Selected Recent Developments and Current Trends in Estate Planning

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By

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Selected Recent Developments and Current Trends in Estate Planning

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I. THE IMPACT OF 2020 AND 2021 ON ESTATE PLANNING

A. Introduction

The years 2020 and 2021 were like no other in the memory of most of us. We were all impacted in a significant way by the onslaught of COVID-19, the economic dislocation that followed, social unrest unmatched since the 1960s and some polarizing national elections. Estate planning professionals strove to adjust to what some referred to as "the new normal." Without doubt, estate planning evolved – in some ways, perhaps, permanently.

At this time, and for the indefinite future, as a result of the 2017 Tax Act,[1] individuals have a greatly enhanced, historically high basic exclusion amount.[2] This large basic exclusion amount is scheduled to be reduced significantly on January 1, 2026,[3] and could be reduced by legislation at any time before that date.

Thus, clients having significant wealth who wish to maximize their use of what could be a fleeting opportunity to use the basic exclusion amount now in place may wish to consider expeditiously making one or more lifetime taxable gifts that fully absorb the basic exclusion amount. Individuals making gifts sooner rather than later will remove more appreciation from their gross estate, which would be highly beneficial if the basic exclusion amount declines on January 1, 2026 or sooner. Making a gift, however, is always subject to the risk that a basis step-up upon the owner's death with respect to the gifted asset will be forfeited. Moreover, if the basic exclusion amount doesn't decline, an individual whose net worth is safely under the basic exclusion amount may regret having made a gift to remove post-gift appreciation and income with respect to the gifted asset(s) from his or her gross estate.

B. A Few Specific Strategies

- Outright gifts to children and/or more remote descendants
    - Conceptually simple.

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[1] An Act To Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, Pub. L. No. 115-97, (December 22, 2017).
[2] The term "basic exclusion amount" is defined in IRC Section 2010(c)(3). The current basic exclusion amount is $12,920,000.00.
[3] To $5,000,000.00, indexed by the cost-of-living adjustment referenced in IRC Section 2010(c)(3)(B)(ii). *See* IRC Section 2010(c)(3)(C).

- Generally, quick and easy to implement.

- Gifts in trust exclusively for children and/or more remote descendants
  - The longer the term, the more efficacious. A large gift to a long-term irrevocable trust fully utilizing a client's basic exclusion amount, to which the client's GST exemption is allocated, puts potentially very substantial value in a vehicle that for the indefinite future escapes estate tax, gift tax and generation-skipping transfer tax and enables the fine-tuning of income tax consequences (basis step-up using formula general powers of appointment for beneficiaries and minimizing income taxes for the trust and its beneficiaries through the making of judicious distributions).
  - The benefit is maximized if the trust is a "grantor trust" for income tax purposes.

- "Spousal lifetime access trusts" ("SLATs")
  - All the rage these days.
  - If the marriage dissolves, a SLAT strategy can backfire badly.
  - Take care to avoid the reciprocal trust doctrine, step transaction doctrine and conferring interests and/or powers than could cause inclusion in the gross estate of the Settlor's spouse or the Settlor.

- Defined value gifts
  - Make gift, outright or in trust, the terms of which gift provide that any amount of the gift in excess of the donor's basic exclusion amount, as finally determined for federal tax purposes, shall pass in a manner not triggering a requirement to pay gift tax.[4]
  - Excess amount could pass:
    - In a manner qualifying for the gift tax marital deduction or charitable deduction;
    - To a zeroed-out grantor retained annuity trust ("GRAT"); or
    - To an incomplete gift trust.

[4] *See Estate of Christiansen v. Commissioner*, 130 T.C. 1 (2008), *aff'd* 586 F.3d 1061 (8th Cir. 2009); *Estate of Petter v. Commissioner*, T.C. Memo. 2009-280, *aff'd* 653 F.3d 1012 (9th Cir. 2011); *Hendrix v. Commissioner*, T.C. Memo. 2011-133; *Wandry v. Commissioner*, T.C. Memo. 2012-88.

C. Leveraging Strategies

The power of certain leveraging strategies ordinarily depends very little on use of a client's basic exclusion amount and far more on one or more or all of the following factors: (1) applicable federal rates that are materially below the actual total return to be achieved by the assets being considered for a given strategy; (2) the current fair market value of such assets; (3) being able to engineer valuation discounts with respect to such assets; and (4) using a trust that is a "grantor trust" for income tax purposes as the operative structure.

Applicable federal rates, although proportionately much higher than they were throughout much of last year, remain relatively low. Carefully constructed valuation discounting, as well as grantor trust planning, have so far remained alive and well. Thus, the environment supporting certain leveraging strategies continues.

D. Renewed Emphasis on Planning for Eventual Incapacity

1. *Introduction*

Beyond the obvious fundamentals of estate planning, *i.e.*, dispositive planning, tax minimization planning and selection and succession of fiduciaries, all solid estate planners have long understood that incapacity planning is a vital part of an estate planning package. As medical science has evolved, life expectancies have increased, but with advancing age often comes a deterioration of physical and mental capacity.

The advance of COVID-19 underscored and exacerbated the need for incapacity planning. Large numbers of individuals throughout America became seriously ill in the pandemic, and many were rendered unable for lengthy periods to attend to their business and financial matters and even to make their health care decisions.

Those who haven't taken steps to address how their affairs shall be handled and who shall handle them if they become incapacitated or disabled place themselves and members of their family in a precarious position. The incapacitated or disabled individual's family members may disagree about what the individual wanted or would have wanted under then existing circumstances. Third parties may refuse to honor directions being given on behalf of the individual by family members who lack legal authority to give such directions. It may be necessary to petition a court to appoint a guardian and/or conservator for the individual – a time-consuming, burdensome and expensive process that results in a judge who has limited knowledge of the individual and his or her family having ultimate authority. Decisions that must be made urgently may be deferred and, when made, may be made in a manner inconsistent with the individual's desires and best interests.

There are tools at the estate planner's disposal which, if implemented before the client becomes incapacitated or disabled, may avoid many or all of the problems outlined in the preceding paragraph. The most important of these tools are revocable trusts and durable powers of attorney.

2. *Revocable Trusts*

In many but not all jurisdictions, revocable trusts are the most important element of an estate plan. A revocable trust, although invisible for income tax purposes, is recognized as having an existence under state property law separate and apart from the settlor. The trust instrument specifies the settlor's desired disposition of trust property during the settlor's life and following his or her death and designates an initial Trustee (often the settlor him or herself) and successor Trustees.

Revocable trusts are uniformly designed so that, if and when the settlor becomes incapacitated, the Trustee (often a successor Trustee) is empowered seamlessly, without any court involvement, to continue to manage and dispose of the assets then held in the trust. A revocable trust operates in this fashion precisely because of its existence separate and apart from the settlor. If and when the settlor becomes incapacitated, the trust, as such, remains in place and unimpeded in fulfilling its purposes as set forth in the trust instrument.

The effectiveness of a revocable trust as a device to enable asset management during any period of the settlor's incapacity is maximized to the extent the settlor's property has been conveyed to the Trustee before the onset of incapacity.

3. *Durable Powers of Attorney for Property, Business and Financial Matters*

A power of attorney is a document by which a person legally confers one or more enumerated powers on another person to act on his or her behalf. The person conferring the power(s) is usually referred to as the "principal," and the person to whom the power(s) is (are) given is called the "attorney-in-fact" or "agent." A power of attorney can be broad and comprehensive, allowing the attorney-in-fact to act in innumerable ways, and for an indefinite period of time, for and in the place of the principal, or it may be quite narrow in scope (limited, even, to a single transaction) and may be operative only for a short period of time.

At common law, a power of attorney loses its validity if and when the principal became incapacitated and/or at death (a "common law power of attorney"). A common law power of attorney has utility only to the extent that, when challenged by a third party being asked to rely on the power's efficacy, it can be established to the third party's satisfaction that the principal is then alive and competent. Thus, a common law power of attorney has very limited usefulness – usually only to facilitate individual transactions occurring a short time after the power of attorney was signed.

To cause powers of attorney to have more practical value, the legislative bodies in all states and the District of Columbia over the past few decades have enacted statutes that allow for the creation of powers of attorney that remain legally effective even after the principal has become incapacitated. This still relatively new type of power of attorney is referred to as a "durable" power of attorney – meaning it has duration extending beyond the point in time when the principal no longer has capacity. The statutory rules governing the creation and operation of

durable powers of attorney vary widely from jurisdiction to jurisdiction, but one very common requirement is that the power of attorney, to be "durable," must contain a statement of durability.[5]

A durable power of attorney is a common component of a modern, comprehensive estate plan. Indeed, in the 21st century, it is hard to conceive of a complete estate plan that lacks a durable power of attorney. One of the very most important non-tax objectives of estate planning is to put in place a mechanism by which the client's affairs can continue to be conducted, without undue delay or court involvement, even in the event of the client's incapacity. A durable power of attorney can effectively confer powers on an agent to handle any and all of the principal's matters not involving assets held in trust, even after the client has become incapacitated, and so is an ideal and indispensable tool to enable achievement of this objective.

In cases in which revocable trusts are used, it is nevertheless still important for the client to have a durable power of attorney. This is true for at least two reasons. First, at the moment the client becomes incapacitated, it may be the case that his or her revocable trust is not fully funded (in fact, intentionally or unintentionally, it may not then be funded at all). A durable power of attorney enables the client's designated agent (often the same person who is then serving as Trustee of the client's revocable trust) to deal with the client's assets not in his or her revocable trust, and/or to transfer such assets to his or her revocable trust, during a period in which he or she is incapacitated. Second, a durable power of attorney, unlike a revocable trust instrument, can confer powers that cannot be conferred on the Trustee of a revocable trust, such as the authority to prepare and file the principal's tax returns and to have access to the principal's safe deposit box, and powers relating to non-business, non-financial matters such as health care and similar matters.

4. *Durable Powers of Attorney for Health Care*

A health care durable power of attorney is fundamentally the same sort of device as a traditional durable power of attorney discussed above, but, rather than conferring powers on an agent to address and deal with the principal's property, business and financial matters, it grants powers to address health care and other personal (non-financial) matters. Because a health care durable power of attorney addresses matters entirely different from those covered in a traditional business and financial matters durable power of attorney, ordinarily, it makes sense for a health care durable power of attorney to be contained in a separate document.

Selection of an attorney-in-fact to make health care decisions – perhaps with life and death consequences – is quite different from selecting attorneys-in-fact who will carry out business and financial transactions. A person who may be quite well qualified to handle the principal's property-related, business and financial matters may be wholly unsuitable to make his or her health care and similar decisions – and vice versa.

Also, extremely careful attention needs to be given to the extent and nature of health care-related powers. Of vital (literally) importance is the question of whether the attorney-in-fact shall be given power to direct health care providers to withhold or withdraw artificially supplied

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[5] Hook, 859-3rd T.M., *Durable Powers of Attorney*, at p. A-5; *see*, *e.g.*, Section 404.705, RSMo.

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nutrition and hydration if and when the principal has been determined to have a terminal condition or be in an irreversible coma.

E. Practical Limitations on Client Counseling and Document Signing

1. *Introduction*

The COVID-19 pandemic changed the relationship between estate planning professionals and their clients in ways that, just a couple of years ago, would have seemed unimaginable. Estate planning is a "high-touch" industry. All those involved in the process – lawyers, accountants, trust administrators, investment advisors and life insurance experts – have long understood that in-person, face-to-face communication with clients is by far the most effective way for clients to develop trust in those they have engaged and to facilitate the exchange of information (some of which may be quite sensitive) needed to design and implement the best possible estate plan.

2. *Confined Clients*

a. Meetings and Communication

Depending on the circumstances, live, in-person meetings may awkward or even impossible. If, for example, the client is in a hospital or a nursing home, opportunities for an on-site visit with the client will be extremely limited. In some cases, the client will not be permitted to receive any visitors at all. In other cases, visitors may be limited to certain close family members, and the number of simultaneous visitors, and the times for visitation, may be restricted.

In such a scenario, exchanges of communication with clients may be possible, if the client is physically able to receive and convey information, but communicating with clients in this predicament are often awkward and inefficient. Modes of communication with such a client may include video conferencing (*e.g.*, Zoom), telephone conversations, audio messages (voice mail), text messages and e-mail.

b. Signing of Documents

Assuming that appropriate estate planning documents can be assembled for a client confined to a hospital or a nursing home, the next challenge will be to effectuate the signing of the documents by the client. Navigating that challenge successfully depends largely on applicable state law. The client will need to be able to sign his or her name in some fashion (at least by making a mark) or, in some cases, be able to direct another to sign for him or her. In some jurisdictions, electronic signing, remote electronic witnessing and/or remote, electronic notarization of Wills, trust instruments and/or durable powers of attorney may be possible.[6]

To the extent applicable state law does not allow electronic signing, remote electronic witnessing and/or remote, electronic notarization of Wills, trust instruments and/or durable powers of attorney, physical documents must be delivered to the confined client, and

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[6] For a nationwide survey from December 2020, *see* https://www.actec.org/resources/emergency-remote-notarization-and-witnessing-orders/

accomplishing delivery to a client's bed or room may present uncertainty and difficulties. If and when delivery of physical documents occurs, then the facility's rules regarding who may visit and how many simultaneous visitors will be permitted may seriously impede the signing of documents while adhering to necessary formalities, *e.g.*, witnessing and notarization. Many hospitals and nursing homes refuse to allow their employees to witness or notarize a patient or resident's legal documents. In most jurisdictions, there are no formalities associated with the signing of a trust instrument (even notarization is optional), but the testator's signing of a Will must, at minimum, be witnessed by two disinterested individuals. Durable powers of attorney must be witnessed and/or notarized. If a client already has in place a durable power of attorney that explicitly authorizes the attorney-in-fact to sign trust instruments and fund trusts on behalf of the principal, that approach may be a viable option. The signing of a Will, however, cannot be validly delegated to an agent of the testator.

Clients who may be considered particularly vulnerable to the possibility of being hospitalized or placed in a nursing home (*e.g.*, clients who are older and/or have significant health issues) should establish as a high priority the creation or updating of a modern, comprehensive estate plan.

3. *Clients Who Are Not Confined*

Clients who are not hospitalized or nursing home residents face fewer obstacles to developing and completing an estate plan. Some clients and their advisors, even today, are concerned about being exposed to disease – if not for themselves, because of the possibility that they could infect others. Thus, some estate planning meetings that formerly would have been live and in-person are now conducted using video conferencing services and telephone. Planning meetings that are live and in-person, and document signing meetings, involving unconfined clients occasionally still involve the use of masks by participants and "social distancing."

II. MISCELLANEOUS ESTATE AND GIFT TAX MATTERS

A. Trends in Applicable Federal Rates

Rev. Rul. 2021-1, 2021-2 I.R.B. 294, Rev. Rul. 2021-4, 2021-6 I.R.B. 724, Rev. Rul. 2021-5, 2021-10 I.R.B. 896, Rev. Rul. 2021-7, 2021-14 I.R.B. 982, Rev. Rul. 2021-8, 2021-18 I.R.B. 1120, Rev. Rul. 2021-9, 2021-23 I.R.B. 1171, Rev. Rul. 2021-12, 2021-27 I.R.B. 1, Rev. Rul. 2021-14, 2021-31 I.R.B. 164, Rev. Rul. 2021-16, 2021-36 I.R.B. 359, Rev. Rul. 2021-18, 2021-40 I.R.B. 447, Rev. Rul. 2021-21, 2021-44 I.R.B. 704, Rev. Rul. 2021-23, 2021-49 I.R.B. 779, Rev. Rul. 2022-1, 2022-2 I.R.B. 301, Rev. Rul. 2022-3, 2022-6 I.R.B. 467, Rev. Rul. 2022-4, 2022-10 I.R.B. 790, Rev. Rul. 2022-8, 2022-14 I.R.B. 936, Rev. Rul. 2022-9, 2022-18 I.R.B. 1041, Rev. Rul. 2022-10, 2022-23 I.R.B. 1157, Rev. Rul. 2022-12, 2022-27 I.R.B. 1, Rev. Rul. 2022-14, 2022-31 I.R.B. 110, Rev. Rul. 2022-17, 2022-36 I.R.B. 182, Rev. Rul. 2022-18, 2022-40 I.R.B. 262; Rev. Rul. 2022-20, 2022-___ I.R.B. ___

Month	IRC Section 7520 Rate	Month	IRC Section 7520 Rate
January 2021	0.6%	January 2022	1.6%
February 2021	0.6%	February 2022	1.6%
March 2021	0.8%	March 2022	2.0%
April 2021	1.0%	April 2022	2.2%
May 2021	1.2%	May 2022	3.0%
June 2021	1.2%	June 2022	3.6%
July 2021	1.2%	July 2022	3.6%
August 2021	1.2%	August 2022	3.8%
September 2021	1.0%	September 2022	3.6%
October 2021	1.0%	October 2022	4.0%
November 2021	1.4%	November 2022	4.8%
December 2021	1.6%	December 2022	5.2%
		January 2023	4.6%

B. Time Extended for Using Simplified Procedure to Obtain Extension of Time to Elect Portability

Rev. Proc. 2022-32, 2022-30 I.R.B. 101 (July 25, 2022)

The Internal Revenue Service ("IRS") in Rev. Proc. 2017-34[7] provided a simplified and streamlined procedure for obtaining an extension of time to elect portability. Rev. Proc. 2022-32 supersedes Rev. Proc. 2017-34 but retained all of its substantive elements.

