Smaldino: Recent Tax Court Case Has Important Lessons On How To Do Estate Planning Right!

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Smaldino: Recent Tax Court Case Has Important Lessons On How To Do Estate Planning Right!

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The Case

Overview of the Smaldino Case

Introduction

- Smaldino V. Commissioner Of Internal Revenue, T.C. Memo. 2021-127, November 10, 2021.
- There are two broad aspects to the Smaldino case. One deals with appraisal issues which we will not discuss, and the other deals with planning considerations, which we will delve into in depth.
- From a planning perspective a gift by husband to wife and then wife to an irrevocable trust was recast. Implementation and administration failed or was mishandled from several perspectives. That’s the case in a nutshell.
- Some have dismissed it as a “bad facts, bad law” case. The case has many bad facts but dismissing it as nothing more ignores a great opportunity to learn about how the Smaldino court viewed their transaction and some of the aspects of a plan that may be challenged.
- Provides important lessons for practitioners to consider about how to approach structuring and implementing estate plans for certain clients, especially for clients that practitioners did planning for during the rush throughout 2020 and 2021.

Bad Planning; No Follow Through

1. Mr. Smaldino was certified public accountant (CPA) and even had worked as a CPA. Mrs. Smaldino had a master's degree in economics, so she too should have had the sophistication to have some understanding of the planning they pursued. In addition, the family's real estate portfolio was worth about $80 million, so the family operated a sophisticated and large real estate empire.
2. As a CPA, Mr. Smaldino should have well-understood the need for legal and tax formalities and Mrs. Smaldino should have understood the business/economic shortcomings of the plan. Also, with wealth of the level involved in this case, the family can and should have had a collaborative team of capable advisers (lawyers, accountants, wealth advisers, etc.) that worked together to assure that their estate plan was properly planned, drafted and implemented.

- **LESSON**: Practitioners should be careful in gauging clients and their ability to complete planning, and offer options based upon their discussions with the clients.

Waiting for a Health Emergency

- When Mr. Smaldino was 69, a health scare motivated him to get his estate planning in order. In fact, the Court noted that the LLC was formed in 2003 but it remained inactive until late 2012. The Smaldino's started the process and perhaps got busy with "life" and only may have revisited planning when health concerns became pressing. No clients should wait for health emergencies (or similar external events) to begin planning. All clients need plans that work for their wealth level and other circumstances.
- Waiting, as in the case of the Smaldino's, is not only a bad idea, but that might have been a contributing factor to the rushed planning that led to a step transaction issue in the case.
- **LESSON**: Practitioners who are under time pressure to complete planning, either from events such as possible tax changes or client health scares, should be mindful of avoiding being swept up in the moment, take a step back and ensure that all needed steps are being taken.

Facts - LLC

- Mr. Smaldino owned and operated numerous rental properties.
- Established an LLC, Smaldino Investments, LLC ("LLC"), in 2003, as well as a California revocable trust called the Smaldino Family Trust. The LLC went unused until late 2012, when Mr. Smaldino transferred entity interests in 10 different parcels of real estate into the LLC. The LLC's ownership structure was restated so that there was 10 Class A Voting units and 990 Class B Non-Voting units, all of which were initially held under the Smaldino Family Trust.
- It appears that planning was completed late in 2012. While a significant portion of the planning the Smaldino family completed was in 2013, the planning team may have begun the process and drafted documentation in 2012. That year is somewhat similar to the situation practitioners have been facing in 2020 and 2021 in that there was a massive crush of work completed in a short span of time, so many steps that Mr. Smaldino took (or should have taken) may have been compressed or missed by the planning team due to that fact.

Facts - LLC

- **LESSON**: Planning conceived or completed under pressure should be followed up upon later to see if any portion of the planning was either missed or not implemented correctly.

LLC – Ancillary Comments

- In Smaldino it seems that multiple rental properties were held in a single LLC. The structure of having multiple rental properties owned in separate LLCs is a prudent way to endeavor to minimize a client's personal liability so if a tenant or anyone else, for example, sues the client for harm arising from the property owned by the LLC, the tenant (or other creditor) should only be able, as a general matter, to reach the assets held in the LLCs, not the client's other personal assets. Having each property held in a separate LLC to prevent a "domino" effect of a judgment against one property being able to reach the assets of the other properties held in the LLC. That way, if there is a lawsuit against one property, the others might remain "untouched."
- If the plan included establishing a trust in a trust "friendly" state (e.g., Alaska, Nevada, South Dakota) consider establishing the LLC in the state that the trust will be governed under, and then have the LLC authorized to do business in, the state where the real property assets are located. This may help provide additional nexus, to the trust-friendly jurisdiction.

