust for the benefit of their children were complete for gift tax purposes notwithstanding that the donors retained limited testamentary powers of appointment. The IRS also held that the beneficiary withdrawal rights are unenforceable and illusory and valued the retained testamentary powers at zero under the special valuation rules.

Trust Structure

In IRS Chief Counsel Advisory 201208026, 2012 WL 595483, John and Mary, husband and wife, created an irrevocable trust (Trust) for the benefit of their children, other lineal descendants, and their spouses. Child A is the sole trustee of Trust. Although John and Mary renounce any power to determine or control the beneficial enjoyment of Trust, they each retained a limited testamentary power to appoint so much of Trust as would still be in Trust at the time of his or her death. The Trust agreement is governed by the law of State.

Crummey Withdrawal Powers

Child A, as trustee, has absolute and unreviewable discretion in administering Trust for the benefit of the beneficiaries. Income and principal may also be distributed to a charitable organization. Each beneficiary is given the power annually to withdraw an amount of property up to the annual exclusion amount under Code Sec. 2503(b) (then $10,000, currently $13,000). This right, however, may be voided by the trustee for additions made to the trust.

Arbitration Clause

Although Trust is governed by State law, provision is made for settling disputes and questions to "Other Forum" which is charged with enforcing Trust. A beneficiary filing or participating in a civil proceeding to enforce Trust will be excluded from any further participation in Trust.

Transfers Partially Complete and Partially Incomplete

Generally, a transfer is complete for gift tax purposes when the donor has so parted with dominion and control as to leave in the donor no power to change the disposition whether for the donor's benefit or for the benefit of another. However, when a donor reserves any power over the disposition of the transferred property, as in the instant situation, the gift may be wholly incomplete, or it may be partially complete and partially incomplete, depending upon all of the facts and circumstances. Reg. Sec. 25.2511-2(b).

The position of the IRS has been that a power holder's testamentary limited power of appointment relates only to the remainder of a trust. See *Chanler v. Kelsey*, 205 U.S. 466 (1907); *Poinier v. C.I.R.,* 858 F.2d 917 (3d Cir. 1988); and *Robinson v. C.I.R.,* 675 F.2d 774 (5th Cir. 1982).

Transfer of Term Interests Complete

In the present case, each of the donors retained a testamentary power to appoint so much of Trust as would still be in Trust at his or her death. With respect to the term interests, John and

(Continued on Page 3)

FAMILY LIMITED PARTNERSHIP PLANNING

Expert's Opinion: Creation of Family Asset Satisfies Nontax Reason for FLP Transaction – The *Stone* Case

By J.L. Pierson, ASA, Business Valuation

In *Estate of Joanne H. Stone v. C.I.R.,* T.C. Memo. 2012-48, 2012 WL 573003 (February 22, 2012), Mr. and Mrs. Stone jointly owned 740 undeveloped acres of woodlands in a rural Tennessee county where their family had been living for decades. In the early 1990's, one of their sons purchased land near his parents' holdings, built a house, and obtained approval to dam and develop the resulting lake-front property. Mrs. Stone died in 2005 at the age of 81. At the time of trial in June 2011, Mr. Stone was 95. Their FLP was formed on Dec. 29, 1997.

Family Intentions

After the dam was built and the lake created, the Stones wanted the woodlands to become a family asset. Their hope was that at some point in time the family would develop and sell homes near the lake. A further motive was to protect the property from partition. There were several long-term issues to be resolved. First, the shallow soil depth made it difficult to connect sewerage systems to potential homes near the lake. Second, the water utility would draw down the water level in the lake during the summer months. Resolving these problems would include installing additional sewer lines closer to the lake and constructing a new primary reservoir for the County.

The Stone Family Limited Partnership of Cumberland County

To further the family planning momentum, the Decedent and her spouse created the Stone Family Limited Partnership of Cumberland County ["SFLP"]. Their attorney at the time advised that, as the couple wanted to gift real estate interests periodically to family members, a partnership structure would simplify the process by not requiring deeds for each gift. He also indicated that any future land partition effort would be made more difficult by reason of the partnership structure.