The general rule regarding making a portability election is that it must be made, if at all, on a timely, complete and properly prepared estate tax return.[8] Before Rev. Proc. 2017-34 was issued, the only method to extend the time for filing to elect portability was to request a private letter ruling under Treasury Reg. § 301.9100-3. This option is expensive and time consuming, and the result isn't guaranteed.

Under Rev. Proc. 2022-32, the time within which such a return may be filed is extended to the fifth anniversary of the decedent's death.[9] To qualify for relief under Rev. Proc. 2022-32, the estate must meet all the following requirements:

- The decedent must have died after December 31, 2010;
- The decedent must be survived by a spouse;
- The decedent must have been a U.S. citizen or resident at death;
- The estate must not have been required to file an estate tax return because of Internal Revenue Code ("IRC")[10] Section 6018(a);
- The estate must not have filed the estate tax return timely;
- The estate must file a complete and properly prepared estate tax return; and
- The estate tax return must contain the following language across the top of page one:

> "FILED PURSUANT TO REV. PROC. 2022-32 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A)."

If the estate doesn't meet all of the above-recited requirements, the only method by which it may obtain an extension to file for portability is via the private letter ruling procedure, and even that method wouldn't be an option if the estate was required to file an estate tax return because of IRC Section 6018(a).

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[7] Rev. Proc. 2017-34, 2017-26 I.R.B. 1282 (June 9, 2017).

[8] Treas. Reg. Section 20.2010-2(a).

[9] Under Rev. Proc. 2017-34, the time had been extended to the second anniversary of the decedent's death.

[10] All references to "Internal Revenue Code" or IRC" are to the Internal Revenue Code of 1986, as amended.

Section 7.01 of Rev. Proc. 2022-32 says its effective date was July 8, 2022. That statement, standing alone, however, seems to beg the question whether the five-year window provided by Rev. Proc. 2022-32 is available with respect to estates where the predeceased spouse died before July 8, 2022 but less than five years ago. Rev. Proc. 2022-32 isn't as explicit as it should be on this point, but the first sentence of Section 7.02 says, flat out, that, for predeceased spouses who died not more than five years ago, Rev. Proc. 2022-32 is the "exclusive procedure" for getting the portability election extension. That sentence, coupled with Section 7.01 referring to July 8, 2022 as the "effective date," appears strongly to suggest that Rev. Proc. 2022-32 is so available. Furthermore, the second sentence of Section 7.02 says any Treas. Reg. Section 301.9100-3 relief request that was in the hands of the IRS and was pending on July 8 will be returned and the file closed and that the subject estate was to proceed under Rev. Proc. 2022-32. Obviously, such an estate could then have been outside the two-year window provided by Rev. Proc. 2017-34, so wasn't the IRS essentially saying that such an estate has a five-year window? In addition, Section 2.05 of Rev. Proc. 2022-32 refers to the IRS' continuing burden in responding to Treas. Reg. Section 301.9100-3 portability election extension relief requests, so it would seem the IRS will be looking for justifications to accept a Rev. Proc. 2022-32 request for extension of time to elect.

C. "No Clawback" Rule

Treasury Regulation Section 20.2010-1(c), REG-106706-18, 84 Fed. Reg. 64995 (November 26, 2019)

In response to IRC Section 2001(g)(2), enacted as part of the 2017 Tax Act, in which the Secretary of the Treasury was directed to prescribe regulations to carry out IRC Section 2001(g) with respect to the difference between the basic exclusion amount applicable at the time of a decedent's death and the basic exclusion amount applicable with respect to any gifts made by the decedent, the Secretary issued Prop. Reg. Section 20.2010-1(c).[11] The final version of this provision was released on November 22, 2019 and published in the Federal Register on November 26, 2019.

Treas. Reg. Section 20.2010-1(c) ensures that, if a decedent uses the increased basic exclusion amount for gifts made while the 2017 Tax Act was in effect and dies after the sunset of the 2017 Tax Act (currently scheduled for January 1, 2026), such decedent won't be treated, on such decedent's estate tax return, as having made adjusted taxable gifts solely because the increase in the basic exclusion amount effectuated by the 2017 Tax Act was eliminated.

The mechanism by which Treas. Reg. Section 20.2010-1(c) achieves this result is to provide that, if the total credits that were used in computing a decedent's gift tax on post-1976 gifts, within the meaning of IRC Section 2001(b)(2),[12] is greater than the applicable credit amount used, pursuant to IRC Section 2010(a), to compute the estate tax on the decedent's estate,[13] the credit that can in that circumstance be used to compute the estate tax is deemed to be the total credits that were used in computing the decedent's gift tax.

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[11] Prop. Reg. Section 20.2010-1(c), REG-106706-18, 83 Fed. Reg. 59343 (November 23, 2018).
[12] To the extent based solely on the basic exclusion amount. *See* IRC Section 2010(c)(3).
[13] *Id*.

Unlike Prop. Reg. Section 20.2010-1(c), Treas. Reg. Section 20.2010-1(c) explains how the deceased spousal unused exclusion ("DSUE") amount[14] interacts with the basic exclusion amount to produce the intended "no clawback" result. Treas. Reg. Section 20.2010-1(c)(1)(ii) and Example 4,[15] taken together, make several important points clear. First, when a surviving spouse makes taxable gifts, any DSUE amount that was available to him is deemed to have been applied to those gifts before his basic exclusion amount was so applied.[16] Second, if that surviving spouse dies after the sunset of the 2017 Tax Act, the DSUE amount applied to those gifts is not reduced. Third, if both the DSUE amount and the surviving spouse's basic exclusion amount were applied to those gifts, in calculating the amount of the credit available in computing the surviving spouse's estate tax, the undiminished DSUE amount is removed. Fourth, the total credits that were used in computing the surviving spouse's gift tax based on that intact DSUE amount, *plus* the credit determined by applying the general "no clawback" rule of Treas. Reg. Section 20.2010-1(c), are available to offset the surviving spouse's estate tax liability.

Although, surprisingly, it took a year to bring this relatively small regulatory project to a conclusion, it was a welcome development. In particular, the IRS' treatment of the DSUE amount in the "no clawback" context was good news. It is somewhat disappointing that the Service declined to address whether GST exemption allocated before sunset of the 2017 Tax Act would, like the basic exclusion amount and the DSUE amount applied in computing the gift tax on post-1976 gifts, would remain in place without reduction. It seems significant, though, that, in the preamble to the final regulation, after observing that the GST exemption amount is defined by reference to the basic exclusion amount,[17] the Service stated: "There is nothing in the statute that would indicate that the sunset of the increased [basic exclusion amount] would have any impact on allocations of the GST exemption available during the increased [basic exclusion amount] period."

There was a "sleeper" aspect of these final regulations. Space was explicitly reserved for, and the preamble makes cryptic reference to, a then not-yet-developed anti-abuse rule. The preamble provides in part as follows:

> A commenter recommended consideration of an anti-abuse provision to prevent the application of the special rule to transfers made during the increased BEA period that are not true *inter vivos* transfers, but rather are treated as testamentary transfers for transfer tax purposes. Examples include transfers subject to a retained life estate or other retained powers or interests, and certain transfers within the purview of chapter 14 of subtitle B of the Code. The purpose of the special rule is to ensure that *bona fide inter vivos* transfers are not subject to inconsistent treatment for estate tax purposes. Arguably, the possibility of inconsistent treatment does not arise with regard to transfers that are treated as part of the gross estate for estate tax purposes, rather than as adjusted taxable gifts. An anti-abuse provision could except from the application of the special rule transfers where value is included in the donor's gross estate at death. Although the Treasury Department and the IRS agree that such a

[14] IRC Section 2010(c)(4).
[15] Treas. Reg. Section 20.2010-1(c)(2)(iv).
[16] This conclusion is not at all surprising. It is entirely consistent with Treas. Reg. Sections 20.2010-3(b) and 25.2505-2(b).
[17] IRC Section 2631(c).

provision is within the scope of the regulatory authority granted in section 2001(g)(2), such an anti-abuse provision would benefit from prior notice and comment. Accordingly, this issue will be reserved to allow further consideration of this comment.

D. Breadth of "No Clawback" Rule to be Limited
Proposed Regulation Section 20.2010-1(c)(3), REG-118913-21, 87 Fed. Reg. 24918 (April 27, 2022)

The anti-abuse provision presaged in the Treas. Reg. Section 20.2010-1(c) preamble, discussed and quoted from immediately above, has been developed, at least preliminarily. Clearly, the IRS is persuaded that, for an individual to be able to make a completed gift by which he or she takes advantage of the historically high basic exclusion amount but not relinquish all economic benefits that may flow from the transferred property, is abusive.

Accordingly, Prop. Reg. Section 20-2010(c)(3) sets forth an exception to the general "no clawback" rule of Treas. Reg. Section 20.2010(c)(1). Specifically, Prop. Reg. Section 20-2010(c)(3) provides that the "no clawback" rule doesn't apply to transfers includable in the gross estate, including:

- Transfers includable under IRC Section 2035, 2036, 2037, 2038 or 2042;
- Transfers made by enforceable promise to the extent they remain unsatisfied as of date of death;
- Transfers described in Treas. Reg. Section 25.2701-5(a)(4) or 25.2702-6(a)(1); and
- Transfers that would have been described in the three bullet points above but for the fact that the subject interest, power or property was relinquished or eliminated within 18 months before the decedent's death.

There is, however, an exception to this exception. The "no clawback" rule will apply in cases in which the taxable portion of a transfer (the portion not retained) was five percent or less of the total value of the transfer.

Note that, a properly designed spousal lifetime access trust ("SLAT") would not fall within the parameters of Prop. Reg. Section 20-2010(c)(3) but, as a practical matter, would provide many of the same advantages, albeit indirectly, of a transfer with retained beneficial interests.

E. Selected Trusts and Estates-Related Areas in Which Rulings or Determination Letters Will Not Be Issued
Rev. Proc. 2022-3, 2022-1 I.R.B. 144, Section 3 (January 3, 2022)

- ***IRC Sections 101 and 671***—Whether there has been a transfer for value for purposes of IRC Section 101(a) in situations involving a grantor and a trust, or whether the grantor will be considered the owner of any portion of a trust, when (1) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse; (2) the Trustee or any other person

has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse; (3) the Trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate; and (4) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under IRC Sections 673 to 677.

F. Selected Trusts and Estates-Related Areas in Which Rulings or Determination Letters Will Not Ordinarily Be Issued

Rev. Proc. 2022-3, 2022-1 I.R.B. 144, Section 4 (January 3, 2022)

- ***IRC Section 664***—Whether a charitable remainder trust that provides for annuity or unitrust payments for one or two measuring lives or for annuity or unitrust payments for a term of years satisfies the requirements described in IRC Section 664.

- ***IRC Section 664***—Whether a trust that will calculate the unitrust amount under IRC Section 664(d)(3) qualifies as an IRC Section 664 charitable remainder trust when a grantor, a Trustee, a beneficiary or a person related or subordinate to a grantor, a Trustee, or a beneficiary can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract to take advantage of the difference between trust income under IRC Section 643(b) and income for federal income tax purposes for the benefit of the unitrust recipient.

- ***IRC Section 678***—Whether a person will be treated as the owner of any portion of a trust over which that person has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner of the trust under IRC Section 671 if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of IRC Section 2041, if the trust purchases the property from that person with a note and the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

- ***IRC Sections 2035, 2036, 2037, 2038 and 2042***—Whether trust assets are includible in a trust beneficiary's gross estate under IRC Sections 2035, 2036, 2037, 2038 or 2042 if the beneficiary sells property (including insurance policies) to the trust or dies within three years of selling such property to the trust, and: (1) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of IRC Section 2041; (2) the trust purchases the property with a note; and (3) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

- ***IRC Section 2055***—Whether a transfer to a charitable remainder trust described in IRC Section 664 that provides for annuity or unitrust payments for one or two measuring lives or a term of years qualifies for a charitable deduction under IRC Section 2055(e)(2)(A).

- ***IRC Sections 2501 and 2702***—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary will be treated as a gift for purposes of IRC Section 2501, or whether the sale of property (including insurance policies) to a trust by a trust beneficiary is subject to IRC Section 2702 if: (1) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of IRC Section 2041; (2) the trust purchases the property with a note; and (3) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

- ***IRC Sections 2503 and 2514***—Whether the transfer of property to a trust will be a gift of a present interest in property, or, if the beneficiaries of a trust permit a power of withdrawal to lapse, whether IRC Section 2514(e) will be applicable to each beneficiary in regard to the power, when: (1) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse; (2) the Trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse; (3) the Trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate; (4) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust; and (5) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under IRC Sections 673 to 677.

- ***IRC Section 2522***—Whether a transfer to a charitable remainder trust described in IRC Section 664 that provides for annuity or unitrust payments for one or two measuring lives or a term of years qualifies for a charitable deduction under IRC Section 2522(c)(2)(A).

- ***IRC Section 2601***—Whether a trust that is exempt from the application of the generation-skipping transfer tax because it was irrevocable on September 25, 1985, will lose its exempt status if the situs of the trust is changed from the United States to a situs outside of the United States.

- ***IRC Section 2702***—Whether annuity interests are qualified annuity interests under IRC Section 2702 if the amount of the annuity payable annually is more than 50 percent of the initial net fair market value of the property transferred to the trust, or if the value of the remainder interest is less than 10 percent of the initial net fair market value of the property transferred to the trust. For purposes of the 10 percent test, the value of the remainder interest is the present value determined under IRC

Section 7520 of the right to receive the trust corpus at the expiration of the term of the trust. The possibility that the grantor may die prior to the expiration of the specified term is not taken into account, nor is the value of any reversion retained by the grantor or the grantor's estate.

- ***IRC Section 2702***—Whether a trust with one term holder satisfies the requirements of IRC Section 2702(a)(3)(A) and Treas. Reg. Section 25.2702-5(c) to be a qualified personal residence trust.

- ***IRC Section 2702***—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary is subject to IRC Section 2702 if: (1) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of IRC Section 2041; (2) the trust purchases the property with a note; and (3) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

G. Selected Trusts and Estates-Related Areas in Which Rulings or Determination Letters Will Not Be Issued Until the Internal Revenue Service Resolves the Issue Through Publication of a Revenue Ruling, a Revenue Procedure, Regulations or Otherwise

Rev. Proc. 2022-3, 2022-1 I.R.B. 144, Section 5 (January 3, 2022)

- ***IRC Sections 661 and 662***—Whether the distribution of property by a Trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is a distribution for which a deduction is allowable under IRC Section 661 or which requires an amount to be included in the gross income of any person under IRC Section 662.

- ***IRC Section 671***—Whether the grantor will be considered the owner of any portion of a transfer in trust under IRC Sections 673 to 677 that is purported to be an incomplete gift under IRC Section 2511, specifically including, but not limited to, a transfer to a trust providing for distributions at the direction of a committee to the donor and the committee members either by unanimous consent of the committee members or a majority of the committee members with the consent of the donor.

- ***IRC Section 678***—Whether the beneficiaries of a trust will be considered the owners of any portion of such trust when two or more of such beneficiaries have the power to distribute income or principal to themselves by unanimous consent.

- ***IRC Section 1014***—Whether the assets in a grantor trust receive an IRC Section 1014 basis adjustment at the death of the deemed owner of the trust for income tax purposes when those assets are not includible in the gross estate of that owner under chapter 11 of subtitle B of the Internal Revenue Code.

- ***IRC Sections 2036 and 2038***—Whether the corpus of a trust will be included in a grantor's estate when the Trustee of the trust is a private trust company owned partially or entirely by members of the grantor's family.

- ***IRC Section 2041***—Whether the corpus of a trust will be included in an individual's estate when the Trustee of the trust is a private trust company owned partially or entirely by members of the individual's family.

- ***IRC Sections 2041 and 2514***—Whether the beneficiaries of a trust hold general powers of appointment over any portion of a transfer to a trust when: (1) two or more of such beneficiaries have the power to distribute income or principal to themselves by unanimous consent and without the consent of the donor, and either: (a) such beneficiaries must be replaced upon the lapse of their powers as the result of death or otherwise; or (b) all of such beneficiaries' powers described by (1) lapse upon the death of any one of the beneficiaries.

- ***IRC Sections 2056 and 2523***— Whether an estate is entitled to an estate tax marital deduction, or a donor is entitled to a gift tax marital deduction, for any portion of the annuity or unitrust interest of a charitable remainder trust (as described in IRC Section 664) that may be distributed between the decedent's, or donor's, spouse and an organization described in IRC Section 170(c) at the discretion of a Trustee.

