



FALLING FROM LEGISLATIVE GRACE

March 25, 2019

Author: Brianna L. Marquis

Trusts & Estates Magazine Website

Brianna L. Marquis and Andrew M. Nerney, attorneys in the Private Clients Group, wrote an article for *Trusts and Estate Magazine Website* entitled "Falling From Legislative Grace" which was published March 26, 2019.

For a link to this article, please [click here](#).

Falling From Legislative Grace

The charitable deduction is meant to incentivize taxpayers to contribute to charities, not find ways to cheat the system

When assets are transferred to one or more qualified charitable organizations on death, Internal Revenue Code Section 2055(a) allows for a deduction from the value of the decedent's gross estate.

This section is an act of "legislative grace," as its purpose is to encourage philanthropy. *Commissioner v. Shoong*, 177 F.2d 131, 132 (9th Cir. 1949). As the petitioner in *Dieringer v. Comm'r of Internal Revenue*, No. 16-72640, 2019 WL 1119598, at *5 (9th Cir. Mar. 12, 2019) found, this "grace" extends only so far. Executors must take care to ensure the estate's charitable contributions are valued appropriately, and the charity actually receives what the estate claims as a deduction.

A Family Affair

Victoria Dieringer (the decedent) and her family owned Dieringer Properties, Inc. (DPI), a closely held corporation, which managed commercial and residential properties and a fast food restaurant. Before her death, the decedent owned 425 of 525 voting shares and 7,736.5 out of 9,220.5 nonvoting shares of DPI. Her sons, Eugene and Patrick, owned the remaining voting and nonvoting shares. Eugene was the president of DPI; Patrick was the executive vice president and secretary; the decedent was vice president; and another of her sons, Timothy, was the office manager. The board of directors included the decedent, Eugene, Patrick, Timothy and Thomas Keepes, an unrelated party.

According to the decedent's trust, at the decedent's death, the vast majority of the decedent's assets were to be distributed to various charitable organizations and to her foundation. Eugene was the sole trustee of both the trust and the foundation and was appointed as executor of her estate. After the decedent's death, the estate requested an independent appraisal of the net asset value of DPI, which valued DPI at about \$17 million.

In the meantime, the board of directors converted DPI from a C corporation to an S corporation. They also decided that DPI would redeem the decedent's shares, and the purchase price would pass into the foundation. To facilitate

CUMMINGS & LOCKWOOD LLC

the redemption, another appraisal was performed. Eugene instructed the appraiser to value the decedent's shares as if they were a minority interest in DPI when, in fact, there was no reason to do so. As a result, the redemption appraisal included a 15 percent discount for lack of control and a 35 percent discount for lack of marketability. This produced a valuation significantly lower than what was shown on the date-of-death appraisal. DPI eventually redeemed the shares using these much lower values. Ultimately, the foundation received the purchase price of the DPI shares, worth about \$6 million. The estate, however, claimed a charitable deduction of about \$18 million based on the date-of-death value of the decedent's DPI shares.

Court Involvement

In 2013, the commissioner issued a notice of deficiency and advised that it would seek an accuracy-related penalty. The estate filed a petition in the Tax Court challenging the notice, but the Tax Court upheld the commissioner's findings. The Tax Court concluded that the decision to apply a minority discount to the redemption value also reduced the value of the charitable deduction. The estate appealed.

The estate challenged the Tax Court holding on three grounds. The central issue was whether, in determining the appropriate charitable deduction, an estate should consider post-death events that lowered the value of assets passing to charity or simply value the deduction at the time of the decedent's death. The estate also claimed that if post-death events should be considered, the Tax Court should have found that economic forces led to the decline in value of the decedent's shares. Finally, the estate argued that the penalty shouldn't have been upheld. The U.S. Court of Appeals for the Ninth Circuit rejected all three of the estate's arguments in turn.

No Uniform Rule in Considering Post-Death Events

While some prior cases had applied a date-of-death valuation method, the Ninth Circuit explained that this can't be the definitive rule as certain deductions, like the IRC Section 2053(a) deduction for estate administration and funeral expenses, can't accrue until after the testator's death. The Ninth Circuit relied on *Ahmanson Foundation v. United States*, 674 F.2d 761, 772 (9th Cir. 1981) in deciding that post-death events should be considered in determining the amount of a charitable deduction. *Ahmanson* involved an estate plan that left voting shares in a corporation to family members and nonvoting shares to a charitable foundation. That court held that a discount should be applied when valuing the charitable deduction for the nonvoting shares because they had been stripped of their voting power. It also set forth the rule that the value actually received by the charity can't be ignored when determining the charitable deduction.

Applying the decision in *Ahmanson*, the Ninth Circuit upheld the Tax Court's decision. The court held that executors and beneficiaries can't be allowed to rewrite the decedent's estate plan so as to achieve tax savings. The court found that Eugene had virtually unfettered discretion as trustee of the decedent's trust and foundation, president, director and majority shareholder of DPI and executor of the decedent's estate. He intentionally commissioned an appraisal using inaccurate information and took a deduction for more than double what the Foundation actually received. For these reasons, the Ninth Circuit held that the Tax Court was correct in considering the disparity between the amount the foundation actually received and the deduction taken by the estate.

Unfavorable Market Forces

The estate next argued that if post-death events are taken into account when determining the charitable deduction, the Tax Court should have acknowledged that market forces caused a decline in the value of DPI stock. While the value of the stock did decrease about \$1 million over a period of seven months, no other evidence was presented to support this theory. The Ninth Circuit concurred with the Tax Court's holding that the disparity in value between the two appraisals was primarily due to Eugene's instructions to the appraiser and the resulting discounts.

Accuracy-Related Penalty

CUMMINGS & LOCKWOOD LLC

Finally, IRC Section 6662(a) imposes a 20 percent penalty on the amount of an underpayment attributable to negligence or disregard of the rules and regulations. The Ninth Circuit agreed with the Tax Court's finding that the estate was negligent because it didn't inform the appraiser that the redemption was for a majority interest and, in fact, told the appraiser that it was a minority interest. The Ninth Circuit also agreed with the Tax Court in determining that the estate didn't act with reasonable good cause or in good faith for its negligent act. The estate didn't rely on its attorney's advice; rather, Eugene knowingly gave the appraiser incorrect information.

Make Sure Deductions Match What Charities Receive

While it's true that most of us would gladly accept any opportunity to avoid paying taxes, especially when the bill is over \$4 million, we also need to consider the possible consequences of doing so. Here, not only did the estate have to pay over \$4 million in taxes it originally owed, but also over \$800,000 in penalties. The court in *Dieringer* made clear that the charitable deduction is meant to incentivize taxpayers to contribute to charities, not find ways to cheat the system. Legislative grace won't help the double-dealer.