LLC – Ancillary Comments

- Mr. Smaldino had the LLC interests owned by the revocable trust that he established. If the intention of the planning is for the client to transfer interests to an irrevocable trust, transferring those interests to a revocable trust first would create additional steps such as changing title to the trustees of the revocable trust and assuring that the revocable trust has adequate gifting provisions to support the later gratuitous transfers.

Dynasty Trust

- On December 21, 2012, Mr. Smaldino established the Smaldino 2012 Dynasty Trust ("Trust"), which was established for the benefit of his children and grandchildren.
- The case noted that the Smaldino family was "blended," with all of Mr. Smaldino's children being from a previous marriage.
- In 2013, Mr. Smaldino transferred about 8% of the Class B Non-Voting member interests to the Trust, which is the amount he reflected on his gift tax return.
- A later gift by Mrs. Smaldino was made of the LLC Class B Non-Voting member interests to the Dynasty Trust.

Dynasty Trust – Ancillary Comments

- Mr. Smaldino was in a second marriage and his spouse was not included as a beneficiary of the trust he established. For clients who advise counsel that they are in a solid marriage, using a trust that includes the client's spouse as a beneficiary might be an option to propose to a client, as that preserves access, through the spouse, to the trust assets after the gift. Although measures might be taken in any event to address the potential implications of divorce even if the clients view that as remote. While Mr. Smaldino opted not to include his spouse, a floating spouse clause may have been acceptable and provided more access.

Gifts by Mr. Smaldino to Mrs. Smaldino

- Mr. Smaldino "purportedly" transferred about 41% of the LLC membership interests to his wife on April 14, 2013. Mrs. Smaldino "purportedly" gifted those same interests to the Dynasty Trust the next day.
- The Court recharacterized the claimed gift Mr. Smaldino made to his wife, followed by her gift to the Dynasty Trust, as if Mr. Smaldino himself had made the gift directly to the Dynasty Trust.

Gifts by Mrs. Smaldino to the Dynasty Trust - Generally

- Mrs. Smaldino held the interests only for a day.
- She transferred the same exact interests she received from her husband as a gift to her, as her gift to the Dynasty Trust, and the family and their advisers skipped numerous steps that should have been followed to corroborate that they respected the transaction.
- While the interests were transferred by Mrs. Smaldino to the Dynasty Trust the day after she received them, there was additional discussion in the case regarding if she ever had dominion over the assets at all, due to the fact that the transfer documents were not dated when signed, they merely had an effective date.

LESSON: How Long Must Assets Be Held?

- How long is long enough to hold on to an asset before retransferring it? What should practitioners recommend to clients, or discuss with them regarding the timing between phases of a transaction? Practitioners will need to carefully communicate with clients the various concerns, advantages and disadvantages to how long to hold assets in spouses' names to defray the various challenges the IRS can argue to collapse transactions. Practitioners may need to consider providing different suggestions to clients based on the facts of the case, as the kind of assets being transferred could affect what is a sufficient amount of time between phases.
- In the *Holman* case, the Court accepted six days as sufficient time between phases of a plan. In *Holman*, the IRS also argued that the gift should be viewed as an indirect gift, applying the step transaction doctrine in that instance. Holman v. Commissioner, (2008) 130 TC 170 (2008). aff'd, 601 F.3d 763 (8th Cir. 2010).

LESSON: How Long Must Assets Be Held?

- One of the common themes that can be identified between *Smaldino* and *Holman* is economic substance. The courts want to see that there was the potential for real and meaningful economic impact during the time period any person or entity held interests, or they may not respect the purported form of that transaction as it was structured.

Gifts Mrs. Smaldino to the Dynasty Trust – Her Intent

- Intent when transferring assets is important.
- Mrs. Smaldino testified that before the purported transfer in question she had already made "a commitment, promise" to her husband and family that she would transfer the LLC units to the Dynasty Trust. When asked on examination whether she could have changed her mind if she had wanted to, she responded: "No, because I believe in fairness."
- Mrs. Smaldino's testimony that she had no intent to hold the equity interest contradicted the purported substance of the transaction that was presented by her supposedly accepting ownership of the interests.
- **LESSON**: Too often clients become impatient with planning, don't want to devote the time or effort to understanding their transactions, or want to minimize professional fees and thus avoid the meetings or memoranda necessary to their better understanding the transactions. Practitioners should be cautious in allowing clients to take such short-cuts. A common claim in malpractice cases is that the client did not understand the plan or transactions.