- ***IRC Section 2501***—Whether the distribution of property by a Trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is a gift under IRC Section 2501.

- ***IRC Section 2511***—Whether a transfer in trust that is purported not to be considered owned by the grantor under IRC Section 671 is an incomplete gift, specifically including, but not limited to, a transfer to a trust providing for distributions at the direction of a committee to the donor and the committee members either by unanimous consent of the committee members or a majority of the committee members with the consent of the donor.

- ***IRC Sections 2601 and 2663***—Whether the distribution of property by a Trustee from an irrevocable GST exempt trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is the loss of GST exempt status or constitutes a taxable termination or taxable distribution under IRC Section 2612.

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H. Inflation-Adjusted Trusts and Estates-Related Figures for 2023

Rev. Proc. 2022-38, 2022-45 I.R.B. 1 (October 18, 2022)

1. *Tax Rate Schedule for Estates and Trusts for 2023*

If Taxable Income Is:	The Tax Is:
Not over $2,900	10% of taxable income
Over $2,900 but not over $10,550	$290 plus 24% of the excess over $2,900
Over $10,550 but not over $14,450	$2,126 plus 35% of the excess over $10,550
Over $14,450 (up from $13,450 in 2022)	$3,491 plus 37% of the excess over $14,450

2. *Basic Exclusion Amount for Gifts Made and Decedents Dying in 2023*

$12,920,000 (up from $12,060,000 for gifts made and decedents dying in 2022).

3. *GST Exemption Available for 2023 Generation-Skipping Transfers*

$12,920,000 (up from $12,060,000 for 2022 generation-skipping transfers).

4. *Gift Tax Annual Exclusion for 2023 Gifts*

$17,000 (up from $16,000 for present interest gifts made in 2022).

5. *IRC Section 2032A Special Use Valuation Reduction Limit*

$1,310,000 (up from $1,230,000 for 2022).

6. *IRC Section 6166 2% Portion*

The portion of estate tax that can be deferred under IRC Section 6166 at a 2% annual interest rate for decedents dying in 2023 is $1,750,000 (up from $1,640,000 for decedents dying in 2022).

7. *Gift Tax Annual Exclusion for 2023 Gifts to Non-Citizen Spouses*

$175,000 (up from $164,000 for 2022 gifts).

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I. User Fee for Estate Tax Closing Letters

Treasury Regulation Section 300.13, TD 9957, 86 Fed. Reg. 53539 (September 28, 2021)

Before June 1, 2015, the IRS generally issued an estate tax closing letter (Letter 627) for every estate tax return filed.[18] A closing letter was generated by the IRS automatically, without the executor's having to request it and without charge, to indicate acceptance of the estate tax return and to convey certain other information. Consistent with Rev. Proc. 2005-32,[19] a closing letter explains that the IRS won't reopen or examine the estate tax return to determine estate tax liability unless the estate notifies the IRS of changes to the return or there's: (1) evidence of fraud, malfeasance, collusion, concealment or misrepresentation of a material fact; (2) a clearly defined substantial error based upon an established IRS position; or (3) a serious administrative omission.[20]

As the IRS explicitly observed in the preamble to Prop. Reg. Section 300.13, "executors, local probate courts, State tax departments, and others had come to rely on the convenience of estate tax closing letters and the return information and procedural and substantive explanations such letters provided for confirmation that the examination of the estate tax return by the IRS had been completed and the IRS file had been closed."

From and after June 1, 2025, however, the IRS changed its practice and began offering a closing letter only at the request of an authorized person. Additionally, effective October 28, 2021, the IRS charges a $67.00 user fee for issuing a closing letter.[21] Under Treas. Reg. Section 300.13(c), "the person liable for the fee is the estate of the decedent or other person requesting, in accordance with applicable procedures and policies, an estate tax closing letter to be issued with respect to the estate."

Treas. Reg. Section 300.13 is virtually identical to Prop. Reg. Section 300.13, REG-114615-16, 85 Fed. Reg. 86871 (December 31, 2020).

The preamble to Prop. Reg. Section 300.13 stated:

> In view of the resource constraints and purposes of issuing estate tax closing letters as a convenience to authorized persons, the IRS has identified the provision of estate tax closing letters as an appropriate service for which to establish a user fee to recover the costs that the government incurs in providing such letters.

While the preamble proceeded at great length in an effort to justify assessing a user fee and to explain how the Department of the Treasury came up with $67.00 as the appropriate amount, one may wonder what "costs" the government incurs in providing closing letters other than the cost of a couple of sheets of paper, an envelope and postage. In Notice 2017-12,[22] the IRS essentially acknowledged that an account transcript with a transaction code and explanation of "421—Closed examination of tax return" (which gives rise to no user fee) is the functional

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[18] Preamble to Prop. Reg. Section 300.13, REG-114615-16, 85 Fed. Reg. 86871 (December 31, 2020).
[19] Rev. Proc. 2005-32, 2005-1 C.B. 1206.
[20] Preamble to Prop. Reg. Section 300.13.
[21] Treas. Reg. Section 300.13, TD 9957, 86 Fed. Reg. 53539 (September 28, 2021).
[22] Notice 2017-12, I.R.B. 2017-5.

equivalent of an estate tax closing letter. If that's the case, why couldn't the IRS program its computer simply to crank out a closing letter whenever such an account transcript comes into existence?

Imposition of the user fee has been grudgingly accepted by estate tax return preparers and their clients, and the user fee's existence is now well-known. To the shock of many, however, was the IRS' tacit acknowledgment, barely a month after publication of Treas. Reg. Section 300.13, that, with respect to a sizable majority of estate tax returns that are filed, a closing letter is essentially worthless.

J. Issuance of Closing Letter Doesn't Prohibit Examination of Estate Tax Return

Chief Counsel Advice 202142010 (October 22, 2021)

In Chief Counsel Advice ("CCA") 202142010, the Office of Chief Counsel ("OCC") advised that the issuance of a closing letter won't necessarily preclude the IRS from examining an estate tax return. In rendering its advice, the OCC stated that, in the matter before it, the minimal contacts/communications between the IRS and the estate were "narrow, limited contacts" and "[did] not involve the Service inspecting the taxpayer's books of account." "[T]hus the prohibition of 'only one inspection' in section 7605(b) [did] not apply."

The OCC noted that, in the case under consideration, the IRS accepted the return as filed, issued a refund and sent a closing letter and opined that "[a]cceptance of a return as filed does not constitute an examination." Since the return wasn't examined in the first place, the opening letter (the letter announcing the beginning of an examination) wasn't a reopening of a closed examination, and so an examination could properly be commenced without running afoul of the reopening criteria in Rev. Proc. 2005-32.[23]

In paying homage to closing letters, many practitioners have ignored, or been ignorant of, the fundamental difference between an estate tax return that was examined and one that was accepted as filed. CCA 202142010 serves as a stark reminder that there's a crucial distinction. With an examined return, the elements required to be satisfied for reopening as set out in Rev. Proc. 2005-32 apply and significantly limit the IRS' ability to reopen. In the case of a return that was accepted as filed, the IRS can commence an examination for any reason or for no reason so long as the applicable period of limitations hasn't expired.[24]

Only a small percentage of estate tax returns is selected for examination.[25] CCA 202142014 teaches that, as to all estate tax returns that are accepted as filed, a closing letter is utterly meaningless. In light of CCA 202142014, it's hard to fathom why the IRS even offers to provide closing letters with respect to estate tax returns that are accepted as filed. Indeed, it would seem that issuing a closing letter in such cases is misleading because in fact nothing is "closed." A closing letter usually isn't the security blanket it's frequently presumed to be.

[23] Rev. Proc. 2005-32, 2005-1 C.B. 1206.

[24] *See* IRC Section 6501.

[25] *See*, *e.g.*, Kelly Dickson Cooper, *Recent Statistics Related to Estate and Gift Tax Returns*, The National Law Review, June 6, 2016, Vol. VI, No. 158, stating that 7.8 percent of estate tax returns filed in 2014 were audited in 2015.

K. Trusts and Estates-Related Items in the Priority Guidance Plan

Office of Tax Policy and Internal Revenue Service, 2022-2023 Priority Guidance Plan (Release Date November 4, 2022)

1. *Final Regulations Relating to Gifts and Estates and Trusts*

The IRS intends to issue the following final regulations under the subject heading "Gifts and Estates and Trusts":

- Final regulations under IRC Sections 1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. [**<u>NOTE</u>:** Proposed and temporary regulations were published on March 4, 2016.]

- Final regulations under IRC Section 2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate. [**<u>NOTE</u>:** Proposed regulations were published on June 28, 2022. Prop. Reg. Section 20.2053-1(d)(6), (d)(7), (f), -3(d) and -4(d)(5), REG-130975-08, 87 Fed. Reg. 38331 (June 28, 2022).]

- Final regulations under IRC Section 2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption.

- Final regulations under IRC Section 2801 regarding the tax imposed on U.S. citizens and residents who receive gifts or bequests from certain expatriates. [**<u>NOTE</u>:** Proposed regulations were published on September 10, 2015.]

- Final regulations relating to SECURE Act modifications to IRC Section 401(a)(9) and addressing other issues under §401(a)(9). [**<u>NOTE</u>:** Proposed regulations were published on February 24, 2022. Prop. Reg. Section 1.401(a)(9), REG-105954-20, 87 Fed. Reg. 10504 (February 24, 2022).]

2. *Additional Regulations and Guidance Relating to Gifts and Estates and Trusts*

The IRS intends to issue the following additional regulations and guidance under the subject heading "Gifts and Estates and Trusts":

- Guidance regarding availability of IRC Section 1014 basis adjustment at the death of the owner of a grantor trust described in IRC Section 671 when the trust assets are not included in the owner's gross estate for estate tax purposes.

- Guidance on portability regulatory elections under IRC Section 2010(c)(5)(A). [**NOTE:** Rev. Proc. 2022-32, 2022-30 I.R.B. 101, was published on July 25, 2022.]

- Regulations under IRC Section 2010 addressing whether gifts that are includible in the gross estate should be excepted from the special rule of Treas. Reg. Section 20.2010-1(c) (the "no clawback" rule). [**NOTE:** Proposed regulations were published on April 27, 2022. Prop. Reg. Section 20.2010-1(c)(3), REG-118913-21, 87 Fed. Reg. 24918 (April 27, 2022).]

- Regulations under IRC Section 2032(a) regarding imposition of restrictions on estate assets during the six-month alternate valuation period. [**NOTE:** Proposed regulations were published on November 18, 2011.] The fact that issuance of these regulations is on the Priority Guidance Plan obviously reflects the IRS' concern about *Kohler v. Commissioner*, T.C. Memo. 2006-152 (July 25, 2006).

- Regulations under Treas. Reg. Section 20.2056A-2 for qualified domestic trust elections on estate tax returns, updating obsolete references.

- Regulations under IRC Section 2632 providing guidance governing the allocation of GST exemption in the event the IRS grants relief under IRC Section 2642(g), as well as addressing the definition of a GST trust under IRC Section 2632(c), and providing ordering rules when GST exemption is allocated in excess of the transferor's remaining GST exemption.

- Regulations under IRC Section 7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests. [**NOTE:** Proposed regulations were published on May 5, 2022. Prop. Reg. Sections 1.170A-12, -14, 1.642(c)-6, -6A, 1.664-2, -4, -4A, 1.7520-1, 20.2031-0, -7, -7A, 20.2032-1, 20.2036-1, 20.2055-2, 20.2056A-4, 20.7520-1, 25.2512-0, -5, -5A, 25.2522(c)-3, 25.7520-1, -3, REG-122770-18, 87 Fed. Reg. 26806 (May 5, 2022).]

L. Executor's Personal Liability for Estate Tax

Estate of Lee v. Commissioner, T.C. Memo 2021-92 (July 20, 2021)

This was a collection due process case involving unpaid federal estate tax. The salient facts were simple, and they were not disputed.

1. *Facts*

The Executor, Mr. Frese, filed a federal estate tax return on May 21, 2003. He made distributions to estate beneficiaries totaling $1,045,000 between July 2003 and February 2007. Notably, included in the total distribution amount of $1,045,000 was a distribution in the amount of $640,000 he made on February 28, 2007. After these distributions, the remaining estate assets totaled in value about $183,000.

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On April 26, 2006, the IRS mailed to Mr. Frese a notice of deficiency asserting unpaid estate tax in the amount of $1,020,129 plus an addition to tax[26] and an accuracy-related penalty.[27] On March 24, 2010, the Tax Court issued a decision reducing the estate tax deficiency to $536,151 and eliminating the addition to tax and the penalty. On July 19, 2010, the IRS assessed the tax due as decreed by the Tax Court, and, on April 16, 2013, the IRS tendered a Notice of Federal Tax Lien.

Mr. Frese made an Offer in Compromise ("OIC") to settle the estate tax debt. The IRS declined the OIC because, upon investigation, the IRS determined the full amount of the debt could be collected from the Executor, under 31 U.S.C. Section 3713, and/or the beneficiaries under IRC Section 6324(a)(2). Mr. Frese then petitioned the Tax Court, arguing that the IRS abused its discretion in rejecting the OIC and that the applicable statute of limitations within which the IRS could collect the unpaid estate tax had expired.

2. *Tax Court Holding*

The Tax Court entered summary judgment in favor of the IRS. The Tax Court concluded the IRS did not abuse its discretion in refusing the OIC. Mr. Frese had argued the abuse of discretion lay in the IRS' improperly considering amounts potentially collectible from third parties, *i.e.*, Mr. Frese and the beneficiaries, in computing the estate's "reasonable collection potential" ("RCP"). Mr. Frese did not dispute that he made distributions that caused the estate to be unable to pay its estate tax obligation, but he argued that, nevertheless, those distributions should be disregarded in determining the estate's RCP because, when he made the distributions, he lacked the requisite notice of the IRS' claim. The Tax Court must have found that assertion incredible but responded in a reserved manner, simply pointing out that, when Mr. Frese made the $640,000 distribution on February 28, 2007, he had in hand the IRS' notice of deficiency that was mailed to him on April 26, 2006 and was a named party in the Tax Court petition filed in July 2006 disputing the notice of deficiency. If even that one distribution hadn't been made, Mr. Frese would have been in a position easily to have paid from estate funds the $536,151 ultimately determined to be due. Moreover, Mr. Frese presumably had the sophistication to have known better. He was a licensed attorney-at-law as well as a municipal judge.

The Tax Court also couldn't agree with Mr. Frese that the statute of limitations applicable to collections had expired. Mr. Frese asserted the applicable statute was 24 U.S.C. 2415(a) and that the six-year limit under that provision ran from the February 28, 2007 distribution. The Tax Court pointed out language in 24 U.S.C. 2415(a) making it inapplicable and ruled that the statute in play was actually IRC Section 6901(a) which gave the IRS ten years from the date of assessment (July 19, 2010) within which to proceed against Mr. Frese under 31 U.S.C Section 3713.

[26] IRC Section 6651(a)(1).
[27] IRC Section 6662(a).

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M. Lawyer's Computer Error Doesn't Excuse Late Filing of Form 706 and Late Payment of Estate Tax

David Andrews v. United States, Case No. 20-641T (U.S. Court of Federal Claims, May 12, 2021)

1. *Facts*

Frank J. Andrews died on August 8, 2015. The Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return was due on May 9, 2016. David Andrews, the Executor, engaged a lawyer to assist in preparing the Form 706. The lawyer advised David that, by filing Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate and/or Generation-Skipping Transfer Taxes, he could obtain an automatic six-month extension of time to file the Form 706 and pay any estate tax due. David authorized the lawyer to file the Form 4768, but the lawyer failed to do so due to a "computer calendaring error." The lawyer filed the Form 706 a few days short of three months late. The Form 706 reflected estate tax due of about $3 million. Payment was not tendered along with the filing of the Form 706. The IRS assessed a late filing penalty, a late payment penalty and interest on tax and on the penalties. David, as Executor, eventually paid all tax due, penalties and interest and thereafter filed suit in the Claims Court for refund of the penalties and the interest on the penalties.

Seeking to avoid dismissal under *Boyle*,[28] David's Petition alleges that he didn't delegate to the lawyer the responsibility for filing Form 706 but, rather, relied on the lawyer's advice as to the due date for filing Form 706 and paying estate tax, that such advice was erroneous and that such reliance could constitute "reasonable cause" for not filing and not paying on time.

2. *Court Rules <u>Boyle</u> is Controlling*

The Claims Court was not persuaded by David's characterization of the issue, noting, first, that David and the Government agreed that "a taxpayer has a nondelegable duty to comply with his tax obligations." A taxpayer cannot delegate "ministerial tasks" and thereby be absolved of his duty to comply with statutory deadlines. The Claims Court observed that the evidence adduced in the case, including correspondence from the lawyer, clearly showed that David had indeed delegated his filing duty. This was not a case of erroneous advice; the lawyer's advice was flawless. The lawyer's execution was terribly flawed, however.

