



Current Federal Tax Developments

June 10, 2024

Kaplan Financial Education



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This Week We Look At:

US Supreme Court rules that a requirement to redeem the decedent's shares cannot be considered to reduce the value of the entity, but life insurance proceeds received by the entity to fund the buyout will increase the value

Taxpayer denied relief for late rollover when funds were accidentally transferred from employer plan to Roth IRA

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<https://www.currentfederaltaxdevelopments.com>



This Week We Look At:

IRS rules certain payments related to East Palestine, Ohio derailment are §139 disaster payments

What options exist for an employer with a pending ERC claim?



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<https://www.currentfederaltaxdevelopments.com>



Supreme Court Determines Estate Valuation Impact of Funded Stock Redemption Agreements



Image from Unsplash+/Getty Images

- *Estate of Connelly v. United States*, USSC Case No. 23-146, June 6, 2024
- Issue involves a buy/sell at death arrangement where the corporation holds a life insurance policy intended to fund the buyout
 - Per the 11th Circuit when valuing the entity, the redemption liability fully or at least partially offsets the value of the insurance proceeds
 - The 8th Circuit had ruled in this case that that liability does not reduce the value, though the proceeds do increase the value

Estate of Connelly v. United States (Supreme Court opinion):

<https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/insurance-proceeds-included-estate-tax-value-supreme-court-holds/7k9cn>



Supreme Court Determines Estate Valuation Impact of Funded Stock Redemption Agreements



Image from Unsplash+/Getty Images

- *Estate of Connelly v. United States*, USSC Case No. 23-146, June 6, 2024
- Closely held entities often will use life insurance to fund a buy-sell agreement to provide liquidity to allow other owners to continue the business as a whole - but there are two options to do so
 - Cross-purchase arrangement - each equity holder buys proportionate share of deceased's interests and holds insurance on each to fund this
 - Redemptions agreement - the entity redeems the interest and holds the insurance policy

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Supreme Court Determines Estate Valuation Impact of Funded Stock Redemption Agreements



Image from Unsplash+/Getty Images

- *Estate of Connelly v. United States*, USSC Case No. 23-146, June 6, 2024
- In this case a corporation was owned by 2 brothers
 - Michael Connelly who held 77.18% of the shares
 - Thomas Connelly who held the remaining 21.82%

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Supreme Court Determines Estate Valuation Impact of Funded Stock Redemption Agreements



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- *Estate of Connelly v. United States*, USSC Case No. 23-146, June 6, 2024
 - Buy/sell agreement provided that at either brother's death an independent valuation would be undertaken
 - The other brother would first have the option to acquire the shares at fair market value
 - If the brother declined, then the company was required to redeem the shares at that price
 - Michael Connelly died in 2013

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 - The other brother would first have the option to acquire the shares at fair market value
 - If the brother declined, then the company was required to redeem the shares at that price
 - Michael Connelly died in 2013 with Thomas as the executor of his estate and his son as the heir

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Supreme Court Determines Estate Valuation Impact of Funded Stock Redemption Agreements



Image from Unsplash+/Getty Images

- *Estate of Connelly v. United States*, USSC Case No. 23-146, June 6, 2024
 - Thomas did not have the valuation performed, but rather he negotiated a “fair” price with Michael’s son
 - The corporation had a \$3.5 million life insurance policy on Michael’s life
 - The corporation redeemed Michael’s shares for \$3 million
 - Thomas reported the value of the shares as \$3 million on Michael’s estate tax return

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Supreme Court Determines Estate Valuation Impact of Funded Stock Redemption Agreements



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- *Estate of Connelly v. United States*, USSC Case No. 23-146, June 6, 2024
- When the IRS examined the estate tax return, Thomas obtained a valuation
 - The firm valuing the interest took the position outlined in *Estate of Blount v. Commissioner*, 428 F. 3d 1338 (CA11 2005) that the redemption price was a liability to be considered
 - The IRS disagreed, holding that the redemption proceeds did not reduce the value of the entity, finding the value of Michael's shares with that adjustment were \$5.3 million, not \$3 million

Estate of Connelly v. United States (Supreme Court opinion):
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Supreme Court Determines Estate Valuation Impact of Funded Stock Redemption Agreements



Image from Unsplash+/Getty Images

- *Estate of Connelly v. United States*, USSC Case No. 23-146, June 6, 2024
 - The Supreme Court sided with the IRS in a unanimous decision
 - A key factor was the Court's finding that when a corporation redeems shares, the value must go down - but to accept the estate's numbers we had to find that the corporation was worth the same amount the day after it wrote a \$3 million check to redeem an equity interest as it was the day before

