

STETSON UNIVERSITY COLLEGE OF LAW

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Tax Intensive (But Not Too Intense): Don't Fear the Tax Code

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Hierarchy of Authority for IRS Guidance & Sources

1. Internal Revenue Code (Title 26, U.S.C.)
Enacted Statutory Law of Congress

2. Treasury Regulations (TDs in C.F.R.)
Final & Temporary Regulations • Force & Effect of Law

3. Revenue Rulings & Revenue Procedures (RR / CR)
Notices & Announcements • Binding on IRS Personnel

4. Written Determinations (PRLs, TAMs)
Non-precedential (§ 6119(k)(3)) • Invaluable for IRS reasoning in SNTs

5. Other IRS Information: Forms, Publications, Instructions, FAQs & BLM
Helpful guidance, but NOT legal authority – cannot be cited as precedent in an audit or litigation

Adapted from GAO-10-720 Regulatory Guidance Processes | U.S. Government Accountability Office

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PERSPECTIVE & MINDSET

Common Phobias



Ophidiophobia

Evolutionary survival instinct against pit vipers and venom.



Arachnophobia

Anxiety triggered by webs, fangs, and unexpected crawl spaces.



Acrophobia

A physiological terror of losing footing along steep precipices.



Codaphobia

Fear of the Tax Code.

The Antidote: The Tax Code is not random chaos. Once you learn its statutory anatomy and architectural blueprint, the fear vanishes.

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EXPLAINING CODAPHOBIA

Tax Law is Constantly Changing

Major federal tax and statutory acts impacting SNTs, qualified disability planning, and trust taxation.

Major Tax & Legislative Acts Impacting SNTs

- Omnibus Budget Reconciliation Act of 1993.
- Small Business Job Protection Act of 1996.
- Deficit Reduction Act of 2005.
- Health Care and Education Reconciliation Act of 2010.
- American Taxpayer Relief Act of 2012.

Modern Era & Retirement Integration

- Achieving a Better Life Experience (ABLE) Act of 2014.
- Special Needs Trust Fairness Act of 2016.
- Tax Cuts and Jobs Act of 2017.
- SECURE Act of 2019.
- SECURE 2.0 Act of 2022.

Why???

- To encourage social and economic behavior—e.g., § 529A ABLE Accounts & SECURE Act § 401(a)(9) "Eligible Designated Beneficiary Rules".
- To close tax loopholes and eliminate tax avoidance gimmicks—e.g., § 1(e) compressed fiduciary tax brackets & grantor trust rules (§§ 671-678).
- To provide relief to taxpayers—e.g., § 642(b)(2)(C) QDT exemption.

Key Takeaway for SNT Practitioners: Subchapter J (§§ 641-692) in Subtitle A is your primary home base.

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STATUTORY ARCHITECTURE

Breaking Down the Beast: Subtitles & Priorities

Title 26 of the United States Code is divided logically into nine functional Subtitles.

Subtitle A Income Taxes

- §§ 1-1564: Individual & corporate income tax structures.
- Chapter 1: Normal taxes
 - Subchapter A (§§ 1-59A): Rate brackets, § 1(e) trust rates, and credits.
 - Subchapter B (§§ 61 et seq): Computation of taxable income
 - Subchapter J (§§ 641-692): The holy grail for trusts, estates, beneficiaries, and DNI.

Subtitle B Estate & Gift Taxes

- §§ 2001-2801: Transfer tax system.
- Crucial for 3rd-Party SNTs: Completed gift vs. incomplete gift structuring.
- §§ 2036 / 2038: Retained strings pulling 1st-party SNT assets into gross estate for § 1014 basis step-up.

Subtitle F Procedure & Administration

- §§ 6001-7874: Fiduciary compliance rules.
- Form 1041: Reporting filing deadlines and fiduciary responsibilities.
- § 6213: Deficiency notices and the 90-day ticket to the U.S. Tax Court.

Key Takeaway for SNT Practitioners: Subchapter J (§§ 641-692) in Subtitle A is your primary home base.