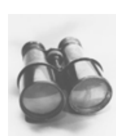
FLP Structure

On formation of SFLP (December 29, 1997), the decedent and Mr. Stone each received a one percent general partner interest and a 49 percent limited partnership interest in exchange for their interests in the woodlands which were promptly transferred to SFLP by quit claim deeds on December 30, 1997. The partnership agreement placed restrictions on a partner's ability to transfer his/her partnership interest. SFLP was allowed to buy any partner's interest upon death. Mr. and Mrs. Stone, as general partners, exercised considerable powers over SFLP, including deciding what parcels would be sold, managing its day-to-day business, and determining the amounts of any distributions. However, limited partners owning 67 percent of SFLP had the right to dismiss a general partner. The woodlands constituted the only asset of SFLP; no income was generated, and its expenses were minor.

Gifts of SFLP Limited Partnership Interests

The woodlands transferred to SFLP by the Stones were appraised at $1.575 million; that appraisal was used as the basis for all subsequent gifts. **No discounts were taken for gift tax purposes** either at the time of the transfers or on the gift tax returns. On December 31, 1997, the Stones gifted limited partnership interests to 21 individuals (children, children's spouses, and grandchildren). After the gifts, the 21 recipients held a combined 26.6 percent limited partnership interest. More gifts were made during the following three years. At the end of 2000, each of the Stones held only a one percent general partner interest while their descendants and spouses held the remaining 98 percent balance through the limited partnership interests.

The 2000 gifts were for a smaller percentage of the partnership because all other limited interests had already been gifted, and because two prior recipients were then involved in divorce proceedings and did not receive any gifts. In an effort to keep the development in the family, a deal was reached whereby the divorcing relatives would receive four acres of lakefront property in exchange for his/her interests in the woodlands parcels which was accomplished by quitclaim deeds of their interests in the woodlands.



Insight

For some unknown reason the divorcing in-laws did not transfer their limited partnership interests. The court stated that although proper partnership formalities were not followed, other factors demonstrated the bona fides of the transaction.

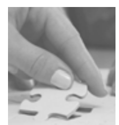
Nontax Purpose

After Mrs. Stone's death, the IRS issued a notice of deficiency to her estate. At the time of her death, the project had not advanced beyond a large parcel being considered for subdivision into lots. The IRS claimed that IRC Sec. 2036(a) applied. The purpose of that section is to include in the gross estate the value of lifetime transfers that are testamentary in nature. The section applies if (1) the decedent made an inter vivos transfer of property, (2) the transfer was not a bona fide sale for adequate and full consideration, and (3) the decedent retained an interest or right in the property which was not relinquished before death. The parties agreed that (1) was satisfied but the estate denied the existence of requirements (2) and (3). The court agreed with the estate.

As set forth in *Bongard,* 124 T.C. 95 (2005), the bona fide sale for adequate and full consideration exception is satisfied if the record demonstrates the existence of a legitimate and significant nontax reason for creation of the limited partnership. The court was satisfied there were two nontax motives: (1) creation of a family asset that could be developed and sold by the family; and (2) to protect the woodland parcels from division in the event of partition litigation.

Although there was a failure to follow proper partnership procedures (failure to transfer the limited interests in the two divorces, no SFLP bank account, payment by the Stones of the SFLP expenses, some inadequate documentation), these factors are outweighed by the bona fides of the FLP transaction.

A bona fide sale is supported by the following: Decedent received SFLP interests proportional to the parcels transferred; the Stones did not rely on distributions from SFLP and none were ever made; the parcels were all transferred to SFLP; there was no commingling of funds (SFLP had no partnership funds); there was no discounting of SFLP interests; the parcels were appraised and valued for all purposes in accordance with the appraisal; the Stones were in good health at the time of the transaction.



Planning Strategy

Because the transfer of the woodlands was bona fide, only decedent's one percent general partner interest is included in her gross estate notwithstanding the failure to follow proper partnership procedures and the payment by the Stones of the SFLP (minor) expenses.

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(Continued from Page 1)

Mary divested themselves of all dominion and control over the transferred property. With respect to the term interests, Child A, as trustee, has sole and unquestionable discretion to distribute income and principal to the beneficial term interests, including terminating Trust by distributing all of its property. Therefore, the transfers are complete with respect to the term interests but are incomplete as to the remainder interests because of the retained testamentary powers. With respect to the remainder, the relinquishment of the testamentary power would affect only the disposition of the remainder but not the term interests.