Boyle requires that David should have verified that his lawyer was fulfilling, on a timely basis, **<u>David's</u>** ministerial tasks of filing Form 706 and Form 4768 and rendering payment of estate tax. The consequences of David's failure to do that fall on David. Presumably, however, as a result of this decision, those consequences will be shifted to the lawyer's professional liability insurance carrier.

[28] *United States v. Boyle*, 469 U.S. 241, 105 S.Ct. 687, 83 L.Ed.2d 622, 53 U.S.L.W. 4059 (1985).

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N. Transferee Liability for Estate Tax

United States v. Estate of Kelley, et al., Case No. 3:2017cv00965 (D. N.J. October 22, 2020)

The results of this case are unsurprising, but the convoluted facts make the case interesting. It can best be understood by following a bullet-point timeline:

- **12/30/2003:** Lorraine Kelley died.
- Richard Saloom (Lorraine's brother) and Richard J. Lecky became Co-Executors. Richard Saloom was the sole beneficiary of Lorraine's estate.
- **09/23/2004:** Federal estate tax return was filed.
- **10/28/2004:** The IRS commenced examination of the federal estate tax return.
- **06/27/2006:** Richard Saloom, as Co-Executor, consented to a gross estate larger than reported within the estate tax return and additional estate tax liability.
- **Late 2007:** Richard Saloom attempted to resolve with the IRS the additional estate tax liability and made several significant estate tax payments.
- **03/31/2008:** Richard Saloom died. Before his death, Richard Saloom had received distribution of all property composing Lorraine's estate.
- Rose Saloom (Richard Saloom's daughter) became sole Executor and was the sole beneficiary of Richard Saloom's estate.
- Rose, as Executor, filed a New Jersey inheritance tax return, which referenced $456,406 as indebtedness for "federal tax."
- Rose received distribution of the entirety of her father's estate
- **02/10/2017:** The United States filed a five-count Complaint in the federal district court for the District of New Jersey against Lorraine's estate, Lecky, Rose and Richard Saloom's estate.
- **03/02/2020:** The District Court entered a Consent Judgment as to Count I (reduction of the estate tax assessment to judgment against Lorraine's estate) and closed the case.
- **03/04/2020:** In response to a letter request filed by the United States, the District Court reopened the case as to Counts II, III, IV and V.

As to Counts II, III, IV and V, the District Court entered summary judgment as follows:

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- **<u>Count II, Transferee Liability Against Richard Saloom's Estate</u>:** IRC Section 6324(a)(2) provides that a transferee who receives property from a decedent's estate is personally liable for any unpaid estate tax based on the value of the property received. It was undisputed that Richard Saloom had received all the assets of Lorraine's estate before he died. Richard Saloom's estate was his financial *alter ego*. The federal estate tax assessed against Lorraine's estate remained partially unpaid. Summary judgment granted.

- **<u>Count III, Fiduciary Liability Against Richard Saloom's Estate</u>:** The federal insolvency statute, 31 U.S.C. Section 3713, wholly separate and apart from the Internal Revenue Code, provides in subsection (a) that, when a person indebted to the United States Government is insolvent, a claim of the Government almost always has priority over all other claims, including in the case of a deceased debtor. Subsection (b) provides, in part, that an estate representative who pays any person's claim ahead of a United States Government claim is (personally) liable to the extent of the shortfall. That Richard Saloom had "at least constructive knowledge of the unpaid tax liability of [Lorraine's] estate," coupled with the same facts giving rise to Richard Saloom's estate's IRC Section 6324(b) liability also result in the estate's 31 U.S.C. Section 3713 liability. Summary judgment granted.

- **<u>Count IV, Fiduciary Liability Against Rose Saloom</u>:** The United States sought summary judgment against Rose under 31 U.S.C. Section 3713 because she distributed to herself all assets comprising the Richard Saloom estate, by so doing she rendered that estate insolvent, Richard Saloom owed a tax liability to the Government and Rose knew her father owed that tax liability. Summary judgment granted.

- **<u>Count V, UFTA Liability Against Rose Saloom</u>:** Finally, the United States contended it was entitled to summary judgment against Rose under the New Jersey version of the Uniform Fraudulent Transfers Act for her father's 31 U.S.C. Section 3713(b) liability because she was a fraudulent transferee of his property. The District Court concluded that Rose's distribution to herself of Richard Saloom's estate's assets was a testamentary transfer, not a type of transfer within the scope of the UFTA. Further, the District Court noted that such distribution didn't put Richard Saloom's property outside the reach of the United States. The Government retained its transferee liability rights. Summary judgment denied.

O. Penalty for Late Filed Estate Tax Return

Estate of Skeba v. United States, No. 3:17-cv-10231 PGS TJB, 2020 WL 70962 (D. N.J. October 3, 2019)

1. *Facts*

In *Skeba*, the decedent died on June 10, 2013, leaving an estate having a value of over $14,000,000.00. The estate tax return due date was March 10, 2014. On March 6, 2014, the estate filed a Form 4768 seeking a six-month extension of time within which to file the estate tax return and pay the estate tax. Along with the Form 4768, the estate paid $725,000.00 and eight

days later paid another $2,745,000.00.[29] These payments would render a zero balance due on the estate tax return when it was later filed.

The six-month extension period passed. The estate tax return was filed nine months thereafter. The IRS assessed, under IRC Section 6651(a), a 25% late filing penalty of $450,959.00. The estate's response to the assessment was that the late filing was due to reasonable cause and not willful neglect. The IRS wasn't impressed, and the penalty remained. The estate paid the penalty and sued for refund in U.S. District Court.

2. *Analysis*

The case turned on an interpretation of IRC Section 6651. The District Court ruled in favor of the estate, holding that, reading IRC Section 6651(a)(1) and (a)(2) together, the failure to file penalty applies only when there is an underpayment of tax within the extended time to pay. The District Court acknowledged the validity of the Government's point that, if a penalty for failure to file timely can't be imposed is a case such as this, a taxpayer may unilaterally impede conclusion of tax matters, but the District Court answered that it was the job of Congress to solve that problem.

The IRS asked the District Court to reconsider. On reconsideration, the District Court didn't change the result but added its finding that the estate had reasonable cause – likely making it more difficult for the case to be reversed on appeal. Nevertheless, the Government has appealed to the Third Circuit.

The result seems directly contrary to IRC Section 6151(c), Rev. Rul. 81-237[30] and *Ridenour*.[31] Several respected commentators have questioned the court's opinion.

III. INCLUSION IN GROSS ESTATE

A. Formula General Power of Appointment Approved
Private Letter Ruling 202206008 (February 11, 2022)

1. *Facts*

In Private Letter Ruling ("PLR") 202206008, the Trustee of a "grandfathered" generation-skipping trust wanted to confer on a child of the Settlor a power of appointment. The Trustee's stated reasons for so doing were: (a) to keep trust assets in the Settlor's descendants' hands and to minimize transfer taxation. Other trust beneficiaries opposed what the Trustee's exercise of discretion in this manner, and litigation ensued. A settlement agreement, to be consummated upon the issuance of a favorable private letter ruling, would modify a provision of the trust's governing instrument to give the child a testamentary power to appoint to the child's estate the largest portion of the trust property that could be included in the child's estate without increasing the total amount of all inheritance, estate and other death taxes, plus all federal and state

[29] The total amount due on March 10, 2014 was $2,528,838.00.
[30] Rev. Rul. 81-237, 1981-2 C.B. 245.
[31] *Ridenour v. United States*, 98 A.F.T.R.2d 2006-7965, 468 F.Supp.2d 941 (S.D. Ohio 2006).

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generation-skipping transfer taxes, over and above the amount that would have been actually payable in the absence of such provision.

2. *Rulings*

The IRS ruled, as requested, that the modification of the trust instrument pursuant to the proposed settlement agreement:

- Won't cause the trust to lose its GST exempt status or otherwise become subject to generation-skipping transfer tax; and
- Won't cause trust property to be includible in the child's gross estate under IRC Section 2041(a)(2).
- Will result in only the trust property subject to the child's testamentary power of appointment being included in the child's gross estate under IRC Section 2041(a)(2).

The ruling is a bit muddled in that it includes the following statement: "However, the exercise by Child of Child's testamentary general power of appointment will result in the appointed property being includable in Child's gross estate under § 2041(a)(2)." This statement is clearly incorrect. IRC Section 2041(a)(2) addresses the estate tax treatment of general powers of appointment created after October 21, 1942. Under IRC Section 2041(a)(2), merely the possession of such a power at death, regardless of whether it was exercised, causes inclusion in the gross estate of the powerholder of the value of all property subject to the power.

Post-2017 Tax Act, not only do many clients anticipate having no estate tax issues, they reasonably believe their children and grandchildren will also have no such issues. It's possible to design trusts for such clients' descendants in a manner that will cause the value of the assets in such trusts to be included in their respective gross estates just up to the point beyond which estate tax would be incurred. The point of causing inclusion in the gross estate of the value of property while not generating estate tax liability is to obtain a cost-free stepped-up basis with respect to such property for income tax purposes.[32]

The most common and popular method so to design such trusts is to confer on trust beneficiaries a testamentary general power of appointment of the type described and ruled on favorably in PLR 202206008. Whether the holder of a testamentary general power of appointment chooses to exercise it, the property that was subject to the power will be deemed to have been acquired from the deceased powerholder and will, therefore, qualify for the step-up in basis.[33] Although PLRs can't be used as precedent by taxpayers at large,[34] it is heartening to see the IRS issue a ruling on the estate tax effect of a formula general power of appointment that's consistent with what estate planning professionals would expect.

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[32] *See* IRC Section 1014(a) & (b)(9).
[33] *See* Treas. Reg. Section 1.1014-2(a)(4) & (b)(2).
[34] IRC Section 6110(k)(3).

B. Value of Family Limited Partnership Assets Included in Gross Estate; No Offsetting Charitable Deduction

Moore v. Commissioner, No. 20-73013 (9th Cir. November 8, 2021), *aff'g* T.C. Memo. 2020-40 (April 29, 2020)

1. *Facts*

Moore starts out as a "classic" family limited partnership case. Howard Moore, shortly after he emerged from the hospital having had a heart attack, created five trusts and a family limited partnership ("FLP"). He transferred 80% of his farm to the FLP. Five days later, he sold the farm to an unrelated party pursuant to a pre-existing contract. Nevertheless, he retained a life estate in the farm and continued to live on the farm and manage it. He used FLP funds to pay his legal bills and his living expenses. He died within four months after the transfer.

2. *Tax Court Opinion*

The Tax Court held the value of the farm was includable in Howard's gross estate under IRC Section 2036(a)(1). The transfer of the farm to the FLP wasn't a bona fide sale for full and adequate consideration because the FLP wasn't created for a legitimate and significant nontax reason.[35] There was no business to run after the farm was sold, and there was no proof that the decedent or his children had any legitimate creditor concerns. Furthermore, the decedent retained possession and enjoyment of the farm after the transfer by continuing to live on the property and manage the farm.

In addition, the Tax Court took up the "double inclusion" question that it had addressed in *Powell*.[36] The *Powell* Tax Court explained that its approach to determining the includable amount under IRC Section 2036 has been simply to disregard the existence of an FLP and hold that the value of the FLP's assets themselves is included in the decedent's gross estate. Applying that theory, there is no concern with double taxation, *i.e.*, subjecting to estate tax **both** the value of a retained FLP interest **and** the value of the FLP's underlying assets. The Tax Court opined that, while interpreting the applicable statutes to avoid double taxation leads to the correct result, the reason for so doing has gone "unarticulated."

The difficulty with the Tax Court's analysis in *Powell* (as the Tax Court itself acknowledged in footnote 7) is that, in a case in which asset values **increase** from the date of transfer of assets into the FLP up until the decedent's date of death, the **net** result is the double taxation that the Tax Court said is "not allowed." In such a circumstance, the value of the FLP interest held at date of death and included in the gross estate under IRC Section 2033 is **not** fully offset by the subtraction, under IRC Section 2043(a), of the value of the FLP interest the decedent received in exchange for his or her transfer of assets into the FLP, **determined at the time it was received**.[37]

[35] *See Estate of Bongard v. Commissioner*, 124 T.C. No. 8 (March 15, 2005).

[36] *Estate of Powell v. Commissioner*, 148 T.C. No. 18 (May 18, 2017).

[37] Interestingly, the Tax Court's opinion in *Powell* does not represent anything close to a unified voice on "double inclusion." Seven judges agreed with Judge Halpern's opinion for the court. Judge Lauber authored a concurring opinion, with which six judges agreed, expressing the view that, in ascertaining what values must be considered as

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The Tax Court embarked on an exceptionally detailed discussion, accompanied by numerous examples presented with what look like algebraic formulae, of how the estate tax law mandates inclusion in the gross estate of both the value of property a decedent had transferred into an FLP[38] plus the value of FLP interests held by a decedent at death[39] and then subtraction of any consideration that had been received by the decedent in exchange for his transfer(s) into the FLP.[40] The Tax Court admits some of its examples it gives "lead to what may seem odd results" and "might be thought to be less sensible" but doesn't offer any solution to the often anomalous interaction of the relevant statutory provisions. Thus, where FLP asset values have increased between the date of FLP funding and the decedent's date of death, the "double inclusion" anomaly remains an unresolved mess.

3. *Ninth Circuit Opinion*

A very narrow issue was presented on appeal. The estate didn't challenge inclusion of the value of the farm (or proceeds from sale of the farm) in Howard's gross estate under IRC Section 2036(a)(1) but did assert it was entitled to charitable deductions for funds transferred to the Howard V. Moore Charitable Lead Annuity Trust. In response, the Ninth Circuit examined the language in the governing instrument of a separate irrevocable trust by which the estate maintained the transfers to the CLAT were properly made and noted that such language mandated the transfers only upon a determination that "any asset of this trust" is also an asset of the gross estate. The Court of Appeals pointed out that no "asset of this trust" was determined to be included in the gross estate. The farm sale proceeds were assets of the FLP into which they flowed when the farm was sold. 98% of the equity in the FLP was an asset of the trust, but the FLP interest was not an asset included in Howard's gross estate. The estate's counter-argument that the phrase "asset of this trust" was ambiguous fell flat, and the Court of Appeals ruled no charitable deduction would be allowed.

C. IRC Sections 2036, 2038 and 2703 Inapplicable to Split-Dollar Arrangements, but Receivables Grossly Undervalued

Estate of Morrissette v. Commissioner, T.C. Memo. 2021-60 (May 13, 2021)

1. *Facts*

Clara Morrissette ("Clara") established a revocable trust in 1994 ("Clara's Trust") and transferred all of her stock in a group of family-owned companies called the Interstate Group to Clara's Trust. The governing instrument of Clara's Trust contained a provision allowing the Trustee to pay life insurance premiums on "policies acquired to fund the buy-sell provisions of the [Interstate Group's] business succession plan" and to enter into split-dollar arrangements.

In 2006, Clara's conservator, Ms. Hatfield, established three dynasty trusts (the "Dynasty Trusts") - one for each of Clara's sons and their respective families. Shortly thereafter, each Dynasty Trust purchased universal life insurance policies on the lives of the two other siblings

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includable in the gross estate in a case such as *Powell*, the FLP is merely an "empty box" that can be ignored, and so there is no "double inclusion."

[38] *See* IRC Section 2036(a).

[39] *See* IRC Section 2033.

[40] *See* IRC Section 2043(a).

(*e.g.*, Arthur's trust purchased policies on the lives of Donald and Kenneth, and so on). To fund the purchase of these policies, Clara's Trust entered into two split-dollar agreements[41] with each Dynasty Trust and contributed a combined $29.9 million in substantially equal shares to each of the Dynasty Trusts. The Dynasty Trusts used these funds to make lump-sum premium payments on the life insurance policies the Dynasty Trusts, respectively, held.

The split-dollar agreements provided that, on the death of an insured, Clara's Trust was to receive a portion of the death benefit generated by the policy insuring that insured's life equal to the greater of the policy's cash surrender value ("CSV") or the aggregate premium payments on the policy. If a split-dollar arrangement were terminated during a son's life, Clara's Trust would receive the greater of the underlying policy's CSV or the aggregate premiums paid on the policy, and the Dynasty Trust would receive nothing. Neither Clara's Trust nor the Dynasty Trusts retained the right to borrow against the CSV of the policies.

Disposition of all Interstate Group stock was subject to a shareholders' agreement, which provided, among other things, that, upon the death of any of Clara's sons, the surviving siblings and their respective Dynasty Trusts would purchase the stock held by or for the benefit of a deceased son.

Clara died on September 25, 2009, and the aggregate value of the receivables from the Dynasty Trusts was reported on the federal estate tax return at $7,479,000. The IRS countered that the entire CSV of the policies or the aggregate premiums paid on all policies were properly included in the gross estate under IRC Section 2036(a) or IRC Section 2038.