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CODE NAVIGATION

Deciphering the Hieroglyphics: Anatomical Breakdown

Case Study Example: The QDT Personal Exemption—Section 642(b)(2)(C)

Section § 642

Special rules for credits and deductions of estates & trusts.

Subsection (b)

Deduction for personal exemptions.

Paragraph (2)

Special rules for trusts (simple vs. complex vs. disability).

Subparagraph (C)

Qualified Disability Trusts (QDTs) receive individual-level exemption.

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CODE VOCABULARY

Statutory Magic Words: Congressional "Abracadabra"

Congress has absolute power over Code language; specific phrases alter the operation of law.

"For Purposes of . . ."

The Congressional Redefinition

Signals that a standard English term is being given a specialized, artificial statutory definition that applies strictly to that specific provision.

"Except as Provided . . ."

The Code Red Flag

Warns you that another Code section may override the general rule you are reading. Always stop and check the cross-reference.

"Notwithstanding Any Other Provision . . ."

The Trump Card

Congress tells you to ignore everything else in the Code on point; this specific rule reigns supreme over conflicting general provisions.

Reading the Code requires treating every modifier as an active navigational switch.

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CODE VOCABULARY

Legal Fictions: "Treated As" or "Considered"

When the Code requires practitioners to pretend a transaction is something else.

Retrospective Distribution Fiction

Distributions paid within the first 65 days of Year 2 "shall be considered" paid on December 31 of Year 1 at the trustee's election.

Ignoring the Trust Entity

The grantor is "treated as the owner" of trust assets; for income tax purposes, the IRS pretends the trust entity does not exist.

Trust Taxed as an Estate

A qualified revocable trust is "treated and taxed as part of an estate," unlocking fiscal tax years and charitable set-aside deductions.

In-Kind Distribution "Sale"

An in-kind distribution of appreciated property is "treated as a sale" at fair market value if the trustee elects to realize gain at the trust level.

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ADMINISTRATIVE GUIDANCE

Treasury Regulations: Giving the Monster Fangs

Treasury Regulations carry the force and effect of law pursuant to IRC § 7805(a).

Identify the Tax Arena

- 1.xxx: Income Tax (e.g., Treas. Reg. § 1.671-4 for Grantor Trust reporting).
- 20.xxx: Estate Tax (e.g., Treas. Reg. § 20.2036-1).
- 25.xxx: Gift Tax (e.g., Treas. Reg. § 25.2511-2).

Proposed vs. Final

- Proposed: Published in Fed. Reg. for public notice & comment. No force of law, but can be applied retroactively.
- Temporary: Binding immediately upon issuance; expires after 3 years.
- Final: Published as Treasury Decisions (TDs) in C.F.R.

The Regulatory Lag

- Congress amends the Code frequently; Treasury can take years (or decades) to update regulations. Always verify whether a regulation reflects current statutory text!

Rule of Thumb: Regulations interpret the Code, but they cannot rewrite statutory text enacted by Congress.

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JUDICIAL REVIEW OF TAX GUIDANCE

Slaying *Chevron*: Post-Loper Bright Tax World

The Supreme Court's monumental 2024 shift from judicial deference to independent judgment.

Chevron / *Mayo* Foundation

- Courts deferred to Treasury Regulations if the statute was ambiguous and the regulation was a "permissible construction."
- IRS easily defended regulations by showing reasonableness.
- Gave executive agencies sweeping interpretive dominion over ambiguous tax statutes.

Loper Bright & *Skidmore* Deference

- Courts must exercise independent judgment under the APA; no reflex deference to IRS interpretation.
- Treasury regulations are evaluated under *Skidmore*: given weight only based on the power to persuade.
- Factors: Thoroughness of consideration, validity of reasoning, and consistency over time.

Litigation Impact: The IRS now bears a heavier burden defending pro-revenue regulatory interpretations in court.

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ADMINISTRATIVE GUIDANCE

IRS Pronouncements: Reading the SNT Tea Leaves

From official positions in the Internal Revenue Bulletin to non-precedential rulings.

