

TAX

Paying the Estate Tax – Part II

By Louis Vlahos

Note: This is part two of a two-part series. Part one was included in our June issue, available at www.scba.org.

Is the loan “necessary?”

A recent decision by the Court of Appeals for the Eleventh Circuit considered the interest deduction claimed by decedent’s estate in connection with a loan from a controlled LLC. (*Est. of Koons v. Commissioner*, 119 A.F.T.R. 2d 2017-16092017 (11th Cir. 2017).

At his death, decedent owned 46.9 percent of the company’s voting stock and 51.5 percent of its nonvoting stock. His children owned most of the remaining stock, either directly or through trusts, while other family members and trusts held the remaining shares.

The decedent’s Revocable Trust held a 50.50 percent interest in LLC on the date of his death, 46.94 percent, of which was a voting interest, and 51.59 percent of which was a nonvoting interest. The Revocable Trust comprised the majority of the assets of decedent’s estate, with the trust’s interest in LLC being its primary asset. LLC was flush with liquid assets at the time of decedent’s death.

The loan

The estate’s remaining liquid assets, however, were insufficient to pay its tax liability. The fiduciaries of the estate declined to direct a distribution of the Revocable Trust’s interest in LLC to pay the estate tax liability, believing that immediate payment would hinder LLC’s plans to invest in operating businesses.

As a result, the trustees instead obtained a large loan from LLC in exchange for a promissory note bearing a market interest rate, though no payment was due for 18 years, at which point principal and interest were scheduled to be repaid in 14 annual installments. Prepayments were not permitted under the terms of the loan, and the projected interest payments were determined with reasonable certainty.

Because the Revocable Trust’s primary asset was its interest in LLC, it anticipated that the loan would be repaid with distributions from LLC, which had significant liquid assets at the time of the loan.

IRS challenges the Estate Tax Return

When the estate filed its estate tax re-



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turn, it claimed a large deduction, as an administrative expense, for the interest payable on the loan.

The IRS determined a significant estate tax deficiency, in large part due to its determination that the interest payments were not properly deductible.

The U.S. Tax Court agreed, holding that estate was not allowed to deduct the projected interest expense on the loan from LLC to the Revocable Trust. In reaching this holding, the Tax Court concluded that the loan was not necessary to the administration of the estate because, at the time the loan was made, LLC had substantial liquid assets and the Revocable Trust had a sufficient voting interest in LLC to force a pro rata distribution by the LLC in the amount of the debt. The Tax Court also rejected the estate’s argument that the loan was preferable because a distribution would have depleted the LLC of cash that could have been used to purchase additional businesses; the court noted that the loan also depleted the LLC of cash.

Additionally, the Tax Court observed that the loan would ultimately be repaid

using the Revocable Trust’s distributions from LLC, such that it merely delayed the use of such distributions to pay the Estate’s tax liability. Further, it stated that the loan repayments were due many years after decedent’s death, which hindered the proper settlement of the estate.

The estate appealed this decision to the Eleventh Circuit.

Administration expense?

An estate is permitted to deduct expenses that are actually and necessarily incurred in the administration of a decedent’s estate. Expenditures that are not essential to the proper settlement of the estate, but that are incurred for the individual benefit of the decedent’s heirs, may not be taken as deductions. Expenses incurred to prevent financial loss to an estate resulting from forced sales of its assets to pay estate taxes are deductible administration expenses. Conversely, interest payments are not a deductible expense if the estate would have been able to pay the debt using the liquid assets of one of its entities, but instead elected to obtain a loan that will eventually be repaid using those same liquid assets.

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REAL ESTATE

Good Faith Purchaser for Value’s Ability to Record Memorandum Heard by Second Department

By Andrew Lieb

In *Vanderbilt Brookland, LLC v. Vanderbilt Myrtle, Inc.*, the Second Department clarified the recording requirements necessitated to establish bona fide good faith purchaser for value status. The case before the Appellate Division concerned the recording of a memorandum of purchase and sale agreement, pursuant to Real Property Law §294(2), rather than the contract itself. While the court held that such a memorandum could provide good faith purchaser for value status under the Recording Act, pursuant to Real Property Law §291, the court denied good faith purchaser for value status because a party to “both the purchase and sale agreement and the assignment, did not execute the memorandum” and hence the memorandum was “improperly recorded in lieu of the purchase and sale agreement and assignment” in violation of Real Property Law §294(2)’s execution requirement.

On appeal was a preliminary injunction interlocutory order from a specific performance action concerning “the right to purchase real property.” At issue were two contract vendees seeking priority status and both claiming a

probability of success on the merits in the underlying action.

The relevant facts were that defendant was a contract vendor, as the purchaser under a purchase and sale agreement, which agreement it assigned twice. Initially, defendant assigned the purchase and sale agreement incident to the sale of five percent of its shares of common stock to plaintiff. Such agreement expressly “prohibited the recording of that agreement or any memorandum thereof.” Nonetheless, plaintiff paid the deposit under the purchase and sale agreement as its partial consideration for the assignment. Next, defendant “assigned its rights under the purchase and sale agreement to All Year Management.” As such, the issue before the court was whether plaintiff had a likelihood of success on the merits in its specific performance action, or, if instead, All Year Management qualified as good faith purchaser for value, and hence, had priority.