2. *Tax Court's Opinion*

The Tax Court held neither IRC Section 2036(a) nor IRC Section 2038 applied because the transfers from Clara (the $29.9 million) were *bona fide* sales for an adequate and full consideration in money or money's worth. The "legitimate and significant non-tax motive" that, in the Tax Court's view, supported the conclusion that Clara's transfers were *bona fide* sales was Clara's desire to cause Interstate Group equity to remain within her family during and after her sons' lives, and the Tax Court was convinced the split-dollar arrangements were designed to accomplish that objective. Moreover, the Tax Court found the split-dollar arrangements would foster a smooth management transition at Interstate Group (another legitimate and significant non-tax incentive for entering into the arrangements).

The Tax Court also ruled the split-dollar arrangements didn't run afoul of IRC Section 2703(a). Specifically, the Tax Court determined the split-dollar plan was a *bona fide* business arrangement, didn't constitute a device to transfer property to members of Clara's family for less than full and adequate consideration in money or money's worth and that its terms were comparable to similar arrangements entered into by persons in an arm's length transaction.[42]

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[41] In a split-dollar arrangement, one party pays the premiums on a life insurance contract, and, in exchange, that party is entitled to recover all or a portion of the premiums, which is secured by the life insurance proceeds. Treas. Reg. Section 1.61-22(b)(1).

[42] *See* IRC Section 2703(b).

Just when it seemed as if Clara's estate was riding high towards a glorious victory, the Tax Court derailed the train on the question of valuation. The Tax Court didn't accept the estate's position that the receivables from the Dynasty Trusts were worth $7,479,000 at Clara's death or an amount even close to that figure. A couple of factors in particular led the Tax Court to conclude the receivables were worth a whopping $27,857,709 (not materially different from the policies' aggregate CSV at Clara's death, about $32.5 million). First, the Tax Court believed the estate's valuation experts used the wrong discount rates to determine the present value of the policies' expected returns. Second, the Tax Court noted evidence adduced at trial, including electronic mail messages, that seemed strongly to suggest Clara's sons, as Trustees of Clara's Trust and as Trustees of the Dynasty Trusts, had hatched a plan to get together and terminate the split-dollar arrangements and take control of the policies almost immediately after expiration of the statute of limitations on the estate tax return.

To add severe insult to already bad enough injury, the Tax Court sustained a 40% gross valuation misstatement penalty. The Tax Court rejected the estate's assertion it had reasonably relied on its valuation experts because, in the Tax Court's view, the $7,479,000 value was so far from reality the estate should have realized it couldn't be correct.

The lesson of *Morrissette* seems to be that generational split-dollar plans will work if structured properly and if there is a provable legitimate and significant non-tax purpose but that the present value of a decedent's split-dollar rights will likely not be nearly as low, compared to a policy's CSV, as asserted in *Morrissette*. Additionally, the surviving parties to a split-dollar arrangement might consider not creating discoverable evidence of a scheme to circumvent the arrangement, and obtain substantial value by so doing, shortly after they think they can get away with it.

D. Intergenerational Loan Regime Split-Dollar Arrangements Revisited *Estate of Levine v. Commissioner*, 158 T.C. No. 2 (February 28, 2022)

Marion Levine entered into a transaction very similar to those that were the subject of *Morrissette*, albeit on a smaller scale. In 2008, Marion's revocable trust entered into a split-dollar agreement with an irrevocable life insurance trust and contributed $6.5 million to the trust. The Trustee of the irrevocable trust used the contributed funds to purchase insurance on the lives of Marion's daughter and her spouse. At the death of an insured, or on premature termination of a policy, the revocable trust was to receive an amount equal to the greater of the policy's cash surrender value ("CSV") or the premium paid. Marion died in 2009.

Just as in *Morrissette*, the Tax Court ruled in favor of the estate on all IRC Section 2036, 2038 and 2703 issues. Very unlike *Morrissette*, though, a family friend and advisor, Bob Larson, was the sole member of the Levine irrevocable trust's investment committee and, as such, had exclusive authority over disposition of the life insurance policies. The Tax Court believed Larson owed real, enforceable fiduciary duties to all trust beneficiaries and so would not and could not collapse the split-dollar arrangements as was apparently planned by Clara Morrissette's sons.

Moreover, valuation of the receivable held by Marion's estate wasn't an issue. The policies' CSV at Marion's death was $6,153,478, but the estate and the IRS had stipulated that the

discounted present value of the receivable was $2,282,195, and that was the amount included in Marion's gross estate – needless to say, an excellent result from the estate's perspective.[43]

Not to be lost in the euphoria of the Levine estate's success in the Tax Court is the fact that there will eventually be an income tax consequence with which to be reckoned. When the insured dies and the note owed by the irrevocable trust to the revocable trust is paid, gain will be recognized.

IV. ESTATE TAX DEDUCTIONS

A. Adjusted Taxable Gifts Determined; Numerous Deductions Denied

Estate of Spizziri v. Commissioner, T.C. Memo. 2023-25 (February 28, 2023)

1. *Facts*

Decedent, who died in 2015, was a wealthy lawyer who had been married four times. His last prenuptial agreement stated he had roughly $25 million in assets at the time of his fourth marriage. He was estranged from his fourth wife at his death, and he had relationships with other women and fathered children with them outside his marriage. His prenuptial agreement with his fourth wife—modified five times over their 18-year marriage—required that he execute a Will providing that, at his death:

- She would receive his interest in his New York City penthouse plus $6 million (or 1/5 of his gross estate);
- She would receive the right to reside at his house in the Hamptons for five years free of charge; and
- Each of her children from a previous marriage would receive $1 million.

He never executed a Will that complied with the prenuptial agreement. He executed his only will in 1979 and four codicils beginning in 2014. His will, as modified, essentially bequeathed his estate to his children and his Miami condominium to the woman—not his wife—with whom he purchased it.

Over the last few years of his life, Decedent made a number of large gifts to various women, which he did not report to the IRS. They ranged from $7,350 to $58,550 but were mostly in the higher end of this range.

Decedent died in 2015 in Aspen, Colorado, where he owned property. His wife made various claims against his estate, and they eventually reached a court-approved settlement. Her children also filed claims seeking their $1 million payments under the prenuptial agreement, which the estate paid, plus interest as required by Colorado law.

[43] The icing on the cake is that the funding of the irrevocable insurance trust pursuant to the split-dollar agreement constituted a taxable gift of $2,644.

2. *Estate Tax Proceedings*

The Estate made an initial estate tax payment of $11.8 million. It received one extension, and its request for a second was denied. It filed the Form 706 several months late, after the probate litigation had concluded. The estate tax return showed the following:

- A gross estate valued at over $81 million, a taxable estate of almost $31 million, and tax due of about $10 million;
- $0 in adjusted taxable gifts;
- Deductions for claims against the estate:
    - The $1 million payments to the wife's children;
    - The value of the wife's right to live in the Hampton property for five years ($600,000); and
- Deductions as administration expenses:
    - Emergency repairs of $22,000 for the NYC penthouse and $315,000 for the decks at the Aspen home; and
    - $455,000 for five years of estimated "property maintenance" related to the wife's right to live in the Hamptons home.

The IRS issued a deficiency notice that determined the following:

- Estate tax deficiency of over $2.2 million;
- Penalty of $450,000 for failing to file timely;
- Increase in adjusted taxable gifts to almost $200,000; and
- Disallowance of all of the deductions listed above.

3. *Tax Court Rulings*

The estate failed to meet its burden to prove that any of the payments to family and friends in the last several years of Decedent's life were not taxable gifts. The estate argued they were payments for services—for care and companionship. There were nine recipients in total, and the estate only called one of them to testify. The court noted this could lead to an adverse inference that their testimony would not have supported the estate's position.

Even without an adverse inference, the adduced facts were insufficient to establish the payments were compensation for services. Decedent made the payments by check with no indication what they were for; he didn't file Forms 1099 or issue Forms W-2; he didn't report them

on his income tax returns; the witnesses addressed payments to only three of the nine recipients; and their testimony didn't even make it clear that these were payments for services.

The $1 million gifts to the wife's children and the wife's right to live in the Hamptons house that the estate deducted as claims against the estate failed both required elements of a deductible claim: (a) that they were made pursuant to a "*bona fide*" contract or agreement, and (b) that there was consideration.[44]

First, the payments and right to live in the Hamptons house were not made under any *bona fide* contractual obligation since there was no evidence the payments were anything but "donative in character" and they were made to family members, which subjected the payments to heightened scrutiny. Rather, the payments were testamentary gifts, as made clear by the language in the prenuptial agreement (in the rights-upon-death section), and the recipients didn't include them as income.

Second, there was no consideration because the wife waived her legal rights in the prenuptial agreement as the surviving spouse in exchange for the payments to her children and right to live in the Hamptons house. IRC Section 2043(b) explicitly provides that waiver of a spouse's marital rights in the other spouse's property is not consideration.

The repairs to the Aspen home's decks could not be deducted under IRC Section 2053(a)(2). Expenses incurred to improve or preserve a property or to enhance its resale value are not deductible. Here, there was no evidence that the repairs were necessary to prepare the property for sale (which was an argument the estate didn't even raise until its reply brief, so the court could have deemed the issue forfeited). The appraisal the estate relied on did not conclude that such repair was required to sell the property.

There was no evidence that the estate had "reasonable cause" to file the return late. It was required to file with the best information available at the time, and it could have filed an amended return. The estate had argued that it was waiting for the probate litigation to conclude before filing, but there was nothing indicating the probate litigation prevented the estate from having sufficient information to file.

The court rejected the argument that the estate filed late because it relied on the tax preparer's advice. The preparer actually testified that he advised the estate to file before the extended deadline.

Finally, the court rejected the estate's argument that a late filing penalty was inappropriate because it remitted an overpayment before the filing deadline. A penalty for late filing applies even when a full payment is made on time.

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[44] IRC Section 2053(c)(1)(A).

B. No Estate Tax Deduction for Unitrust Interest That Can Pass to Charity or Surviving Spouse

Chief Counsel Advice 202233014 (August 19, 2022)

The terms of a testamentary charitable remainder unitrust created by a predeceased spouse provided for annual unitrust payments of five percent throughout the surviving spouse's life. 25% of the unitrust amount was required to be distributed to the surviving spouse. The remaining 75% was required to be distributed but could be distributed to the surviving spouse or to charity in the Trustee's discretion. The issue presented was whether an estate tax charitable deduction and/or an estate tax marital deduction were allowable with respect to the 75% portion of the unitrust interest that the Trustee could allocate between the surviving spouse and the charity.

The OCC ruled that neither an estate tax charitable deduction or marital deduction would be allowable as to the 75% portion. Citing IRC Section 2055(b) and Treas. Reg. Section 20.2055-2(a), the IRS ruled the charitable deduction wouldn't be available because the charity's interest wasn't in the form of a fixed unitrust amount to be distributed annually, and no part of the unitrust amount was ascertainable or severable from the surviving spouse's interest. Citing IRC Section 2056(a), Treas. Reg. Section 20.2056(c)-2(a) and *Estate of Turner v. Commissioner*,[45] the IRS ruled that the surviving spouse's interest in the 75% portion wouldn't qualify for the marital deduction because the extent of that interest couldn't be established as of the predeceased spouse's date of death, and it wasn't possible ascertain as of that date whether the surviving spouse would receive some, all or none of the 75% portion, and so no part of the 75% portion could be considered as having passed to the surviving spouse from the decedent.

Footnote 1 acknowledges that CCA 202233014's conclusions are opposite the conclusions reached in PLRs 200813006, 200832017, 201117005 and 201845014 on virtually the same facts. This taxpayer had to feel burned. CCA 202233014 is a brutal reminder that PLRs can't be cited or used as precedent.[46]

C. Estate Tax Deductions for Payment of Certain Administration Expenses and Claims

Proposed Regulation Section 20.2053-1(d)(6), (d)(7), (f), -3(d) and -4(d)(5), REG-130975-08, 87 Fed. Reg. 38331 (June 28, 2022)

Prop. Reg. Section 20.2053-1(d)(6), (d)(7), (f), -3(d) and -4(d)(5) addresses a number of points relating to estate tax deductions under IRC Section 2053. Among the most important and interesting aspects of the proposal are the following:

1. *Present Value Concepts*

The IRS acknowledges that estates often are unable, for a variety of legitimate and unavoidable reasons, to pay estate administration expenses and claims promptly after a decedent's death. That said, the IRS is concerned that estates may pay certain expenses and claims as much as several years after death but seek to deduct the payment of those expenses and claims on a

[45] *Estate of Turner v. Commissioner*, 138 T.C. 306, 316 (2012).
[46] IRC Section 6110(k)(3).

dollar-for-dollar basis without taking into account the fact that an estate in such circumstances has had the use of the funds for the multi-year period of deferral of payment.

Accordingly, Prop. Reg. Section 20.2053-1(d)(6) would require discounting to present value, for purposes of deducting under IRC Section 2053, any administration expense or claim that is not paid or to be paid within the three-year period following the decedent's death (the "grace period"). Discounting is to be implemented using the mid-term or long-term applicable federal rate ("AFR") determined under IRC Section 1274(d). Detailed instructions for performing the discounting calculations are included. Discounting wouldn't be required for unpaid principal of mortgages and other indebtedness deductible under Treas. Reg. Section 20.2053-7.

Among the most direct and dramatic impacts these rules would have would be on "Graegin" loans. In *Estate of Graegin v. Commissioner*,[47] the estate borrowed funds on a 15-year note to pay estate tax. The note by its terms couldn't be prepaid. All interest provided for throughout the 15-year term, at the annual rate of 15%, would have to be paid under any and all circumstances. The aggregate amount of that interest was calculated to be $204,218. The Tax Court determined that the amount of interest payable was ascertainable and that the interest was an expense "actually and necessarily incurred" and would be paid. Accordingly, the Tax Court allowed the estate to take an immediate IRC Section 2053 deduction for the full $204,218.

Prop. Reg. Section 20.2053-3(d)(1) drives home the points that: (a) "section 6166 interest" isn't deductible under IRC Section 2053(c)(1)(D); and (b) "non-section 6166 interest" accruing on unpaid estate tax and penalties isn't "actually and necessarily incurred" and isn't deductible if attributable to the executor's negligence, disregard of applicable rules or regulations or fraud with intent to evade tax. Prop. Reg. Section 20.2053-3(d)(2) also sets forth detailed requirements for a loan to which interest expense relates will be considered *bona fide* in nature, actually and necessarily incurred and essential to the proper settlement of the decedent's estate.

2. *Decedent's Personal Guarantee*

Prop. Reg. Section 20.2053-4(d)(5) addresses the question of when an IRC Section 2053 deduction will be allowed in connection with a debt of someone other than the decedent that the decedent guaranteed. For the amount of the debt to be deductible, the decedent's guarantee must have been bona fide and in exchange for adequate and full consideration in money or money's worth. If the indebtedness is owed by an entity in which the decedent had an interest at the time the guarantee was given, the "in exchange for adequate and full consideration in money or money's worth" requirement is met if the decedent controlled the entity (within the meaning of IRC Section 2701(b)(2)) or the decedent's maximum liability at the time the guarantee was given didn't exceed the fair market value of the decedent's interest in the entity.

[47] *Estate of Graegin v. Commissioner*, T.C. Memo. 1988-477.

D. Value of QTIP Trust Assets Not Reduced by Settlement Payment for Undistributed Income

Estate of Kalikow v. Commissioner, T.C. Memo. 2023-21 (February 27, 2023)

1. *Facts*

Pearl B. Kalikow died in New York on January 4, 2006. Pearl was predeceased by her husband, Sidney. Sidney's Will created the SK Trust, for the benefit of Pearl, which was funded with the residue of Sidney's estate. The Trustees were to pay the net income to Pearl at least quarterly during her lifetime. The SK Trust was treated as a QTIP trust under IRC Section 2056(b)(7). Upon Pearl's death, the SK Trust assets were to be paid over to trusts for Pearl and Sidney's two children, Edward and Lauren, and their issue. The executors under Pearl's Will were Eugene Shalik and James DeVita.

In 1997, the Trustees of the SK Trust created the Kalikow Family Partnership, L.P. ("KFLP"). The SK Trust transferred interests in ten income-producing New York City apartment buildings to KFLP in exchange for a 98.5% limited partnership interest in KFLP. At the time of Pearl's death, the SK Trust consisted of the KFLP interest and $835,000 in cash and marketable securities.

In 2009, one of Pearl's grandchildren petitioned a New York court to compel the Trustee to render an accounting of the SK Trust, claiming that KFLP failed to distribute to the SK Trust its full share of the KFLP distributable amounts, thereby diminishing Pearl's receipt of trust income by $16,946,827. The parties litigated the issue and agreed that the SK Trust would pay Pearl's estate $9,200,000 (which included $6,572,310 in undistributed income from January 1, 2002 through December 31, 2005).