Formalities

Boring but Critical

Formalities Must Get Respect

- **<u>LESSON</u>**: Respecting the formalities of entities and trusts is essential.
- It is fundamental for much of legal and tax planning that, in order for creditors, the IRS, or others to respect legal structures clients establish as real, the clients themselves should first respect the formalities and maintenance of their separate legal entities. The Smaldino's, even with their formal training (CPA; economics), ignored most formalities.
- Perhaps, the **classic example** is that of clients establishing corporations or limited liability companies in which to operate their businesses. A traditional purpose of doing so is to insulate personal assets from business creditors. Yet, if clients ignore the formalities and reality of the entities (for example, by commingling personal and business funds, using business assets personally such as by having the clients' spouses' personal use cars owned by the businesses, and so forth), the courts and IRS will be loath to respect the entity. This is such a common issue that the phrase "piercing the corporate veil" is used to describe the legal theory of breaking through entities form to reach the clients personal assets as if the entities did not exist.

Formalities Must Get Respect - LLC

- When evaluating the actions taken by the Smaldino's, they did not do well in regard to respecting the formalities of their entity regarding the gift Mr. Smaldino tried to claim he made to his wife. Adhering to the **formalities of the operating agreement restrictions** would not have taken much effort, Mr. Smaldino as trustee of the Dynasty Trust and as manager of the LLC could have given written consent for the admission of Mrs. Smaldino as a member, showing adherence to the formalities required by the operating agreement of the entity.

Formalities Must Get Respect - LLC

- The Court in Smaldino specifically stated "*The record does not suggest that petitioner, in his dual roles as trustee of the Smaldino Family Trust and as manager of the LLC, gave express or implied consent for the admission of Mrs. Smaldino as a member in disregard of the operating agreement's restrictions. To the contrary, the record shows that on April 15, 2013—a day after he purportedly transferred the LLC member interests to Mrs. Smaldino—petitioner executed an amendment to the LLC operating agreement (providing for guaranteed payments to himself) which identified the Smaldino Family Trust as the LLC's 'SOLE MEMBER'.*"
- The Court further notes that "*The LLC's operating agreement was never amended to account for any transfer of units to Mrs. Smaldino. However, exhibit A of the operating agreement was amended 'as of April 15, 2013' to show the Dynasty Trust as holding a 49% ownership interest in the LLC.*" Practitioners should consider whether the failure to adhere to formalities for the gift to Mrs. Smaldino, and then adherence to the formalities for the transfer to the Dynasty Trust, may have hurt the Smaldinos case.

Formalities Must Get Respect - LLC

- **LESSONS**: The lessons of this particular piece of the saga are simple, but central to defending the structure of a plan that includes numerous different legal entities. One must adhere to the legal requirements for a gift and any other estate planning transaction.
- Practitioners should document for any aspects they are involved in and instruct clients to document and retain that documentation for steps the practitioner may not be assisting with, what actions have been taken, and documents prepared, in compliance with the various requirements each of the legal entities involved may have.
- Communicate with clients on the need to confirm that all formalities for their various entities, trusts and plans, similar to the concepts that arose in *Smaldino* but tailored to clients' unique planning structure, have been addressed. If it is determined that steps have been missed or not properly documented, practitioners should recommend to the clients that they should consult with the entire planning team to determine what steps, if any, can be taken to ameliorate the situation.

Formalities Must Get Respect – Dates on Legal Documents

- The problem with dates of legal documents in the Smaldino case was significant. The Court felt that the taxpayers were **disingenuous** in regard to the dates of the documents. The Court noted that the appraisal report that valued the LLC was dated August 22, 2013. The Court believed that the **documents were actually signed after the appraisal, months after their effective dates**.
- Worse yet, consider that in the Smaldino situation, if the documents were actually signed long after the supposed gift to Mrs. Smaldino, she could not have had any opportunity to exercise her ownership over the LLC interests Mr. Smaldino gave her. According to the Court's position, by the time the family signed the legal documents, the effective dates already had the Dynasty Trust owning the LLC interests. The inability for Mrs. Smaldino to exercise any control over the LLC interests she was purported to have received undermines the planning steps the family attempted to take and contributed to the adverse result for the family. Practitioners should focus on the accuracy of the timing and dating of legal documentation and that clients understand the effects that failures to follow dating sequences in transactions can have.