Crummey Withdrawal Rights are Unenforceable

John and Mary argued that if the transfers of the term interests are complete, the gifts were still not taxable since they were equal in value to the withdrawal rights. As noted above, the withdrawal rights are the same as the annual gift tax exclusion of $10,000 under Code Sec. 20503(b). Only a transfer of a present interest qualifies for the annual gift tax exclusion. A gift of a future interest does not qualify. Code Sec. 2503(b).

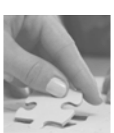
To constitute a present interest, the gift must be legally enforceable in State court. See *Cristofani v. C.I.R.,* 97 T.C. 74 (1991). The federal courts are not bound by decisions of a private forum (such as Other Forum), and State courts are not bound by a private forum's determination of State law pertaining to trust agreements. Under Trust, a beneficiary may not enforce his/her withdrawal rights in a State court and is limited to the Other Forum which may not recognize State or federal law. For these reasons, the withdrawal rights are not legally enforceable rights necessary to constitute a present interest.

Under Trust, as noted above, a beneficiary who proceeds to State court to enforce his/her withdrawal rights faces the threat of losing all rights under Trust. Because of the threat of severe economic punishment, such rights are illusory. See Rev. Rul. 85-24, 1985-1 C.B. 329; Rev. Rul. 81-7, 1981-1 C.B. 474.

The Value of the Gifts Under the Special Valuation Rules

Prior to the adoption of the special valuation rules (Code Secs. 2701-2704), the value of the donor retained interests would have been subtracted from the full fair market value of the transferred property to arrive at the value of the gift for gift tax purposes. Code Sec. 2702(a)(2) provides that the value of any retained interest which is not a qualified interest is valued at zero. The regulation provides, with respect to transfers in trust, that the existence of a power that would cause a portion of a transfer to be treated as an incomplete gift is not a qualified interest and is valued at zero. Reg. Sec. 25.2702-2(a)(4). Therefore, the retained testamentary powers are valued at zero, and the value of the gifts by John and Mary are the full value of the transferred property.

Insight
The IRS noted that the annual exclusion would not be allowable for withdrawal rights relating to trust additions because the trustee can void the withdrawal rights after the addition is made, citing Reg. Sec. 25.2503-3(c), Examples 1 and 3, but does not elaborate further. The examples do not cover trust additions. The examples cover situations where: (1) the trust provides for distributions of income except that the trustee has discretion to withhold income payments, and (2) the income is to be distributed to three beneficiaries but the trustee has discretion as to the amount to be received by each beneficiary.



Planning Strategy
A Crummey withdrawal power may provide that if a beneficiary exercises his or her withdrawal right, the trustee may void future withdrawal rights. Once the withdrawal right is exercised, the annual exclusion would not be allowable for subsequent additions.

POWER OF APPOINTMENT PLANNING

Is the Law Partner of the Trustee/Beneficiary's Husband a Subordinate Party?

In a recent private ruling, the IRS concluded that the power held by the trustee/beneficiary of an irrevocable trust to appoint a successor independent trustee from among the partners of a law firm in which the trustee/beneficiary's husband was a partner, did not cause the trust assets to be included in the trustee/beneficiary's gross estate. The power to appoint a successor independent trustee specifically excluded the husband and any related or subordinate (as defined under Code Sec. 672(c) person or entity). IRS Private Letter Ruling 201209003.

Trust A Structure

Father created Trust A which became irrevocable on his death; Mother created Trust B which became irrevocable on her death. First Father died, then Mother died. The terms and provisions of both Trust A and Trust B are identical. After Mother's death, the two Trusts were merged into one trust with Trust A as the surviving trust. Daughter and Son survived their parents. Trust A is for the benefit of Daughter and Son, and their issue. During the lives of Daughter and Son, all of the net income is accumulated.

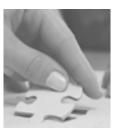
The Independent Trustee

Daughter was named as co-trustee and Individual, a member of CPA Firm 1, was named as the independent trustee. Trust A provides that at least one trustee (including successors) shall be a member of Firm 1. A beneficiary (such as Daughter) who also acts as a trustee cannot make or participate in making any decisions to distribute trust principal to beneficiaries. Since Daughter is a trustee, the independent trustee has the sole power to make distributions of principal as he may deem advisable for any reason whatsoever. Due to illness, the independent trustee is no longer able to act.