In 2007, Pearl's executors filed a Form 706 that was made "in respect of all assets of the estate other than Pearl's interest in the [SK] Trust" and listed on Schedule F, Other Miscellaneous Property Not Reportable Under Any Other Schedule, the amount of $31,869,441 which was noted as including "undistributed income due from the SK Trust" in the amount of $4,632,489, along with other claims against the Trustees of the SK Trust. Edward and Lauren (referred to as limited administrators) filed a separate Form 706, reporting SK Trust assets (including a KFLP value of $42,465,000) and disputing the claim by the executors for the amounts due from the SK Trust.

In a notice of deficiency issued in respect of Pearl's Form 706, the IRS determined that the value of the SK Trust assets was $105,664,857, instead of $42,465,000, and also reduced the estate's Schedule F assets by $4,632,489, the value of the estate's pending claim against the SK Trust.

The estate's petition in Tax Court asserted that it was an error for the IRS to decrease the gross estate value by the $4,632,489 value of the estate's claim against the SK Trust. The limited administrators filed a cross-petition claiming that the value of the SK Trust should be reduced by the amount of any claim allowed for undistributed income due to the estate. The parties then agreed, among other things, that the value of the SK Trust's 98.5% limited partnership interest in KFLP at decedent's death was $54,492,712. The parties then agreed that the only issues to be

decided were: (a) the value of the SK Trust assets to be included in Pearl's gross estate pursuant to IRC Section 2044 and (b) what components of the agreed-upon settlement payment could be deductible by the estate as administration expenses under IRC Section 2053.

2. *Tax Court's Holdings*

The Tax Court held that the value of the SK Trust assets included in Pearl's estate should not be reduced by the amount of the settlement payment representing undistributed income under IRC Section 2044. The court noted that the executors of Sidney's estate had elected to treat the SK Trust as a QTIP trust. Thus, under IRC Section 2044(a), the SK Trust property was included in Pearl's gross estate at its fair market value at her death, which was $54,492,712, plus the $835,000 in marketable securities. The court noted that, having previously stipulated that the relevant value of the SK Trust's KFLP partnership interest was $54,492,712, the limited administrators could not now argue for some lesser value on account of the undistributed income payment liability. Moreover, the liability for the settlement payment does not run to KFLP, so one cannot conclude that this liability would affect the date-of-death fair market value of the SK Trust's KFLP partnership interest. Finally, the court noted that the settlement agreement itself stated that the settlement payment was not expected to be made from the SK Trust's KFLP interest.

The Tax Court also found that the obligation of the SK Trust to make the agreed-upon settlement payment to the estate did not give rise to any deduction under IRC Section 2053. The court instead found that the estate's claim against the SK Trust was property that should be included in the gross estate. The court stated that even if it assumed that the estate incurred the fees and commissions noted in the agreed-upon settlement payment, Reg. Sec. 20.2053-4(d)(3) provides that reimbursement of such expenses under the settlement agreement would preclude any deduction by the estate.

E. Marital Status Determined for Marital Deduction Purposes Using "Place of Celebration" Rule

Estate of Grossman v. Commissioner, T.C. Memo. 2021-65 (May 27, 2021)

This case involves an interesting series of events involving the complicated love life of one Semone Grossman. The relevant timeline can be organized as follows:

- Semone married his first wife, Hilda, in 1955 in New York City. Semone and Hilda were Jewish.
- Semone and Hilda separated in 1967.
- Semone traveled without Hilda to Mexico and unilaterally obtained in a Mexican court a divorce from Hilda on or about August 24, 1967.
- Later in 1967, Semone married his second wife, Katia, in New Jersey. Katia was not Jewish.

- In 1974, Hilda obtained a judgment from a New York court holding that: (1) the Mexican divorce was invalid; (2) Semone's purported marriage was invalid; and (3) Hilda remained Semone's wife.

- In 1986, Semone and Hilda appeared in a rabbinical court in New York and obtained a religious divorce under Jewish law.

- Semone married his third wife, Ziona, in a traditional Orthodox Jewish ceremony in Israel in 1987. Shortly thereafter, Semone and Ziona took up residence in New York and lived there, apparently as husband and wife, until Semone's death. Their filing status for federal income tax purposes was "married filing jointly." During this period, Hilda's filing status for federal income tax purposes was "single."

- Semone died in 2014. Hilda survived Semone but also died in 2014. She did not make any claim against Semone's estate, as allowed by New York law, as a surviving spouse.

Semone's gross estate for federal estate tax purposes had a value of about $87 million. He bequeathed about $79 million to Ziona. His estate, quite predictably, claimed a martial deduction under IRC Section 2056 with respect to the $79 million. The IRS objected on the grounds that Ziona was not Semone's "surviving spouse" and determined a federal estate tax deficiency in the amount of $35,497,032 as well as an accuracy-related penalty under IRC Section 6662 of $7,099,406.

Specifically, the IRS' position was that the 1986 divorce was invalid under New York law, "properly applied," and, therefore, Hilda, not Ziona, was Semone's surviving spouse. The estate's principal position was that a New York law analysis was irrelevant and unnecessary because, for federal tax purposes, it was proper to look only to the law of the "place of celebration" to conclude whether a marriage was valid.[48] The estate also maintained that, under *Estate of Spalding v. Commissioner*,[49] Semone and Ziona's marriage must be presumed valid for federal tax purposes unless a New York court had declared it invalid (and a New York court had not done so). Finally, the estate argued that, even if New York law governed whether Ziona was Semone's spouse, the estate should still prevail.

The Tax Court ruled in favor of the estate. The Tax Court held that a New York court would apply the "place of celebration" test to determine whether Semone's marriage to Ziona was valid. There was no dispute between the parties that, under Israeli law, the marriage was valid. The Tax Court also specifically concluded that, because the "place of celebration" test was controlling under New York law, the question of whether the 1986 divorce was valid for New York civil law purposes was irrelevant. The Tax Court rejected the IRS' insistence that Semone and Hilda's failure to obtain a civil law divorce meant that, for civil law (and federal tax law) purposes, Semone and Hilda's marriage was never dissolved, and so Semone and Ziona could not

[48] *See* Rev. Rul. 2013-17, 2013-38 I.R.B. 201; Rev. Rul. 58-66, 1958-1 C.B. 60; and Rev. Rul. 53-29, 1953-1 C.B. 67.
[49] *Estate of Spalding v. Commissioner*, 537 F.2d 666 (2d Cir. 1976).

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have been validly married under New York law, regardless of where the marriage took place, because bigamy was illegal under New York law.

V. GIFTS

A. Value of Gift Checks Prepared but Not Processed by Investment Firm Included in Gross Estate

Estate of DeMuth v. Commissioner, T.C. Memo. 2022-72 (July 12, 2022)

Donald L. DeMuth, as agent for his father, William E. DeMuth, Jr. under a power of attorney, prepared eleven checks totaling $464,000.00 made out to family members. All but one of the checks were not paid by the drawee financial institution until after William's death. The federal estate tax return for William's estate was selected for examination by the IRS. The IRS issued a notice of deficiency, which determined that the value of the investment account reported on the return was understated by $436,000.00 – the value of the ten checks that weren't paid until after William's death.

Citing Treas. Reg. Section 25.2511-2(b) and discussing various aspects of applicable state law (the law of the Commonwealth of Pennsylvania), the Tax Court held that the value of seven checks, totaling $366,000.00, were included in William's gross estate.[50] The Tax Court reasoned that William's gifts weren't complete because, until the financial institution on which the checks were drawn had paid the checks, William (or his agent, Donald) could have stopped payment on the checks and retrieved the funds represented by the checks. Accordingly, William hadn't "parted with dominion and control as to leave him no power to change [the checks'] disposition."

B. Purported Gifts to Spouse Held to Have Been Gifts to Trust

Smaldino v. Commissioner, T.C. Memo. 2021-127 (November 10, 2021)

1. *Facts*

Louis Smaldino owned an $80 million portfolio of rental real estate. He was married and had six children (and 10 grandchildren) from a prior marriage. He wished to pass a large portion of his real estate rental business to his children separate from any wealth he would give to his wife to promote her financial security.

The components of Louis' estate plan included:

1. The Smaldino Family Trust, a revocable trust created in 2013 of which Louis was the settlor and Trustee;

2. The Smaldino 2012 Dynasty Trust, an irrevocable trust established on December 21, 2012, of which Louis was the settlor, Louis' son, Allen, was

[50] The aggregate amount of three checks, totaling $70,000.00, would also have been included were it not for a concession the IRS made on brief and on which the estate relied at trial. The IRS sought to withdraw the concession, but the Tax Court would not allow it to be withdrawn.

the Trustee and Louis' children and grandchildren were the beneficiaries; and

3. Smaldino Investments, LLC, created in 2003 but inactive until 2012, whose equity interests were structured as 1% Class A Voting member units and 99% Class B Non-Voting member units. Initially, the Smaldino Family Trust was the sole member, and Louis was the manager. The operating agreement did not include a member's spouse as a permitted transferee.

After a health scare, Louis decided he wanted to transfer a portion of his real estate investments to his children and grandchildren and other, non-real estate assets to his wife, Agustina. Agustina agreed with this plan. Accordingly, in December of 2012, Louis transferred ten California properties into Smaldino Investments, LLC. "Effective: April 14, 2013," Louis assigned a "sufficient number" of Class B membership units of Smaldino Investments, LLC to his wife so that the fair market value of such units as determined for federal gift tax purposes would equal \$5.249 million (Agustina's then remaining federal gift tax exemption). "Effective: April 15, 2013," Agustina assigned an identically described interest in Smaldino Investments, LLC to Allen, as Trustee of the Smaldino 2012 Dynasty Trust. "Effective: April 15, 2013," Louis assigned to Allen, as Trustee of the Smaldino 2012 Dynasty Trust, a "sufficient number" of Class B membership units of Smaldino Investments, LLC so that the fair market value of such units as determined for federal gift tax purposes would equal \$1.032 million.

The documents by which the above-referenced three transfers were implemented did not indicate the date on which they were signed. Neither the LLC's operating agreement nor any federal income tax return filed for the LLC ever indicated that Agustina was ever a member of the LLC.

To quote the Tax Court, "[w]hen the dust settled," the following assignments had ostensibly occurred:

1. A 41% interest in Smaldino Investments, LLC from the Smaldino Family Trust to Agustina;

2. A 41% interest in Smaldino Investments, LLC from Agustina to the Smaldino 2012 Dynasty Trust; and

3. An 8% interest in Smaldino Investments, LLC from the Smaldino Family Trust to the Smaldino 2012 Dynasty Trust.

Louis reported on his 2013 gift tax return the \$1.032 million assignment from the Smaldino Family Trust to the Smaldino 2012 Dynasty Trust. He didn't elect to split the gift.[51] He didn't report any gift to Agustina. Agustina reported on her 2013 gift tax return her \$5.249 million assignment to the Smaldino 2012 Dynasty Trust. She didn't elect to split the gift.

The IRS issued a notice of deficiency to Louis and determined that Louis had a \$1.154 million gift tax deficiency. It alleged, among other things, that the gift Louis purportedly

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[51] *See* IRC Section 2513.

made to Agustina was, for gift tax purposes, in fact, a gift to the Smaldino 2012 Dynasty Trust – thus, regardless of whether reported on Louis' 2013 gift tax return, not qualifying for the gift tax marital deduction.[52]

2. *Tax Court's Opinion*

The Tax Court found that Louis effectively gifted a 49% interest in Smaldino Investments, LLC to the Smaldino 2012 Dynasty Trust and didn't gift any interest in Smaldino Investments, LLC to his wife.

First, the Tax Court highlighted that the LLC's operating agreement did not recognize a member's spouse as a permitted transferee, and so Agustina was precluded (in the absence of board approval, which was never sought or obtained) from receiving the interest in Smaldino Investments, LLC that Louis claimed to have transferred to her. Second, the Tax Court observed that Exhibit A of the operating agreement wasn't amended to reflect that Agustina was ever the holder of any membership interest, but, notably, it was amended to show the Smaldino 2012 Dynasty Trust's status as holding a 49% membership interest. Third, the Tax Court found it "more likely than not" that the assignment documents were signed no earlier than August 22, 2013, and so, as a practical matter, Agustina never had any ability to exercise ownership rights. Fourth, the Tax Court noted that the LLC's 2013 tax return didn't reference Agustina as an LLC member at any time during that year. Fifth, the Tax Court emphasized that, particularly in connection with transactions between family members, heightened scrutiny is warranted, and so the substance of an intra-family transfer, rather than deference to paperwork, should govern its tax consequences.

In sum, the Tax Court held that the preponderance of the evidence supported: (a) the conclusion that the gifts from Louis to his wife and from his wife to the Smaldino 2012 Dynasty Trust were effectuated pursuant to a prearranged plan; and (b) re-characterizing Louis' alleged transfer of membership interests in Smaldino Investments, LLC to his wife as, in reality, a gift by him to the Smaldino 2012 Dynasty Trust. Indeed, quite damaging to Louis' position in Tax Court was Agustina's sworn testimony that, before Louis gave her any LLC membership interests, she had already made "a commitment, promise" to transfer such interests to the Smaldino 2012 Dynasty Trust and that she could not have changed her mind "because I believe in fairness."

3. *How Case Might Have Gone Differently*

Though no fact in this case was independently dispositive, making one or more of the following changes in the facts may have rendered a different result:

- Increase the amount of time between Louis' gift to Agustina and Agustina's gift to the Smaldino 2012 Dynasty Trust;
- Engineer Louis' gift and Agustina's gifts so they are not of the exact same assets and/or not in the exact same amount.

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[52] *See* IRC Section 2523.

- Ensure Louis' transfer to his wife was authorized – either by amending the operating agreement expressly to include a member's spouse as a permitted transferee or by obtaining prior board approval;

- Carefully memorialize the transfers of the LLC's membership interests within the LLC's organizational documents; and

- Ensure the LLC's tax returns reflect the existence of all members for relevant the periods of membership, however short.

C. Division of QTIP Trust Coupled With Nonqualified Disclaimer

PLR 202146001 (August 9, 2021)

1. *Facts*

In PLR 202146001, the IRS issued favorable rulings related to the division of a QTIP trust coupled with a disclaimer. A predeceased spouse established a revocable trust during her life the terms of which provided for the trust assets to pass at her death, if her spouse survived her, in two shares, a bypass share and a marital share. The surviving spouse was named the Trustee of the marital share, and the marital share was to be administered for the sole benefit of the surviving spouse during his life. The deceased spouse's executor elected to treat the marital share as qualified terminable interest property (QTIP) under IRC Section 2056(b)(7).

The surviving spouse proposed to divide the marital share into two separate but identical trusts (Trust A and Trust B), on a pro-rata, fractional basis. Trust A was to be funded from marital share assets having a net fair market value equal to the basic exclusion amount under IRC Section 2010(c)(3), and Trust B was to be funded with all remaining assets of the marital share. The surviving spouse, the Trustee and the trust's remainder beneficiaries (the decedent's children) all agreed that the proposed division would not impair the rights of any trust beneficiaries and would not adversely affect the original purposes of the marital share. The trust would continue to be held under identical terms, through Trust A and Trust B, before and after the division.

Following the division of the marital share, the surviving spouse intended to make a non-qualified disclaimer his interest in Trust A, thereby causing the assets of Trust A to be distributed to trusts created for the benefit of the decedent's children.

2. *Rulings*

The surviving spouse requested, and the IRS granted, the following rulings:

1. The division of the marital share would not cause the marital share, Trust A, Trust B or any beneficiary to recognize ordinary income or loss, or capital gain or loss, under IRC Section 61 or 1001;

2. Following the division of the marital share, Trust A and Trust B would continue to be QTIP trusts under IRC Section 2056(b)(7);

3. As a result of his disclaimer, the surviving spouse would be treated as having made a gift of his qualifying income interest in Trust A under IRC Section 2511 and a gift of all interests in Trust A other than the qualifying income interest under IRC Section 2519;

4. The disclaimer would not cause any property in Trust B to be treated as a gift by the surviving spouse under IRC Section 2519;

5. The value of the property of Trust A treated as transferred under IRC Section 2519 would not be included in the surviving spouse's gross estate under IRC Section 2044(a) because of the application of IRC Section 2044(b)(2); and

6. The disclaimer would not cause the surviving spouse's interest in Trust B to be valued at zero under IRC Section 2702.

D. Gift or Contractual Payment?

Pratte v. Bardwell, No. CV-19-00239-PHX-GMS (D. Ariz., August 4, 2021)

1. *Facts*

Ronald Pratte owned a construction business, and he hired Jeffrey Bardwell to manage a Phoenix lumberyard. Pratte and Bardwell became close friends. Pratte sold his business in 2005 and thereafter met Bardwell and four others at the Las Vegas airport. At that meeting, Pratte handed each of the other five attendees a check in the amount of $2 million. He said he would be transferring real estate in the coming months to each of them as well. He expressed the desire that each of them use the money and the real estate to start up a home construction business. Notwithstanding that Pratte paid gift tax in connection with the transfers, Pratte sued Bardwell in federal district court in Phoenix on the grounds of breach of contract, promissory estoppel and unjust enrichment, claiming that, in exchange for the transfers, Bardwell promised Pratte he would work for him for the rest of his life. Bardwell countered that the transfers were gifts. Both parties filed motions for summary judgment.

