Folks:

**Take-Away:** High net worth individuals with whom we work are often the targets of tax scams. The IRS just provided a Warning about three that are not being ‘regularly identified’ in its recent enhanced compliance audits of high-net-worth individuals.

**Background:** On April 10, 2024, the IRS issued a Warning to high-net-worth individuals about three tax traps that are currently promoted by what it calls ‘shady tax practitioners.’ Examples highlighted in the Warning, part of its *Dirty Dozen Campaign* for 2024, include inflated art donation deductions to extreme charitable remainder annuity trusts and or planning ‘strategies’ designed to delay paying capital gains. The IRS has become aware of these ‘schemes and scams’ as it increases its compliance work involving high net worth individuals who are targeted for these ‘schemes and scams.’ The three identified tax traps in the Warning are summarized below.

**Inflated Artwork Donation Deductions:** Apparently there are now promoters who aggressively use direct solicitations to promise or guarantee values of artwork that are in the ‘too good to be true’ category, by encouraging the high net worth individual to purchase art at a discounted price, including fees for storage, shipping, appraisal, and donation. The promoter then encourages a one-year holding period. The artwork is the contributed to a charitable remainder trust (CRT) for which a charitable income tax deduction is claimed using the over- inflated fair market value- a charitable income tax deduction that is for substantially more than what was actually paid for the artwork. The promoters also encourage the individual purchasers to donate art annually and allow them to purchase a quantity of art that guarantees to them a specific deductible amount and then arrange for some ‘select’ charities to take the

artwork donation.

**Basis *Step-up* CRATs:** According to the IRS, charitable remainder annuity trusts (CRATs) are being ‘misused’ to eliminate capital gains. This tax strategy entails appreciated property to be transferred by a donor to a CRAT. The IRS states that the donor then wrongly claims the transfer of the appreciated asset to the CRAT, which gives those assets a *step-up* in income tax basis to fair market value, as if the asset had been *sold* to the CRAT. The CRAT then sells the asset but does not recognize any gain due to the claimed *step-up* in tax basis. The CRAT then purchases a single premium immediate annuity using the sales proceeds. The CRAT beneficiary then reports, as income, only a small portion of the annuity he/she receives. In short, through a misapplication of the law that relates to CRATs, the CRAT beneficiary treats the remaining portion of the annuity payment as a ‘return on investment’ for which no income tax is due.

**Monetized Installment Sales:** With this scheme, the promoters look for individuals who seek to defer recognition of gain upon the sale of their appreciated property, and then form an ‘abusive’ shelter through selling them monetized installment sales. According to the IRS,  an intermediary purchases the appreciated property from the seller in exchange for an installment note, which normally provides for payments of interest only, with principal paid at the end of the note term. Under this arrangement the seller receives the ‘lion’s share’ of the proceeds but improperly delays gain recognition on the appreciated property until the final payment on the installment note, often many years later.

**Conclusion:** We at Greenleaf Trust have the privilege of serving many high-net-worth individuals. We understand that those individuals are regularly approached by other ‘advisers’ with ‘great ideas’ for helping them to save taxes. We owe it to those who we serve to alert them to some of these high-risk tax ‘traps’ that are now being aggressive promoted throughout the country. As the IRS notes in its Warning, “if its too good to be true, then it probably isn’t true.” That’s good advice we can all understand.

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