The beneficiaries of Trust A propose to petition State Court to modify the terms of Trust A to allow a partner of Firm 2 (a local law firm) to act as the independent trustee. As noted above, Daughter's husband is a partner of Firm 2. The proposed modification provides that the husband may not be appointed as a trustee, and that **no** person or entity related or subordinate (within the meaning of Code Sec. 672(c)) to any beneficiary of Trust A shall be appointed as independent trustee.

Inclusion in the Gross Estate

If at the time of her death, Daughter possesses a general power of appointment over Trust A, then the value of the trust property would be included in her gross estate. Code Sec. 2041(a)(2). A general power of appointment is a power exercisable in favor of the decedent, her estate, her creditors, or the creditors of her estate. Sec. 2041(b)(1)(A). It also includes all powers which are in substance and effect powers of appointment notwithstanding the nomenclature used and without regard to local law. For example, a power in a donee to remove or discharge a trustee and appoint himself as trustee may be a power of appointment. Reg. Sec. 20.2041-1(b).



Planning Strategy

The reservation of an unqualified power to remove a trustee and to appoint a successor that is not related or subordinate to the decedent (within the meaning of Sec. 672(c)) is not considered a reservation of the trustee's discretionary powers of distribution over trust property. Rev. Rul. 95-58, 1995-36, 1995-2 C.B. 191.

Definition of Related or Subordinate

The term "related or subordinate" refers to any nonadverse (any person who does not have a substantial interest in the trust) person, and includes the grantor's spouse, parents, and siblings, as well as employees of the grantor. (The term also includes a corporation and its employees in which the grantor and the trust have voting control, and a subordinate employee of a corporation in which the grantor is an executive.) Generally, a related or subordinate party is presumed to be subservient to the grantor in the exercise or nonexercise of the powers given to him/her. Sec. 672(c).

IRS Holdings

1. While Daughter is serving as trustee, only the independent trustee can make decisions with respect to distributions. Therefore, Daughter does not have a general power of appointment by reason of the power of the trustees to make distributions.

2. Although Daughter has the power to appoint a successor independent trustee, she is prohibited from appointing her husband as trustee. Daughter may only appoint an independent trustee who is not related or subordinate to her within the meaning of Sec. 672(c). Therefore, the existence of the power to appoint a successor trustee is not considered a reservation of the trustee's discretionary powers of distribution over the trust property under Rev. Rul. 95-58.

3. Daughter's power of appointment is not a general power of appointment. Therefore, the proposed modification will not result in the trust assets being included in Daughter's gross estate.

Insight

Whether the partner selected as the independent trustee is subordinate is a factual issue which would be determined at the time of audit of the Daughter's estate tax return.

POST-MORTEM PLANNING

No Adverse Tax Consequences on Reformation and Modification of Trust Due to Scrivener's Error

In a recent private ruling, the IRS has concluded that the reformation and modification of a credit shelter trust, required by reason of a scrivener's error, will not cause the surviving spouse to possess a general power of appointment over the trust property, or result in the spouse making a taxable gift, and no part of the trust assets will be included in the spouse's gross estate. IRS Private Letter Ruling 201210008.

Decedent's Trust Structure

Decedent's revocable trust provided for a marital trust and a residuary trust which was intended to hold the credit shelter amount and therefore be exempt from federal estate tax. On decedent's death, after certain outright bequests to his spouse, the balance of decedent's assets (less than $2 million) were allocated to the residuary trust. The marital trust was not funded. The surviving spouse is the trustee and executor. It is represented that decedent's available generation-skipping transfer (GST) tax exemption at death was $2 million.

Unlimited Withdrawal Power: Scrivener's Error

In addition to being the income beneficiary of the residuary trust, the surviving spouse also has a noncumulative right to withdraw annually from the trust an amount of cash and assets as she may specify. This unlimited withdrawal power would cause the residuary trust to be included in the surviving spouse's gross estate.

In connection with the reformation of the trust, the attorney who prepared the trust stated that he made a scrivener's error; that decedent intended for spouse to receive the income of the trust, and principal based on an ascertainable standard, and that no part of the trust would be included in spouse's gross estate.

Reformation and Modification of Trust

A state statute provides that the court may reform the terms of a trust to conform to the intent of the settlor even if the trust is unambiguous, provided intent is established by clear and convincing evidence and the trust terms were effected by a mistake of fact or law.