Estate of Connelly v. United States (Supreme Court opinion):

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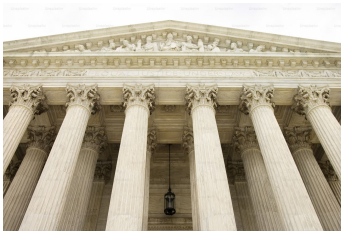


Image from Unsplash+/Getty Images

- *Estate of Connelly v. United States*, USSC Case No. 23-146, June 6, 2024
- The Court in oral arguments noted that Thomas received value from Michael's estate in addition to Michael's son
 - Michael got \$3 million in exchange for his father's interest in the company
 - But Thomas now had a 100% ownership interest in a company worth \$3.86 million rather the 21.82% interest in a company *worth the same amount* on the day before Michael died

Estate of Connelly v. United States (Supreme Court opinion):

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Supreme Court Determines Estate Valuation Impact of Funded Stock Redemption Agreements



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- *Estate of Connelly v. United States*, USSC Case No. 23-146, June 6, 2024
 - The Justices believed that the transfer of value to Thomas was going untaxed if the court followed the 11th Circuit's reasoning
 - The decision raises questions about the use of redemption agreements where the insurance policies to fund the agreement are held by the entity
 - Justice Thomas pointed out that a cross-purchase arrangement would have resulted in a lower valuation, but the brothers decided against going that route

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IRS Denies Relief for Late Rollover, Taxpayer Failed to Show Financial Institution Error



Image from Unsplash+/Mariia Shalabaieva

- PLR 202423009, June 7, 2024
 - Taxpayer was attempting to do a direct rollover from her employer retirement plan to a traditional IRA
 - She requested a trustee-to-trustee transaction to the financial institution that she believed had set up a traditional IRA to receive the funds
 - When she received a Form 5498 it was discovered that the IRA account set up was a Roth IRA account

Private Letter Ruling: <https://www.irs.gov/pub/irs-wd/202423009.pdf>



IRS Denies Relief for Late Rollover, Taxpayer Failed to Show Financial Institution Error



Image from Unsplash+/Mariia Shalabaieva

- PLR 202423009, June 7, 2024
 - A taxpayer cannot rollover from a traditional (non-Roth) employer plan to a Roth IRA - rather she would have needed to “park” the funds in a traditional IRA initially and then undertake a Roth conversion
 - As the funds had left the employer account and had not actually been directly transferred to a traditional IRA, the 60-day rollover rule came into play
 - She did not realize the issue until the 60-day period was over

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- PLR 202423009, June 7, 2024
 - IRS is authorized to grant relief for late rollovers under IRC §402(c)(3)(B) where failure would be against equity or good conscious
 - IRS outlined the items the IRS would consider to grant such relief in Revenue Procedure 2003-16 - one circumstance that will lead to a grant of relief is if the late rollover is due to *financial institution* error
 - Taxpayer argued that is what happened here, but the IRS did not agree (at least based on what she was able to show)

Private Letter Ruling: <https://www.irs.gov/pub/irs-wd/202423009.pdf>

Revenue Procedure 2003-16: <https://www.irs.gov/pub/irs-drop/rp-16-47.pdf>

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- PLR 202423009, June 7, 2024
 - Financial institution error usually requires:
 - Showing a specific step the financial institution took that was clearly erroneous (such as all paperwork filed to open the account clearly specified this was to be a traditional IRA)
 - But if the error is simply because the taxpayer herself managed to herself accidentally direct the institution to create or deposit funds into a Roth IRA that would not count
 - It most often helps if the institution admits the error

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- PLR 202423009, June 7, 2024
 - In this case it appears she failed to give (or prove) sufficient details on how the Roth IRA either came into being or was used to receive the funds
 - We don't know what happened exactly, but one possibility is that she was planning to park funds in a traditional IRA and then move it to a Roth (or at least an adviser believed he/she had told her to do it that way)

Private Letter Ruling: <https://www.irs.gov/pub/irs-wd/202423009.pdf>

Revenue Procedure 2003-16: <https://www.irs.gov/pub/irs-drop/rp-16-47.pdf>



Certain Payments to Those Impacted by the East Palestine, Ohio Derailment are §139(a) Payments



Image from Unsplash+/Ricardo Resende

- Notice 2024-46, June 6, 2024
 - IRS rules on how IRC §139 (qualified disaster payments) applied to certain payments related to the train derailment in East Palestine, Ohio on February 3, 2023
 - The derailment is ruled to be a qualified disaster under IRC §139
 - Ruled certain payments made to victims described in Section 2 of the notice by the common carrier are excluded