Formalities Must Get Respect – Dates on Legal Documents

- The legal document used to transfer the LLC interests from Mr. Smaldino to Mrs. Smaldino said that it was "Effective: April 14, 2013" but it did not include a section for each individual signing the document to indicate when that individual actually signed it.
- **LESSON**: There is nothing inherently wrong with indicating a date a document should be effective (as long as the effective date is not contradictory to the facts). However, legal documents could indicate the date they were actually signed even if there is a different effective date. Having a transaction present a clear timeline of how steps proceeded may help prevent an alternative, and adverse to the client, sequence of events being asserted during an audit or other challenge.

Formalities Must Get Respect – Create and Sign Essential Documents

- In *Smaldino,* the facts belied the legal document. Through the assignment from Mr. Smaldino to Mrs. Smaldino, she legally only held the LLC interests for a day. In addition, there were no additional legal documents or actions taken to support that assignment. Mrs. Smaldino never signed an operating agreement, never received a distribution, was not listed as an owner on the LLC income tax return and acknowledged in testimony that she had no intent of retaining the interests.

Formalities Must Get Respect – Create and Sign Essential Documents

- After each transfer of LLC membership interests there should have had been a signing of updated governing documents (e.g., operating agreement or perhaps a joinder agreement) to reflect the changes in membership interests. Pro-rata distributions from the LLC to each of the members could have been made during even a short period that Mrs. Smaldino held interests.
- Having properly drafted and executed legal documentation is critical for clients to enhance the likelihood of their plans succeeding, but it may not suffice to win a challenge by the IRS. Mr. Smaldino did in fact sign a certificate of assignment transferring interests in the LLC to Mrs. Smaldino. The courts don't consider legal papers as controlling for tax purposes when the objective economic realities are contrary to the content of those documents. The Court said that this was "*a factor to be considered, [but it] is not controlling.*
- **LESSON**: Practitioners should recommend that all the formalities that they would recommend to third party transactions be followed in family/estate planning transactions. A client buying into an LLC with an unrelated party would certainly be advised to execute appropriate governing documents.

Formalities Must Get Respect – Tax Reporting – Partnership Reporting

- In Smaldino, the LLC filed its initial partnership income tax return (Form 1065), U.S. Return of Partnership Income. On the Schedules K-1, Partner's Share of Income, Deductions, Credits, etc., attached to the Form 1065, the LLC listed Mr. Smaldino as a 51% partner, and the Dynasty Trust as a 49% partner for the entire tax year. Mrs. Smaldino was not listed as a partner for any part of the tax year. Thus, the income tax returns did not reflect a partial year ownership (1 day) for Mrs. Smaldino, which was contradictory to the position the taxpayers' tried to argue.

Gifts by Mr. Smaldino to Mrs. Smaldino – Gift Tax Reporting

- As a gift to a US citizen spouse is not a taxable event (to the extent qualifying for the gift tax marital deduction), clients therefore do not need to report such a gift on a Form 709.
- The instructions to Form 709 provide: "Gifts to your spouse. You must file a gift tax return if you made any gift to your spouse of a terminable interest that does not meet the exception described in Life estate with power of appointment, later, or if your spouse is not a U.S. citizen and the total gifts you made to your spouse during the year exceed $157,000. You must also file a gift tax return to make the qualified terminable interest property (QTIP) election described under Line 12. Election Out of QTIP Treatment of Annuities, later. Except as described earlier, you do not have to file a gift tax return to report gifts to your spouse regardless of the amount of these gifts and regardless of whether the gifts are present or future interests."
- **LESSON**: perhaps, as in the Smaldino case, practitioners should discuss the pros and cons of reporting a spousal gift, even if it not required to do so, on the Form 709. Reporting that gift could potentially provide additional evidence of respecting the transfer and the process of the planning.