In hearing the appeal, the court addressed whether All Year Management qualified as a good faith



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purchaser for value, pursuant to Real Property Law §291. The statute provides, in pertinent part, as follows:

Every such conveyance not so recorded is void as against any person who subsequently... contracts to purchase... the same real property or any portion thereof...

in good faith and for a valuable consideration, from the same vendor or assignor... and whose conveyance, contract or assignment is first duly recorded...

In hearing the issue, the court found that “All Year established that it was a good faith purchaser for value at the time the purchase and sale agreement was assigned to it.” The court explained that “good faith is not a requirement at the time the contract is recorded,” but, instead, only at the time of entering into the contract. Nevertheless, the court observed that All Year did not record the purchase and sale agreement and the assignment,” but instead recorded “a memorandum of the” same, pursuant to Real Property Law §294, and hence it was

necessary to examine whether such recording was proper. The statute provides, in pertinent part, as follows:

In lieu of the recording of an executory contract, there may be recorded a memorandum thereof, executed by the parties, and acknowledged or proved, and certified, in the manner to entitle a conveyance to be recorded...

Operatively, the court found that defendant, the contract vendor, who was “a party to both the purchase and sale agreement and the assignment, did not execute the memorandum.” As such, the court held that the memorandum was improperly recorded, pursuant to Real Property Law §294, and, as such, it “did not serve to give All Year’s claim to the property priority.”

Practitioners should observe the strict construction of Real Property Law §294 under which the Appellate Division heard the case. While the error in the execution of the memorandum did not provide any more or less notice of its existence or affect the validity of the purchase and sale agreement and the assignment, such

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ABA Holds 2017 Annual Meeting in New York City (Continued from page 1)

“seeking legal status.” The resolution passed over significant opposition.

The House approved Resolution 10B, which reaffirmed the ABA’s prior policy opposing mandatory minimum sentences, which tend to limit a judge’s discretion to consider mitigating circumstances, and has a disparate impact on African Americans, whom proponents say are more likely to be charged with offenses with sentences in this category.

The House voted to approve Resolution 102C, which supports the common-interest doctrine, whereby the sharing of privileged communications with persons of common interest, who have agreed to maintain confidentiality, is not deemed to constitute a waiver of the privilege.

The House approved Resolution 112E, which recommends that solitary confinement no longer be utilized for prisoners under 18 years old.

The House approved Resolution 112C, which urges governments to adopt policies that favor release on recognizance, advocating that pre-trial detention should not occur solely on the basis of inability to pay.

The House approved Resolution 118, which urges governments to allow courts to issue gun violence restraining orders, including *ex parte* orders. Proponents called the resolution a “modest, common-sense reform” that would help families and others prevent suicides and other acts of violence through temporary restraining orders. Opponents raised First, Second and Fourth Amendment concerns, as well as the one-sided nature of an *ex parte* proceeding. The resolution passed on a voice vote with some opposition.

With respect to records expungement, the House passed two resolutions affecting those exonerated from a charge as well as those found guilty of minor offenses. Resolution 112F urges governments to allow individuals to petition to expunge all criminal records pertaining to charges of arrests that did not end in a conviction. Resolution 112G urges that convictions for minor violations for certain crimes related to homelessness be eligible to be expunged.

With regard to the federal courts, the House approved Resolution 104, which reaffirmed its opposition to restructuring the U.S. Court of Appeals for the Ninth Circuit, one of 13 in the federal appellate system. Legislation has been proposed in Congress to split up the Ninth Circuit, but there is strong opposition in the legal community. Speakers said the large majority of the 29 appellate judges on the court also oppose the split, as have bar groups in the western states and others.

In the area of right to counsel, the House approved Resolution 106, which urges Congress to give the U.S.

Department of Justice more powers — including the power to bring civil actions in federal court — to enforce compliance with the 1963 U.S. Supreme Court decision in *Gideon v. Wainwright*, which gave defendants in most criminal cases the right to counsel pursuant to the Sixth Amendment to the U.S. Constitution. The House also approved Resolution 115, which supports the appointment of counsel at federal government expense to represent all indigent persons in immigration removal proceedings.

The meeting of the House also featured the “passing of the gavel” from outgoing ABA President Linda Klein of Georgia to new ABA President Hillary Bass of Florida.

President Bass addressed the House and spoke about the initiatives she intends to pursue, starting with ABA Legal Fact Check. “The concept is simple,” she explained. “In an era of alternative news and fake facts, the ABA should be the definitive source of ‘real facts’ when it comes to the law.” So, whenever a politician or member of the media makes a statement about the law that is false or inaccurate, “ABA Legal Fact Check will, within a matter of hours, post the correct facts on the ABA website and distribute the message through press releases,” Bass said.