Revenue Rulings & Rev. Procs

- Revenue Rulings: Official IRS Position. Published weekly in the Internal Revenue Bulletin (IRB). Binding on IRS Personnel: Can be relied upon by any taxpayer whose facts are substantially identical.
- Revenue Procedures: Outline internal IRS administrative practices, calculation formulas, and safe harbor procedures.

Private Letter Rulings (PLRs)

- Issued by IRS National Office: Written for a fee in response to specific taxpayer transactions.
- No Precedential Value: § 6110(k)(3) strictly prohibits citing PLRs as precedent in other cases.
- Invaluable SNT Guidance: Reveal IRS thinking on matters (e.g., first-party grantor trust triggers and completed gift transfers).

Other Sources: Technical Advice Memoranda (TAMs) and General Counsel Memoranda (GCMs) illuminate reasoning.

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LITIGATION STRATEGY

Picking Your Legal Battlefield: Pay First or Fight First?

Strategic forum selection when the IRS issues a Notice of Deficiency.

U.S. Tax Court

- No Prepayment: File within 90 days of deficiency notice.
- Expert Judges: 19 tax specialists; regular decisions create binding precedent.
- No Jury: Bench trial only.
- Golsen Rule: Follows court of appeals precedent for the taxpayer's circuit.

U.S. District Court

- Pay First: Pay deficiency, file administrative refund claim, sue upon denial.
- Jury Trial Available: The only tax forum offering a jury trial.
- Generalist Judges: Appeals go to local Federal Circuit Court of Appeals.

U.S. Court of Federal Claims

- Pay First: Full payment required prior to filing refund action.
- No Jury: Based in Washington, D.C.
- Appeals to Federal Circuit: Bypasses local regional circuit precedent.

Acquiescence Watch: Check whether the IRS acquiesces (agrees) or non-acquiesces in adverse Tax Court rulings.

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CONGRESSIONAL INTENT

Legislative History: How Statutory Sausage Gets Made

Committee reports reveal the rationale, purpose, and mechanical operation behind ambiguous statutes.

The Legislative Gauntlet

- House Ways & Means: Revenue bills must originate in the House (U.S. Const. Art. I, § 7). Produces House Committee Report.
- Senate Finance Committee: Rewrites or amends bill. Produces Senate Report.
- Conference Committee: Resolves House/Senate differences. Generates Conference Committee Report (the gold standard of legislative intent).

When statutory language has multiple interpretations, courts look first to the Conference Report.

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RESEARCH CAUTIONS

Tax Research Caveats: Four Ways to Get Bitten

Common statutory traps where unseasoned estate planners make expensive miscalculations.

Don't Judge by Cover

Section headings are non-binding. E.g., § 677 heading is "Income for benefit of grantor," but the body also taxes the grantor if income is distributed to the grantor's spouse.

Time Travel Traps

Always verify the exact effective date for the tax year in issue. Grandfathered provisions and transition rules often hide in uncodified public laws.

Watch the Boundaries

Scope creep: "For purposes of this subtitle" governs all income taxes (§§ 1–5564), while "For purposes of this section" is strictly confined to that one unit.

Ghost Regulations

Beware regulations that fail to reflect recent statutory amendments, and statutes for which no regulations have ever been promulgated.

Litigation Golden Rule: Never cite a regulation without confirming the underlying Code section hasn't been amended since.

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RESEARCH TOOLKIT

Where to Find Tax Resources: Free & Commercial

High-quality primary and secondary federal tax authorities for trust practitioners.

Free Government & Academic Portals

- Govinfo (govinfo.gov): Official U.S. Government Publishing Office database for Title 26 and C.F.R.
- Cornell Law UI: Fast, hyperlinked Code and Treasury Regulations.
- IRS FOIA Library: Electronic reading room for IRB Bulletins, TAMs, and Chief Counsel Advice.
- IRS Written Determinations: Searchable database of all PLRs issued since 1999.

Commercial & Editorial Databases

- Bloomberg Tax / BNA Portfolios: The undisputed standard for in-depth Subchapter J portfolio analysis.
- Tax Analysts / Tax Notes (taxnotes.com): Real-time daily tax reporting, commentary, and full-text primary documents.
- Westlaw & LexisNexis: Comprehensive judicial citations (KeyCite/Shepard's) to track judicial treatment of rulings.