Formalities Must be Respected – Tax LESSONS

- **LESSON**: Often clients do not want to involve their counsel in communicating with the CPAs preparing tax returns for entities and trusts, believing that attorneys roles are completed once the documents for transactions are signed. Practitioners should caution clients as to the critical role that these documents can play in supporting the positions taken in the transactions, and how the planning teams should be involved in the transactions, from inception to implementation to reporting.
- **LESSON**: It is imperative that all tax reporting (income and gift tax returns), legal documents (assignments, operating agreements, etc.), economics (e.g., distributions), third party documents (trust records) be consistent with the position the clients intend to achieve.

Legal Doctrines Tripped up the Smaldinos

Substance was Lacking in Smaldino Transactions

Circular Nature of Transaction

- The value of LLC interests that Mr. Smaldino transferred to Mrs. Smaldino were equal to her then available Federal estate and gift tax exemption. That was the same value which Mrs. Smaldino purportedly transferred to the trust as her gift the following day.
- **LESSON**: It would have been advisable not to have consummated the transaction with similar amounts/interest on each phase. It may have been wiser for Mr. Smaldino to have transferred a larger LLC interest to Mrs. Smaldino so that his gift to her, and her gift to the trust were, not identical, but of course, that would have meant she would really own a portion of the LLC. Perhaps, he should have also transferred additional assets to her which she might not have transferred to the trust for his descendants. Practitioners should consider discussing with clients how to vary the transfers made in each phase of a transaction.
- Varying the types of assets transferred in each phase. Consider if Mrs. Smaldino had instead of transferring the same LLC interests she had just received from Mr. Smaldino to the trust, she had instead transferred a portion of the LLC interests, retained a slice of those LLC interests, and then gifted cash and/or marketable securities to make up the difference for the LLC interests she retained in her own name. This would then cause Mrs. Smaldino to continue to be a member of the LLC, even after the transfers are completed, while still having the same value of transfers made to the Dynasty Trust.

Steps Should have Economic Consequences

- In *Smaldino*, there was no economic consequence to Mrs. Smaldino holding interests in the LLC for one day before regifting them to the ultimate donee, the Dynasty Trust. That lack of economic reality, coupled by all the missed formalities, made the court conclude that Mrs. Smaldino was no more than a "straw person" passing the interests on as Mr. Smaldino wished.
- **LESSON**: The courts have often recognized that the tax consequences of transactions involving nominees or straw parties must be determined with regard to the true beneficial interests involved. Transactions which do not vary, control or change the flow of economic benefits are to be dismissed from consideration.
- Snyder v. Commissioner, 66 T.C. 785, 791 (1976).

Substance Over Form

- In the *Smaldino* case, the court applied the doctrine of substance over form to disregard petitioner's purported transfer of the LLC member interests to Mrs. Smaldino and her purported retransfer of those same interests to the Dynasty Trust a day later because the court found their actions were part of a prearranged plan between all the parties involved to effectuate the transfer of the ownership of the LLC from Mr. Smaldino to the Dynasty Trust.
- **LESSON**: The substance of transactions, rather than the form in which they have been cast, can determine the tax consequences from those transactions. This is an important touchstone for practitioners to evaluate all planning against. The courts have used substance over form principles to recharacterize multistep property transfers among related parties as indirect gifts between the persons who were determined to be, in substance, the actual donors and donees.

Marital Deduction Doesn’t Supersede Substance Over Form Doctrine

- Mr. Smaldino tried to argue that because the tax law permitted him to make a gift to his wife, that gift should be permitted and the substance over form doctrine should not apply. The Court responded that the marital deduction rules do not supersede the substance over form doctrine, and under that doctrine Mr. Smaldino’s actions were ineffective to transfer membership interests in the LLC to Mrs. Smaldino.
- Therefore, the Court sided with the IRS in concluding that Mr. Smaldino, in substance, made all the gifts to the Dynasty Trust.
- **LESSON**: Practitioners might use this example to communicate to clients that the marital deduction is not a cure-all for defective transactions, and that the various phases of the transactions must be completed properly to afford a better chance for the planning to be successful. For example, in funding the many spousal lifetime access trusts (“SLATs”) and other irrevocable trusts created and funded on a rushed basis in 2020 and 2021, if assets were retitled between spouses prior to the donee spouse making a gift, the issue in the *Smaldino* case may be present and the marital deduction argument advanced in *Smaldino* won’t be effective.