Based on the scrivener's error, the applicable state court modified the trust as follows:
(1) spouse receives all of the trust income;
(2) principal is distributed in the trustee's discretion based on an ascertainable standard;
(3) spouse has an annual noncumulative "5 and 5" withdrawal power (the power to withdraw the greater of $5,000 or five percent of the trust value), and spouse may specify the cash or assets to be distributed. The court's order also modified the trustee succession after spouse.

IRS Holdings

The IRS concluded that the purpose of the reformation was to correct the scrivener's error in order to carry out decedent's intent, and not to modify the residuary trust. IRS consequently held as follows:

General power of appointment under Code Sec. 2041. This section includes in the gross estate any general power of appointment possessed by a decedent. The lapse of the power is also included in the gross estate but only to the extent the lapse exceeds the greater of $5,000 or five percent of the aggregate value. Sec. 2041(b)(2). Since the lapse of the corrected withdrawal power is within the "5 and 5" parameters, the reformation and modification does not provide spouse with a general power of attorney.

Gift tax consequences under Code Sec. 2514(b). This section provides that the lapse of a general power of appointment is a transfer subject to gift tax but only to the extent the lapse exceeds the greater of $5,000 or five percent of the aggregate value. As noted in the prior paragraph, since the lapse is within the "5 and 5" parameters, the reformation does not constitute a gift for gift tax purposes.

Estate tax consequences under Code Sec. 2036(a). This section includes in the gross estate transfers with a retained life estate. The IRS ruled that no part of the trust assets will be included in spouse's gross estate by reason of the reformation.

Allocation of decedent's GST tax exemption under Code Sec. 2632(a). The decedent will be considered the transferor of the residuary trust for GST tax purposes. Based on the representation that decedent had a $2 million GST exemption available at the date of death, then under the automatic allocation rules of Reg. Sec. 26.2632-1(d)(2), decedent's exemption was automatically applied to the residuary trust. Since the trust will have a zero inclusion ratio it will be exempt from GST tax on spouse's death.

SPECIAL REPORT

Tax Planning and Transferable State Income Tax Credits

Some states issue nonrefundable transferable income tax credits as incentives to encourage taxpayers to engage in activities (charitable and otherwise) that advance the interests of the state. Credits may be issued in connection with contributions of charitable transfers of conservation easements, historic rehabilitations, low-income housing, as well as other projects. The recipient will usually apply part or all of the credit to current state income tax liability. If the taxpayer does not use all of the credits they may be carried forward or sold and used by the transferee at their face amount even though they are purchased at a discount.

Federal Tax Issues

When the credits are transferred, income tax issues arise. See IRS CCA 201147024.

1. Is the sale by the original recipient a taxable event?
2. What is the basis to the original recipient?
3. Is the gain to the original recipient a capital or ordinary income event?
4. What is the basis of the tax credit to the purchaser?
5. Is gain recognized when the credit is purchased for less than its face value, and when should the gain be recognized?

Resolving the Tax Issues

IRS CCA 201147024 answers the tax issues as follows:

1. The sale of the tax credit is a taxable event.
2. The original recipient of the tax credit has no cost basis in the credit.
3. The original recipient's gain on the sale of a nonrefundable credit is a capital gain (unless the credit falls within one of the statutory exceptions in Code Sec. 1221(a) (discussed in the next section).
4. The purchaser's basis for the tax credit is the purchaser's cost.
5. The purchaser must recognize apportioned gain, if the credit is purchased for less than its face value, when the credit is used to satisfy state tax liability.

The Tempel Case

In *Tempel and Tempel v. C.I.R.,* 136 T.C. No. 15, 20111 WL 1304261, the Tax Court held that transferable state income tax credits, received as an incentive from the State of Colorado in connection with the donation by the taxpayers of a qualified conservation easement, are capital assets with a zero basis. The court also held that for long-term capital purposes, the holding period starts when the credits are issued to the donor.

The Tempels donated a qualified perpetual conservation easement to a qualified organization on about 54 acres of their land in Colorado. The fair market value of the contribution was $836,500, and they incurred expenses of $11,575 (easement costs), mostly for professional fees (accounting, appraisal, surveying). As a result of the contribution, the Tempels qualified for income tax credits from Colorado in the amount of $260,000, the maximum credit allowable for 2004. In certain circumstances (the existence of a budget surplus) a limited refund of up to $50,000 is permitted. Unused credits are carried forward up to 20 tax years or may be transferred to certain eligible taxpayers. Transferees can use the credits to offset a tax liability but are not eligible for a refund. The Tempels sold an aggregate of $110,000 of credits and received an aggregate net amount $82,500. The Tempels also gifted $10,000 of their credits.