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THE TAX CONSTANTS (Basic Concepts That Never Change)

3. Pre-Tax vs. After-Tax Dollars: Deductions & QDTs

Tax deductions allow trustees to spend government dollars on the beneficiary's care.

The Math of Deductions

In the 37% bracket, \$1.58 of income yields only \$1.00 after tax. But if spent on a deductible item, the full \$1.58 is utilized—the IRS effectively subsidizes 50.58 of the expense.

QDT Exemption

Qualified Disability Trusts claim a personal exemption equal to an individual taxpayer, instead of the tiny \$100 or \$300 exemption granted to standard trusts!

Muni Bond Trap

Disallows administrative deductions (trustee fees, legal expenses) to the extent allocable to tax-exempt income. Dangerous for municipal bond portfolios!

Drafting Warning: Don't assume special-needs language automatically qualifies a trust as a QDT under § 642(b)(2)(C). Verify all statutory requirements.

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THE TAX CONSTANTS (Basic Concepts That Never Change)

4. Basis: Preserving Your After-Tax Capital

Basis represents the taxpayer's golden shield: the tax-free return of invested capital.

Cost Basis (§ 1012)

Basis starts at cost. Adjusted under § 1016 downward for depreciation and upward for capital improvements.

Step-Up at Death (§ 1014)

Assets included in the beneficiary's gross estate under § 2036 or § 2038 receive a stepped-up basis to fair market value, erasing all pre-death capital gains.

Carryover Basis (§ 1015)

Lifetime gifts into irrevocable trusts carry over the donor's historical basis. Built-in appreciation remains taxable to the trust when sold.

Estate Planning Pointer: Testamentary 3rd-party SNT funding receives a stepped-up basis; lifetime funding triggers carryover basis.

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THE TAX CONSTANTS (Basic Concepts That Never Change)

5. Realization and Recognition

Satisfying Fixed Pecuniary Bequests

- Distributing appreciated non-cash assets to fund a specific dollar amount bequest (e.g., "\$100,000 to the SNT").
- Tax Trap: Treated as a taxable sale or exchange.
- The trust or estate realizes immediate capital gain on the difference between basis and fair market value!

Discretionary In-Kind Distributions

- Standard discretionary distribution of appreciated property in-kind does not trigger gain realization.
- Trust's basis carries over to the beneficiary.
- Elective Sale (§ 643(e)(3)): Trustee can affirmatively elect to recognize gain at the trust level if beneficial.

Checklist Warning: Before funding any fixed-dollar bequest with appreciated assets, obtain tax advice regarding gain recognition.

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THE TAX CONSTANTS (Basic Concepts That Never Change)

6. Tax Accounting—The Taxable Year and Accounting Methods

Constructive receipt hazards and prepayment limitations under IRC § 446.

Cash Method Realities

- Income: Reported when actually or constructively received (Treas. Reg. § 1.451-2). If a beneficiary has an unfettered right to demand funds, income is taxable immediately.
- Deductions: Taken when paid.
- Prepayment Trap: Prepaying trustee fees or legal expenses in December must be capitalized unless within the narrow 12-month rule (Treas. Reg. § 1.263(a)-4(f)(1)).

Accrual Method & Performance

- All-Events Test: Income included when the right to receive is fixed and determinable (Treas. Reg. § 1.446-1(c)(1)(ii)).
- Economic Performance (§ 461(h)): Deductions unlocked only when services or property are actually provided.
- Prepaying a care provider for 5 years of future care unlocks deductions only year-by-year as care is rendered.

Fiduciary Rule: Almost all SNTs utilize the cash method. Beware constructive receipt when allocating trust accounts.

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Patient Status: Discharged & Fully Rehabilitated

Codaphobia: Full Recovery

Before



After



Diagnostic Findings: Anatomy of Title 26 decoded. Fluent in statutory magic words. Equipped with the 6 Tax Constants that never change!

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