Revenue Procedure 2024-46: <https://www.irs.gov/pub/irs-drop/n-24-46.pdf>



Certain Payments to Those Impacted by the East Palestine, Ohio Derailment are §139(a) Payments



Image from Unsplash+/Ricardo Resende

- Notice 2024-46, June 6, 2024
 - Excluded payments include:
 - Payment or reimbursement of relocation expenses, including for hotels, meals, gas or other fuel, pet boarding, and replacement of clothing and other personal items,
 - Payment or reimbursement of expenses for the repair and rehabilitation of homes and surrounding environment (for example power washing, air purifiers, air duct cleaning, and well-water testing),
 - Medical expenses,

Revenue Procedure 2024-46: <https://www.irs.gov/pub/irs-drop/n-24-46.pdf>



Certain Payments to Those Impacted by the East Palestine, Ohio Derailment are §139(a) Payments



Image from Unsplash+/Ricardo Resende

- Notice 2024-46, June 6, 2024
 - Excluded payments include:
 - Medical expenses,
 - Prescription medications,
 - The one-time inconvenience payments of \$1,000, and
 - Compensation to certain affected individuals who sold their homes if the sale was completed after the Derailment

Revenue Procedure 2024-46: <https://www.irs.gov/pub/irs-drop/n-24-46.pdf>



Certain Payments to Those Impacted by the East Palestine, Ohio Derailment are §139(a) Payments



Image from Unsplash+/Ricardo Resende

- Notice 2024-46, June 6, 2024
 - Not excluded from income are:
 - Payments made for the replacement of income, such as lost wages;
 - Payments of any type made to businesses; or
 - Payments made by the common carrier to access the track for remediation or to access creeks or streams for cleaning

Revenue Procedure 2024-46: <https://www.irs.gov/pub/irs-drop/n-24-46.pdf>



Certain Payments to Those Impacted by the East Palestine, Ohio Derailment are §139(a) Payments



Image from Unsplash+/Ricardo Resende

- Notice 2024-46, June 6, 2024
 - Instructions for claiming these exclusions are found in Section 4 of the Notice:
 - For returns not yet filed for 2023, it provides for
 - A PDF attachment to be send with electronic returns or
 - A statement to put at the top of any paper filed Form 1040

Revenue Procedure 2024-46: <https://www.irs.gov/pub/irs-drop/n-24-46.pdf>



Certain Payments to Those Impacted by the East Palestine, Ohio Derailment are §139(a) Payments



Image from Unsplash+/Ricardo Resende

- Notice 2024-46, June 6, 2024
 - Instructions for claiming these exclusions are found in Section 4 of the Notice:
 - For 2023 returns already filed, Form 1040-X should be filed to claim refunds for payments that were included in income.
 - Attach a similar PDF if filing the 1040-X electronically and
 - Put a similar statement on top of a paper filed Form 1040-X

Revenue Procedure 2024-46: <https://www.irs.gov/pub/irs-drop/n-24-46.pdf>

ERC - What About Claims Stalled at the IRS?



Photo by [Xu Haiweij](#) on [Unsplash](#)

- Lauren Loricchio, "Frustrations Mount Over ERC Processing Delays," *Tax Notes Today Federal*, June 4, 2024
 - Article discussed growing frustration with the IRS over processing ERC claims
 - Have seen multiple such discussions recently on CPA Society forums
 - Taxpayer's options are rather limited
 - Does not appear to be any realistic way to force the IRS to act now
 - Can file with US District Court if claim not acted on in 6 months

ERC - What About Claims Stalled at the IRS?

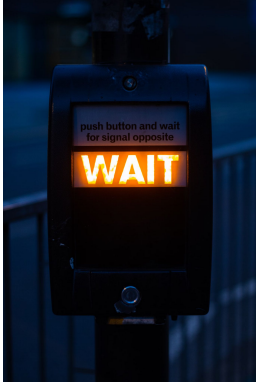


Photo by [Xu Haiweij](#) on [Unsplash](#)

- Lauren Loricchio, "Frustrations Mount Over ERC Processing Delays," *Tax Notes Today Federal*, June 4, 2024
 - There are problems with going to court
 - The costs may be greater than the refund claim (or a huge percentage of such a claim)
 - As well, the case itself will likely take up quite a bit of time
 - Are some cases looking to accelerate this, but seems likely that Courts will simply point to the right to sue as the relief Congress has provided

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