2. *Disposition by the Court*

The District Court opined that made a plausible presentation of his version of the facts and that a reasonable jury could accept as true either party's story. Thus, the District Court ruled, as to the breach of contract and promissory estoppel claims, a genuine issue of material fact remains to be resolved, and so both parties' summary judgment motions were denied. As to the unjust enrichment claim, the District Court stated that, under Arizona law, such a claim cannot be maintained when there is a valid, enforceable contract governing the transaction at issue, and, as noted above, the District Court had yet to determine whether such a contract existed, and so the District Court also refused summary judgment on this claim.

Finally, in a remarkable fit of illogic, Pratte argued he had suffered damages to reimbursement of which he was entitled from Bardwell. Specifically, Pratte maintained the gift tax he paid in connection with the transfers to Bardwell were "paid on behalf of [Bardwell] and his wife." In response, the District Court noted, first, that gift tax is paid with respect to gratuitous

transfers, not transfers in arm's-length transactions.[53] Thus, Pratte's payment of gift tax would seem to be a rather strong piece of evidence that, at the times of the transfers, and at the later time when he filed his gift tax return, Pratte viewed the transfers to Bardwell the same as Bardwell characterized them – as gifts. Second, the District Court observed that the donor, not the donee, is liable for gift tax,[54] and so Pratte could not be damaged by Bardwell's failure to cover Pratte's legal obligation to pay gift tax.

E. Gift Tax Consequences of Commutation of QTIP Trust

Chief Counsel Advice 202118008 (May 6, 2021)

A decedent's surviving spouse ("Spouse"), was beneficiary for life of a typical QTIP trust, was entitled to receive the trust's entire net income, at least annually, and might receive discretionary principal distributions in accordance with an ascertainable standard. Spouse had a testamentary nongeneral power of appointment that could be exercised in favor of the decedent's descendants. Unappointed trust property was to pass at Spouse's death to the decedent's children, by right of representation.

Spouse and the children (the children representing themselves and virtually representing the contingent remainder beneficiaries) entered into an agreement whereby the QTIP trust was terminated, and all trust property was distributed to Spouse.

The following issues were presented and resolved as follows:

- Termination of the QTIP trust was a disposition of Spouse's qualifying income interest within the meaning of IRC Section 2519(a). Spouse was therefore treated under IRC Section 2519(a) as having made a gift of the entire trust property other than the qualifying income interest.

- Distribution of all the QTIP trust's assets to Spouse was treated as a gift by the remainder beneficiaries under IRC Section 2511.

- Spouse's deemed gift under IRC Section 2519(a) and the remainder beneficiaries' gift to Spouse under IRC Section 2511 were separate gifts that do not offset each other.

- The value of Spouse's deemed gift under IRC Section 2519(a) was the fair market value of the entire property of the QTIP trust minus the then present value, determined under IRC Section 7520, of Spouse's qualifying income interest. Following the language of IRC Section 2519(a), the IRS concluded the possibilities that Spouse could have received discretionary principal distributions and/or exercised the nongeneral power of appointment should be ignored for purposes of valuing Spouse's deemed gift.

[53] IRC Section 2501; Treas. Reg. Section 25-2512-8.

[54] The District Court wrote: "The gift tax 'is a primary and personal liability of the donor,'" citing Treas. Reg. Section 25-2511-2(a).

- The children had determined the value of their gifts to Spouse to be $0.00. The IRS disagreed and determined the value of the remainder beneficiaries' gifts under IRC Section 2511 to be the then present value, determined under IRC Section 7520, of their remainder interest. In performing the valuation (since neither the Trustee of the QTIP trust nor the children had done so), the IRS disregarded any possibility that Spouse, had the QTIP trust not been commuted, would have received any discretionary principal distributions or exercised the nongeneral power of appointment.

F. Loans vs. Gifts

Estate of Bolles v. Commissioner, T.C. Memo. 2020-71 (June 1, 2020)

1. *Facts*

Mary Bolles was the mother of five children, all of whom she wished to treat equally for purposes of estate disposition. She transferred funds to her children in varying amounts from time to time. Although not all the facts were consistent with treatment of these transfers as loans, she did keep records of the transfers and occasional repayments. Also, in each year Mary forgave the "loans" to her children up to the amount of the gift tax annual exclusion.

Peter was Mary's eldest child. He was a licensed architect and for several years appeared to have a promising career. Unfortunately, however, Peter's business eventually floundered, and his financial position deteriorated badly. In 1983, the business was unable to stay current on its financial obligations. The business borrowed in the aggregate $159,828 from a trust established by his parents to pay rent and within a short time was unable to make payments. In July of 1983, Peter used property of that same trust as collateral to secure bank loans to his business, and, ultimately, the trust had to pay off those loans. Mary had contemporaneous knowledge of these events.

Between 1985 and 2007 Mary transferred $1,063,333 to Peter or for his benefit. There were no loan agreements, and Mary never attempted to force Peter to repay her. The "loans" to Peter were unsecured. He made no repayments after 1988. In 1989, Mary established a revocable trust, the terms of which excluded Peter as a beneficiary. In 1994, Mary amended the trust instrument by restoring Peter as a beneficiary but providing that the funds she had transferred to him over the years, plus interest, would be treated as advancements against his share of the trust property at her death. Peter acknowledged in writing he could never repay his mother's advances to him.

2. *Parties' Positions*

Following Mary's death, in the estate tax proceedings, the IRS took the position that the receivable from Peter was includable in Mary's gross estate under IRC Section 2031 at a value of $1,063,333 and that interest on that receivable was includable in Mary's gross estate under IRC Section 2033 at a value of $1,165,778. Thus, the value of the gross estate was proposed to be increased by $2,229,111. Alternatively, the IRS proposed to include $1,063,333 on the estate tax return as adjusted taxable gifts under IRC Section 2001(b). The estate's view was that the

receivable from Peter was includable in Mary's gross estate at a value of $0.00 because it was uncollectable.

3. *Court's Decision*

The Tax Court reviewed the record and applicable law and outlined the traditional factors used to decide whether an advance is a loan or a gift.

> Those factors are explained as follows: (1) there was a promissory note or other evidence of indebtedness, (2) interest was charged, (3) there was security or collateral, (4) there was a fixed maturity date, (5) a demand for repayment was made, (6) actual repayment was made, (7) the transferee had the ability to repay, (8) records maintained by the transferor and/or the transferee reflect the transaction as a loan, and (9) the manner in which the transaction was reported for Federal tax purposes is consistent with a loan.[55]

The Tax Court then noted that, "[i]n the case of a family loan, it is a longstanding principle that an actual expectation of repayment and an intent to enforce the debt are critical to sustaining the tax characterization of the transaction as a loan. *Estate of Van Anda v. Commissioner*, 12 T.C. 1158, 1162 (1949), *aff'd per curiam*, 192 F.2d 391 (2d Cir. 1951)."

The Tax Court concluded that, for so long as Mary believed Peter would and could repay her, her transfers to Peter were loans. From and after the point at which Mary faced up to the fact Peter could not repay her, *i.e.*, when she established her revocable trust in 1989, Mary's transfers to Peter that had already been made, as well as all future transfers to him, were gifts.

VI. VALUATION

A. Tax-Affecting Allowed; Net Asset Value Method of Valuing Operating Closely-Held Business Equity Rejected

Estate of Cecil v. Commissioner, T.C.M. 2023-24 (February 28, 2023)

1. *Facts*

The Vanderbilt name is well-known. Specifically, family patriarch Cornelius Vanderbilt used his success in the railroad and shipping industries in 19th century to amass an enormous family fortune. George Washington Vanderbilt II, a grandchild of Cornelius, used some of his generational wealth to build the Biltmore Estate in the 1880s—the largest privately owned house in the United States—located in Ashville, North Carolina. In the 1930s, George Washington Vanderbilt II's daughter, Cornelia Cecil, formed the Biltmore Company (TBC), a Delaware corporation, and transferred the Biltmore Estate to this corporation. Upon Cornelia's death, her son, William A.V. Cecil, inherited TBC. *Estate of Cecil* concerns the valuation of TBC for transfers from William and his wife, Mary Ryan Cecil, to subsequent generations.

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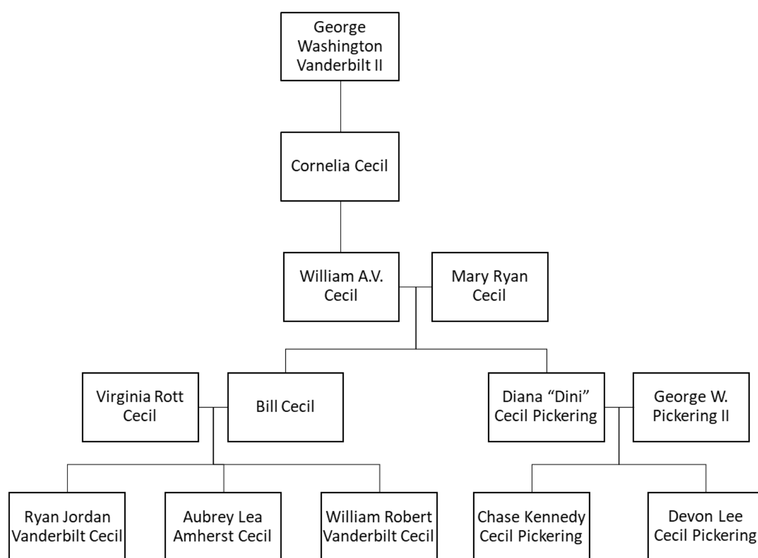
[55] *See Miller v. Commissioner*, T.C. Memo. 1996-3, *aff'd*, 113 F.3d 1241 (9th Cir. 1997)).



TBC was structured with both voting Class A shares and non-voting Class B shares. TBC was a company that did more than just hold the Biltmore Estate. TBC began its operations focusing primarily on tourism by offering guests the ability to visit the property and tour its property. By 1995, the scope of TBC's business expanded to include hotels, restaurants, retail stores and various outdoor activities all located on the Biltmore Estate. By 2010, TBC's operations included at least seventeen lines of businesses and employed over 1,800 employees.

In 2010, Mary gifted one Class A share to Bill and Dini; William gifted Class B shares to separate trusts for the benefit of each of his five grandchildren. The Cecils reported those gifts on a timely-filed gift tax return, which the IRS selected for audit and with respect to which a notice of deficiency was issued, determining the deficient tax based on the value of TBC's net assets.

2. *Tax Court's Opinion*

There were two appraisal issues at trial: First, whether the appraiser could use tax affecting to determine the fair market value of TBC shares. Second, which valuation approach to apply for a privately-held operating company.

a. <u>Tax-Affecting</u>

Several business valuation methods rely on information from other similar companies, many of which are publicly-traded companies organized and taxed as C corporations. This analysis can be cumbersome, though, when there is limited available market data for privately-held companies, like TBC, that are organized and taxed as S corporations. Thus, when the data used to value an S corporation is based largely on data derived from publicly-traded C corporations, valuation experts may apply "tax-affecting"—the process of adjusting earnings for an S corporation based on an assumed corporate tax rate.

Historically, courts have categorically disallowed tax-affecting in the valuation of a closely-held entity.[56] In later developments, courts have permitted tax-affecting on a fact-specific, case-by-case basis,[57] and have disallowed tax affecting in other circumstances.[58] Indeed, even where—as in *Estate of Jackson*—the Tax Court found that the circumstances did not support the application of tax affecting, it—like *Estate of Jones*—left open the door for applying tax affecting in the right factual scenario:

> We do not hold that tax affecting is never called for. But our cases show how difficult a factual issue it is to demonstrate even a reasonable approximation of what that effect would be.[59]

Here, every valuation expert agreed that tax-affecting was necessary to determine the fair market value of TBC. Thus, the Tax Court found that tax affecting was permissible under the carve-out described in *Estate of Jones* and *Estate of Jackson*. It then needed to determine only the specific rate that applied to implement tax-affecting.

b. <u>Valuation Approach</u>

The Tax Court next had to determine which valuation methodology to apply to determine the fair market value of TBC. The taxpayer provided testimony from two valuation experts, and the Government presented one valuation expert. Of the three experts, none applied the same specific methodology to determine the fair market value of TBC, though the taxpayer's experts did apply the same general methodology.

The taxpayer's first expert applied a combination of two approaches: the income approach using the discounted cashflow method, and the market approach using the guideline public company method and the similar transactions method. This expert specifically rejected the asset-based approach. The taxpayer's second expert also applied a combination of two approaches: the income approach using the capitalization of net cashflow method, and the market approach using the guideline public company method. This expert also rejected the asset-based approach. The Government's valuation expert applied the asset-based approach using the net asset value method.

The difference in valuation techniques between appraisers had a marked effect on determination of the fair market value of TBC.

Class of Stock	Estate's Appraisers	Government's Appraiser
Class A	$1,019–$1,131	$4,000
Class B	$1,019–$1,108	$3,066–$3,276

The Tax Court discarded several factors from the experts' valuations. Most notably, the court scrutinized the Government's expert's use of the asset-based approach to value TBC, which was clearly an operating company. The Court highlighted that precedent is clear that an operating

[56] *See Gross v. Commissioner*, T.C. Memo. 1999-254, *aff'd*, 272 F.3d 333 (6th Cir. 2001).
[57] *See, e.g.*, *Estate of Jones v. Commissioner*, T.C. Memo. 2019-101.
[58] *See, e.g.*, *Estate of Jackson v. Commissioner*, T.C. Memo. 2021-48
[59] *Estate of Jackson v. Commissioner*, T.C. Memo. 2021-48, at *82–83.

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company's earnings, rather than its assets, are the best measure of fair market value. Applying the asset-based approach was also inconsistent with the Uniform Standards of Professional Appraisal Practice, which limited using the asset-based approach for operating companies to those with a high likelihood for liquidation. Because TBC has been in the family for four generations, and all of the evidence supported that it would remain closely-held, there was no reasonable justification to determine fair market value using the asset-based approach.

B. Value of Closely-Held Business Stock Includes Life Insurance Proceeds

Connelly v. United States, No. 4:19-cv-1410 (E.D. Mo., September 21, 2021)

1. *Facts*

Two brothers, Michael and Thomas Connelly, owned a closely-held family roofing and siding business, Crown C Supply, Inc. Michael held a 77.18% interest; Thomas held a 22.82% interest. To maintain family ownership and control of Crown C, Michael and Thomas had a stock purchase agreement that governed the disposition of a brother's stock on the first of their deaths. It provided that the surviving brother had the right to buy the deceased brother's shares. If the surviving brother chose to not exercise that right, Crown C was required to redeem the deceased brother's shares. Neither brother ever intended to purchase the predeceased brother's shares. Crown C owned $3.5 million in life insurance policies on Michael and Thomas' lives, which would provide Crown C with the liquidity to redeem a deceased brother's Crown C equity.

The stock agreement also outlined the method for valuing Crown C stock in the estate of the predeceased brother. It required Michael and Thomas annually to determine the value of each share and execute a Certificate of Agreed Value. In Crown C's twelve-year existence, however, Michael and Thomas never determined the value of each share and never executed a Certificate of Agreed Value. Unsurprisingly, the stock agreement anticipated the Connelly brothers' dereliction. If they failed annually to determine the stock value, the stock value was to be determined by an appraisal.

At Michael's death in 2013, as planned, Crown C collected the life insurance proceeds, Thomas opted not to execute his right to purchase Michael's shares, and Crown C sought to redeem Michael's shares from his estate. Rather than obtaining an appraisal of the stock, however, and because there was no Certificate of Agreed Value on which to rely, Thomas and Michael's estate negotiated their own redemption terms and entered into a sale and purchase agreement providing that Crown C would redeem Michael's shares for $3 million, to be paid to Michael's estate, Michael's son, Michael Jr., would receive a three-year option to purchase Crown C (in its entirety) from Thomas for $4.17 million, and Thomas and Michael Jr. would evenly split any gains from the sale of Crown C within ten years.

The estate tax return filed by Michael's estate listed the value of Michael's Crown C shares as $3 million, the redemption price. The IRS examined the estate tax return and asserted the value of Michael's Crown C shares should have included the $3.5 million death benefit paid to Crown C as a result of Michael's death.

The estate paid the additional estate tax the IRS claimed was due and then sued seeking a refund. The parties stipulated that Crown C's value at the time of Michael's death

(excluding the life insurance proceeds) was $3.86 million and that the value of Michael's shares in Crown C was $3.1 million (excluding the life insurance proceeds). The only issue remaining was whether the $3 million paid to Michael's estate from the life insurance proceeds should be included in the valuation of Crown C.

2. *The Court's Ruling*

Ruling on cross motions for summary judgment, the U.S. District Court for the Eastern District of Missouri held that the life insurance proceeds should have been included in the value of Crown C's shares.