Bass said the experience of representing *pro bono* two children who wanted to be adopted by their gay foster parents, which led to Florida overturning its ban on gay adoption, was the impetus for her *pro bono* theme this year. Bass aims to match lawyers at firms, bar associations and in-house counsel departments with more than 350 shelters that provide services for the more than 500,000 children who live on the streets. “We will ensure that our volunteer lawyers have the information they need to address the basic legal issues of this population — whether it is issues relating to entering school, obtaining legal identification or expunging a criminal infraction,” she said. “Extending a helping hand to these children will likely change the trajectory of their lives.”

Bass also discussed the newly formed Commission on the Future of Legal Education, chaired by University of Miami Law School Dean Trish White. That group will examine why bar examination scores have plummeted throughout the country and “also look into the role legal education can play in addressing the justice gap, as well as identifying skills that future lawyers will need to provide the most efficient service to their clients,” she said.

Bass noted that research shows that women lawyers in their 40s and 50s, “who should be at the peak of their success,” are leaving the profession. She

will launch a “longitudinal study to better understand why women are leaving the practice of law in huge numbers.” The effort will begin with a summit at Harvard Law School in November.

Earlier, former President Klein addressed the House and reviewed her year as president, drawing lessons from the violence that had just occurred in Charlottesville, Va., over the previous weekend. “We come to New York to celebrate the rule of law,” she said, “and then we turn on our TV sets and what do we see? We see people filled with hate coming to the hometown of the author of the Declaration of Independence. People who don’t believe we are all created equal . . . The lawyers of America must lead in bringing people together and defend the values that unite us,” she said.

Klein said the ABA was “prepared and ready” and responded “quickly and decisively” to the challenges faced throughout her year as president, including: speaking out when the President of the United States “used the nation’s highest office to question the legitimacy of federal judges;” suing the U.S. Department of Education “for renegeing on the promise of Public Service Loan Forgiveness;” objecting that some states “when carrying out the death penalty, put the expiration date of a drug ahead of due process;” speaking out “for public defenders with overwhelming caseloads in understaffed and underfunded offices;” and leading the fight to restore funding when the administration’s budget “zeroed-out federal funds for the Legal Services Corporation.”

Robert Carlson of Montana assumed the office of President Elect of the ABA. In his remarks to the House, Carlson observed, “The ABA is really a family, a community of members with shared values,” he said. “We work together because we recognize the vital role the ABA plays to improve the profession and promote

the rule of law. Where else could you have a president one year from Miami, who is co-president of one of the world’s largest law firms, followed as president by someone from Montana who practices in a six-person firm?” Carlson asked. Of the ABA’s mission, he said, “Justice must be available to everyone and justice must look like everyone. Though we may need to change how we do things,” he concluded, “we won’t change who we are and we will not change what we stand for.”

At Saturday’s opening assembly, the ABA Gold Medal, the Association’s highest award, was presented to John Ferick, professor and former Dean of Fordham Law School. At Saturday’s Thurgood Marshall Award Dinner, the honoree was Judge Robert Katzmann of the United States Court of Appeals for the Second Circuit. In addition, the ABA Commission on Women in the Profession recognized five outstanding women lawyers with its 2017 Margaret Brent Women Lawyers of Achievement Award during a luncheon ceremony on Sunday. The recipients of the Brent Awards were: Professor Nadine Strossen; Nancy Duff Campbell; Judge Bernice Bouie Donald of the U.S. Court of Appeals of the Sixth Circuit; Lauren Stiller Rikleen; and Justice Lynn Nakamoto of the Oregon Supreme Court. Saturday’s Pro Bono Publico luncheon featured remarks by former New York Chief Judge Jonathan Lippman.

The midyear meeting of the ABA will take place in January-February 2018 in Vancouver.

Note: Scott M. Karson is a partner at Lamb & Barnosky, LLP in Melville. In addition to serving as the Suffolk County Bar Association’s ABA delegate, he is the Treasurer of the New York State Bar Association and a former President of the SCBA (2004-05).

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error was dispositive in denying bona fide good faith purchaser for value status under the Recording Act. Perhaps the reason that the court found such issue as dispositive to a preliminary injunction was the irreparable injury that could have manifest had the injunction not been granted. Specifically, a person claiming bona fide good faith purchaser for value status would have a duty to “make inquiries concerning such” notice as it would alert “a reasonably prudent purchaser” of a title issue. Further, had plaintiff not obtained the preliminary injunction and closed on the deed while the improper memorandum remained, plaintiff would have had

inquiry notice. Still further, had All Year Management corrected its memorandum recording prior to plaintiff having recorded such deed, then All Year Management would have had priority under the Recording Statute. As such, this is a good decision and strict compliance is necessary.

Note: Andrew M. Lieb is the Managing Attorney at Lieb at Law, P.C., a law firm with offices in Center Moriches and Manhasset. Mr. Lieb is a past Co-Chair of the Real Property Committee of the Suffolk Bar Association and has been the Special Section Editor for Real Property in The Suffolk Lawyer for several years.