On their 2004 income tax return, the Tempels reported the sale of the credits as a short-term capital gain of $82,500 with a basis $4,897. The basis represented a pro rata portion of the $11,575 of easement costs. The IRS issued a notice of deficiency claiming the credits were not capital assets and that the proceeds were ordinary income. Alternatively, the IRS argued that there was no basis in the credits.

The starting point is Code Sec. 1221 which broadly defines a "capital asset" as property held by the taxpayer but then lists eight categories of property which are excluded from the definition. A state tax credit does not come within any of the exclusions.

Substitute for Ordinary Income Doctrine

The government made several arguments based on the "substitute for ordinary income doctrine."

1. **The Gladden decision contract analysis:** In *Gladden v. C.I.R.,* 112 T.C. 209 (1999), rev'd on a different issue, 262 F.3d 851 (9th Cir. 2001), the court applied a contract analysis six-factor test to determine whether the relinquishment of water rights in exchange for cash was a capital transaction or ordinary income. The court held that the *Gladden* test does not apply to state tax credits because that test is based upon an analysis of contract rights. There are no contract rights associated with a legislative grant of tax credits.
2. **Substitute for State tax refund:** The sale proceeds are merely a substitute for the $50,000 tax refund that would be received in a year the State incurs a budget surplus. There was no surplus in 2004 (the year of sale) or in the years 2006 through 2010. The Tempels retained $140,000 of credits but

there was no evidence that they sold any credits in a year they could have otherwise used the credits to receive a refund. Therefore, the sale proceeds are not a substitute for a tax refund.

3. **Substitute for reducing State tax liability:** If the Tempels had used the credits to reduce their State tax liability rather than selling the credits, they would have had fewer deductions on their federal income tax return. They have therefore received an economic equivalent of ordinary income. The court rejected this argument, holding that a reduction in a tax liability is not an accession of wealth that results in income. Rev. Rul. 79-315, 1979-2 C.B. 27.

The court concluded there were no authorities that state income tax credits were ordinary income. It also noted there are many instances where state created rights (such as liquor licenses and milk allocation rights) are treated as capital assets. Therefore, under Sec. 1221, since state tax credits do not come within any of the exceptions and there is no case law to the contrary, they are treated as capital assets for federal income tax purposes.

Basis and Holding Period

Under Code Sec. 1012, cost basis is what a taxpayer pays to acquire an asset. The Tempels did not purchase the credits; they were granted by Colorado. The easement costs incurred in connection with the donation are deductible under Code Sec. 212(3) (expenses incurred in connection with the determination, collection, or refund of any tax); they are not allocable as basis to the tax credits.

The holding period commences with the date of issuance of the credits to the Tempels. There is no relation back since the credits do not represent any property right associated with the land. Since the credits were not held for more than one year after issuance, the gain on the sale is a short-term gain.

The McNeil Case

In *McNeil and McNeil v. C.I.R.,* T.C. Memo. 2011-109, 2011 WL 1990545, the McNeils are members of McNeil Ranch, L.L.C. (an LLC taxed as a partnership). In 2003, the LLC, in two bargain sale transactions, sold conservation easements as follows: (1) an easement encumbering about 580 acres having a fair market value of $1,026,000 for $330,000; and (2) an easement encumbering about 520 acres having a fair market value of $819,000 for $195,000. In 2005, the LLC in another bargain sale transferred a conservation easement having a fair market value of $572,000, on 220 acres for $330,000. The court, following its decision in *Tempel*, held that the credits are capital assets (IRS argued the credits were not capital assets), and that the holding period starts at the time the credits are issued by the state (rather than a carryover holding period from the time the land was acquired by the McNeils). Since the credits were not held for more than one year, the gains are treated as short-term capital gains.

IRS CCA 201147024

After the decision in *McNeil,* the IRS issued CCA 201147024, 2011 WL 5893497, which arrived at the same conclusions as the above cases. The IRS ruling, however, took issue with the holding in both cases that the multi-factor analysis (see item 1 above referring to the *Gladden* case six-factor test) was not applicable since cases have applied it outside the contract area. The IRS claimed the result would be the same but that using the multi-factor analysis would further consistent application of the tax law rather than creating a different test for other types of property.

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