Related Party Transactions

- The court notes that heightened scrutiny is appropriate for cases, such as in *Smaldino*, where all the parties to the transactions in question are related.
- **LESSON**: The courts have viewed family transactions as affording much opportunity for deception and that therefore those transactions should be subject to close scrutiny. Estate planning transactions are invariably between related parties, so communicating to clients that greater caution and care in assuring that the substance of the transaction does not compromise the intended results, specifically through the steps taken (and implemented properly) and the documentation prepared is important.
- The court quotes several cases for this doctrine: "*See…Kuney v. Frank, 308 F.2d 719, 721 (9th Cir. 1962) ('Transactions between persons in a close family group, whether or not involving partnership interests, afford much opportunity for deception and should be subject to close scrutiny.' (quoting H.R. Rept. No. 82-586, at 33 (1951), 1951-2 C.B. 357, 381)); Estate of Bongard v. Commissioner*, 124 T.C. 95, *119 (2005) ('A transaction between family members is * * * subjected to heightened scrutiny to ensure that it is not a sham or disguised gift.')*"

LESSONS – Holding Period

- Mrs. Smaldino only held the interests in the LLC for a day. It would have been preferable to have more time pass between the date of the gift and the gift from the spouse to another entity. Some commentators recommend a minimum of 30 days, some say 60+, many agree the more time the better. Tax Court cases in related areas have respected timelines less than 30 days. Throughout 2020 and 2021 many clients feared imminent, even retroactive, tax changes. So, waiting was an anathema to getting planning done before unknown effective dates of new rules (which may never happen). Practitioners completed transactions at a pace that was deemed needed based upon the facts they had at hand. Will that environment change how a court might view transactions done close in time? Perhaps not, but at least there are objective external circumstances that practitioners can point to as the reason for compressed planning if it is later challenged.

LESSONS – Corroborate Ownership in Donee

- During the period Mrs. Smaldino held the LLC interests, there might have been a distribution to confirm the reality of her economic ownership.
- Perhaps, other actions may have occurred during the period of her ownership, e.g., her voting in accordance with the governing documents on an important matter, to demonstrate real ownership.
- The court in Smaldino notes that there was no amended and restated operating agreement signed while Mrs. Smaldino was owner of the LLC interests. When donees receive an interest in entities, they should sign governing legal documentations agreeing to be bound by them. That should have been done in Smaldino to evidence the reality of Mrs. Smaldino's interests. Similarly, after her later transfer of interests to the Dynasty Trust, another amended and restated operating agreement should have been signed reflecting the Dynasty Trust as owner (this was in fact done).

LESSONS – Correct Prior Transactions

- For any clients that have completed planning, if practitioners did not handle updating the governing documents for all entities involved in the planning themselves, the practitioner should communicate to the clients to confirm the clients' corporate counsel created amended and restated governing documents (operating agreements for LLCs, shareholders' agreements for corporations, or partnership agreements for partnerships). If amended documents were not prepared for each of the phases of the transactions, practitioners should encourage clients to do so now, being certain (also as noted in Smaldino) to have the documents dated as of the date they were executed, even if made effective as of the date of the transfer being documented. While dating a document as effective as of a prior date (even in a prior year) is not ideal, it might still demonstrate respect for the formalities of the entities involved.

Conclusion and Additional Information

Lessons to Learn

Conclusion

- Many tax advisers might dismiss the Smaldino case as "bad facts-bad law." That would be a mistake. Some of the oversights in the Smaldino case are common issues that arise in many transactions and could be caused by clients not involving their professional planning teams in the administration of their plans after implementation. Too often clients will take actions without even understanding that it is the kind of action they should ask their team how to address with before taking.
- Instead of dismissing the *Smaldino* case, practitioners should glean lessons about how to communicate with clients regarding common issues that may need to be reviewed to address in existing estate planning transactions, and how to structure new estate planning to reduce the potential for the of issues found in *Smaldino* from occurring.
- *Smaldino* is really a lesson about the danger of clients not wanting to dot the "i's" or cross the "t's." It is about the danger of frenetic estate tax planning and the need for not rushing projects, no matter what proposed tax bills may provide.

Conclusion

- While there certainly were bad facts in the Smaldino case, there is no bright line as to how many issues can occur with a plan before they may cause clients' planning to fail. How many any issues need to be identified by an IRS auditor during a challenge will weaken the client's argument and contribute to a potential adverse outcome for the client. Consider communicating to clients that it is better to be cautious and confirm their planning is in order, that it adheres to legal and tax formalities, and that the underlying economics support the tax objectives they endeavoring to achieve.

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