Michael's estate argued that the stock agreement should determine the value of Michael's Crown C shares for estate tax purposes. The IRS' position was that under the Internal Revenue Code, Treasury regulations and customary valuation principles, life insurance proceeds receivable by an entity due to the death of an owner are properly includable when determining the entity's stock value.

The District Court engaged in a detailed analysis, and lengthy explanation, to support its ruling. The precise legal question was whether the stock agreement controlled the estate tax value of Michael's shares. Under IRC Section 2703, the value of property is to be determined without regard to any option, agreement, right or restriction, subject to certain exceptions. The exceptions are set forth in IRC Section 2703(b) and would allow an agreement between or among shareholders potentially to set estate tax value if:

> (1) It is a bona fide business arrangement;
>
> (2) It is not a device to transfer property to members of the decedent's family for less than full and adequate consideration in money or money's worth; and
>
> (3) Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction.

Treas. Reg. Section 20.2031-2(h) imposes additional requirements that buy-sell agreements must satisfy in order to have effect for estate tax purposes:

> (1) The offering price be fixed and determinable under the agreement; and
>
> (2) The agreement must be legally binding on the parties both during life and after death.

Ultimately, the District Court's conclusion that the stock agreement didn't establish estate tax value in Michael's estate relied on two facts. First, Thomas' 22% interest being worth $3.1 million was incongruous with Michael's 77% interest being worth $3 million, the price Crown C paid Michael's estate. Thus, said the Court, the buy-sell agreement enabled the redemption of Michael's shares for less than full and adequate consideration, was not comparable to similar agreements that an ordinary buyer would enter into in an arm's length transaction, and so the redemption must have been a testamentary transfer rather than the result of a bona fide and fair

business deal. Second, Michael and Thomas had failed to follow the requirements of the stock agreement to value Crown C stock annually or to have Crown C stock appraised. These failures demonstrated that the stock agreement's terms were not binding (during life or after death) and so could not set a fixed and determinable price.

After holding that the buy-sell agreement did not control the value of Michael's shares in Crown C for estate tax purposes, the Court then addressed whether the value of the life insurance proceeds should be included in Crown C's fair market value. After reviewing Treasury Regulations and Tax Court precedent, which explicitly stated that life insurance proceeds payable to or for the benefit of a company should be included as a nonoperating asset when valuing a company, the District Court had no difficulty ruling that the valuation of Crown C should include the life insurance proceeds.

Hovering throughout the case was the Eleventh Circuit's opinion in *Estate of Blount v. Commissioner*, 427 F.3d 1138 (11th Cir. 2005), which held that life insurance proceeds are excluded from the value of an entity for estate tax purposes when those proceeds are offset dollar-for-dollar by an obligation on the part of the entity to redeem shares. However, because Eleventh Circuit precedent was not binding on a District Court in Missouri, and because the District Court found the Eleventh Circuit's opinion "demonstrably erroneous" and determined that there were "cogent reasons for rejecting it," the District Court didn't follow *Blount*.

C. Discount for Gift of Fractional Interest

Buck v. United States, No. 3:18-cv-1253 (AWT) (D. Conn. September 24, 2021)

1. *Facts*

Peter Buck purchased multiple parcels of timberland between 2009 and 2013 for an aggregate purchase price of $82,853,050. From 2010 to 2013, he gifted a 48% interest in these tracts to each of his sons, Christopher and William, retaining a 2% interest in each tract for himself. Peter reported and paid gift tax on these gifts. For gift tax purposes, he valued each gift at $18,496,249, which represented a 55% discount from the purchase price.

The IRS challenged the valuations and assessed gift tax deficiencies. Peter paid the deficiencies and filed claims for refund, which were denied.

2. *Proceedings in District Court*

The government moved for partial summary judgment. It asked the District Court "to conclude as a matter of law that no discount should be available for a gift of a fractional interest unless the taxpayer held such interest in fractional form before the gift, rather than viewing several simultaneously gifted portions of the property as fractional interests in the hands of the donor for purpose of valuing the gift."

The foundation of the government's position had two prongs. First, it maintained that to allow the claimed discounts would allow circumvention of a primary purpose of the gift tax, *i.e.*, to prevent estate tax avoidance and that to hold otherwise would violate the principle that the gift tax is to be construed *in pari materia* with the estate tax. Second, it emphasized that the value of a gift for gift tax purposes is the value of the gifted property to the donor, not the donee.

Put another way, the government's view was that proper application of the gift tax regime requires that the value of a gift be determined before the gift is made.

The District Court rejected both arguments and denied the government's motion. The District Court noted that construing the gift tax and the estate *in pari materia* doesn't mean that property is valued in the same manner for both gift and estate tax purposes; rather, it means that similar language in gift tax and estate tax statutes should be read as having similar meanings.[60] The District Court found no support in any of the cases cited by the government for the notion that the gift tax statutes should be construed to ensure the estate tax isn't avoided. The District Court pointedly observed there are many cases directly undermining the government's position.[61]

In addition, the District Court stated that the gift tax operates in a fundamentally different way than the estate tax. Gift tax law expressly provides that "the value [of a gift in property] at the date of the gift shall be considered the amount of the gift."[62] By contrast, the estate tax applies to "the value of all property to the extent of the interest therein of the decedent at the time of his death."[63] This is a crucial distinction. The gift tax is assessed with respect to "a gift" or "the gift" – not simultaneously to all the donor's property out of which "a gift" or "the gift" was or could have been made. The estate tax applies to a decedent's entire taxable estate – regardless of the number and/or the identity of the recipients of estate property and/or in what amounts or proportions such property is to pass. The District Court noted that the government's failure to recognize this principle is directly contravened by well-known cases of long-standing.[64]

D. Valuation of Image and Likeness Cannot be Based on Speculation
Estate of Michael J. Jackson v. Commissioner, T.C. Memo. 2021-48 (May 3, 2021)

The Tax Court used the opportunity of this case seemingly to back away from broad applicability of "tax effecting."[65] By far and away, however, the most interesting aspect of the Tax Court's 253-page opinion is its approach to valuation of Michael Jackson's image and likeness as of his date of death.

The parties were light years apart. On the estate tax return, Jackson's image and likeness were valued at a grand total of $2,105. The IRS countered with $161,307,045 and urged the Tax Court to sustain valuation misstatement penalties. The Tax Court settled on a value of $4,153,912 and refused to impose penalties, finding that, although it disagreed with the estate's value, that assertion of value was "reasonable" and was based on the opinion, relied upon by the estate in

[60] For example, in *Merrill v. Fahs*, 324 U.S. 308, 65 S.Ct. 655. 89 L.Ed. 963 (1945), a case cited by the government, the Supreme Court held that the phrase "an adequate and full consideration in money or money's worth" means the same thing in the gift tax statutes as in the estate tax statutes.
[61] *E.g.*, *Mooneyham v. Commissioner*, T.C. Memo. 1991-178, 1991 WL 55835.
[62] IRC Section 2512(a); Treas. Reg. Section 25.2512-1 contains almost identical language.
[63] IRC Section 2033.
[64] *LeFrak v. Commissioner*, T.C. Memo. 1993-526, 1993 WL 470956; *Shepherd v. Commissioner*, 115 T.C. 376 (2000).
[65] In its opinion, the Tax Court noted it has approved "tax-effecting" in only one case, *Estate of Jones v. Commissioner,* T.C. Memo. 2019-101 (August 19, 2019). *But see Kress v. United States*, 372 F. Supp.3d 731 (E.D. Wisc. March 26, 2019), summarized beginning at page 56.

good faith, of an accounting firm whose reputation the Tax Court specifically found was "reputable" and "credible."

On the other hand, the Tax Court absolutely hammered the IRS' one and only valuation expert for lack of credibility. The opinion states he "lied" under oath at least twice. The estate moved to strike all his testimony and expert reports. The Tax Court declined to impose that remedy but did state the credibility and weight of the evidence he offered would be discounted.

At the root of the chasm between the estate and the IRS' valuations of Jackson's image and likeness as of his date of death was a stark difference in methodology. The estate focused on current income and revenue while the IRS engaged in speculation as to revenues that might be generated in the future by various endeavors. There were two fundamental problems with the IRS' approach. First, as of Jackson's death, his reputation had been severely damaged due to allegations, even though never proved in court, that Jackson had sexually abused minors at his residential compound, Neverland. The Tax Court observed that, in 2009, the year of Jackson's death, exploitation of his name and likeness earned him a grand total of $24.00. Second, the Tax Court found the IRS' expert's valuation approach to be "fantasy" in that it involved, among other things, valuing the wrong asset (going well beyond image and likeness) and taking into account numerous future events and developments, *e.g.*, a Cirque du Soleil show, a film, a Broadway musical, a theme park at Neverland and branded merchandise, the Tax Court characterized as completely unforeseeable and, in one instance, "ridiculous."[66]

E. Defined Value Clauses

Nelson v. Commissioner, No. 20-61068 (5th Cir. November 3, 2021), *aff'g* T.C. Memo. 2020-81 (June 10, 2020)

1. *Facts*

Nelson involved transfers of limited partner interests in Longspar Partners, Ltd. to a trust. One transfer was a gift; the other was an installment sale. A "Memorandum of Gift and Assignment of Limited Partner Interest" ("Memorandum of Gift") stated that Mary Nelson, the donor, was making a gift of a limited partner interest having a fair market value of $2,096,000.00 as of December 31, 2008, as determined by a qualified appraiser within 90 days of the effective date of the gift. Similarly, a "Memorandum of Sale and Assignment of Limited Partner Interest" ("Memorandum of Sale") provided that Mary, the seller, was selling a limited partner interest having a fair market value of $20,000,000.00 as of January 2, 2009, as determined by a qualified appraiser within 180 days of the effective date of the sale.

The appraisals required by the Memorandum of Gift and the Memorandum of Sale were prepared, but that task was not concluded within the time specified by the Memorandum of Gift and the Memorandum of Sale. The appraiser determined the fair market value of a 1% interest in Longspar to be $341,000.00. The lawyer, using that figure, converted the dollar values set out in the Memorandum of Gift and the Memorandum of Sale to percentages of limited partner interests—6.14% for the gift and 58.65% for the sale. Those percentages were reflected within

[66] *See Grieve v. Commissioner*, T.C. Memo. 2020-28 (March 2, 2020), another recent valuation case in which the Tax Court castigates the Internal Revenue Service ("IRS") for engaging in speculation concerning an event that was by no means certain to occur.

Longspar's records, Longspar's amended partnership agreement and Mary and James Nelson's 2008 and 2009 gift tax returns.[67]

The IRS selected the gift tax returns for examination. The IRS asserted that Mary had gifted limited partner interests representing 6.14% of the value of Longspar and that such interests were worth more than $2,096,000.00 on the effective date. The IRS likewise claimed that Mary had sold limited partner interests representing 58.65% of the value of Longspar and that such interests were worth more than $20,000,000.00. Mary and James countered that, pursuant to the Memorandum of Gift, Mary had gifted limited partner interests with a fair market value on the effective date of $2,096,000.00 and no more, and, pursuant to the Memorandum of Sale, Mary had sold limited partner interests with a fair market value on the effective date of $20,000,000.00 and no more.

2. *Analysis*

In sustaining the IRS' position, the Tax Court noted that the operative language of the Memorandum of Gift and the Memorandum of Sale "hang[s] on the determination by an appraiser within a fixed period; value is not qualified further, for example, as that determined for Federal estate tax purposes." The court cited and favorably discussed cases in which the efficacy of language defining fair market value as that "finally determined for federal [estate][gift] tax purposes" was upheld.[68] The court stated it wouldn't disregard the "by a qualified appraiser within [a fixed period]" language of the Memorandum of Gift and the Memorandum of Sale and replace it with "for federal estate and gift tax purposes."

In affirming the decision of the Tax Court, the U.S. Court of Appeals for the Fifth Circuit didn't add substance to the Tax Court's analysis. The Court of Appeals observed that the operative language referenced in the preceding paragraph effectively redefined "fair market value" to mean that value as determined by a qualified appraiser, and so, once the appraiser had determined the fair market value of a 1% limited partner interest in Longspar, all that was left to do was to convert the dollar value arrived at by the appraiser to percentages. The Fifth Circuit stated: "[t]hose percentages were locked, and remained so even after the valuation changed" and concluded:

> The transfer documents clearly and unambiguously state that Mary [] was gifting and selling the percentage of limited partner interests that an appraiser determined to have a fair market value equal to a stated dollar amount. The transfer agreements must be interpreted as written. The Nelsons therefore transferred what the plain language of their transfer instruments stated—$2,096,000 and $20,000,000 of limited partner interests in Longspar as determined by a qualified appraiser to be 6.14% and 58.65% of such interests.

The Court of Appeals was impressed by the IRS' analogy to selling cows:

[67] James was Mary's husband. Mary and James elected to split gifts under IRC Section 2513.

[68] *Estate of Christiansen v. Commissioner*, 130 T.C. 1 (2008), *aff'd* 586 F.3d 1061 (8th Cir. 2009); *Estate of Petter v. Commissioner*, T.C. Memo. 2009-280, *aff'd* 653 F.3d 1012 (9th Cir. 2011).

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> As the government well-analogized, if a farmer agrees to sell the number of cows worth $1,000 as determined by an appraiser, and the appraiser determines that five cows equals that stated value, then the sale is for five cows. If a later appraisal determined that each cow was worth more, and that two extra cows had been included in the sale, nothing in the agreement would allow the farmer to take the cows back. The parties would be held to what they agreed—a transfer of the number of cows determined by the appraiser to equal $1,000. So too here. No language in the transfer agreements allows the Nelsons to reopen their previously closed transaction and reallocate the limited partner interests based on a change in valuation.

It seems clear that the taxpayers' position crashed and burned because the defined value provisions embedded in the Memorandum of Gift and the Memorandum of Sale were seriously flawed. Those who design and use defined value clauses should closely follow the models provided in the several cases in which the taxpayers have been victorious.[69]

F. Family Limited Partnership Interest Discount for Lack of Marketability, but Not for Lack of Control, Allowed

Estate of Streightoff v. Commissioner, T.C. Memo. 2018-178 (October 24, 2018), *aff'd* 954 F.3d 713 (5th Cir. March 31, 2020)

Just as the estate planning world was pondering how the *Powell*[70] court's application of IRC Section 2036(a)(2) could **ever** be avoided in a case in which the decedent held **any interest** in an FLP at death or relinquished such an interest within three years of death, the Tax Court decided *Streightoff*.

1. *Facts*

On October 1, 2008, Frank Streightoff, acting though his daughter, as his attorney-in-fact, formed an FLP with several family members as well as a revocable trust. Frank transferred cash and marketable securities to the FLP and received in exchange an 88.99% limited partner interest, which he immediately assigned to the Trustee of his revocable trust. The partnership agreement contained restrictions on the transferability of limited partner interests and conferred rights of first refusal. The partnership agreement provided that limited partners owning a 75% or greater limited partner interest could, among other things, approve the admission of additional limited partners, remove the general partner (which would terminate the partnership), reconstitute the partnership and elect a new general partner.

Frank died on May 6, 2011. In valuing the 88.99% interest for federal estate tax purposes, Frank's estate asserted that the interest was an assignee interest and claimed a 13.4% lack of control discount and a 27.5% lack of marketability discount. The IRS countered by characterizing the 88.99% interest as a limited partner interest giving rise to no lack of control discount and an 18% lack of marketability discount.

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[69] *Id. See*, *also*, *Hendrix v. Commissioner*, T.C. Memo. 2011-133; *Wandry v. Commissioner*, T.C. Memo. 2012-88.
[70] *Supra, note* 36.

2. *Analysis*

The Tax Court determined that the 88.99% interest was a limited partner interest – both in form and in substance. Not only did the assignment paperwork indicate that the decedent had conveyed to the Trustee of his revocable trust all of his 88.99% interest and "all and singular the rights and appurtenances thereto in anywise belonging," but the decedent, up to the moment of his death, could have revoked his transfer to his trust of the 88.99% interest, which would have caused that interest to be held by the decedent undeniably as a limited partner interest. Accordingly, the Tax Court ruled there was no valuation discount for lack of control.

Since Frank's estate had offered no evidence as to valuation of the 88.99% interest as a limited partner interest, the Tax Court accepted the IRS' valuation expert's conclusion that an 18% discount for lack of marketability should be allowed.

Frank's estate appealed the Tax Court's decision to the U.S. Court of Appeals for the Fifth Circuit. On appeal, the estate argued strenuously that the 88.99% interest, properly evaluated under applicable state (Texas) law, was an assignee interest. The Court of Appeals staunchly defended the Tax Court's contrary conclusion. In so doing, the Court of Appeals not only noted that the Tax Court appropriately applied the substance over form doctrine but also pointedly observed that the FLP's general partner affirmatively consented to substitution of a limited partner interest to Frank's revocable trust.

Though Frank Streightoff's surviving family members were surely disappointed in the Tax Court's decision and Fifth Circuit's affirmation, clearly the estate could have suffered a much worse fate. Given the facts, it is remarkable that the estate emerged with an 18% discount for lack of marketability with respect to the 88.99% FLP interest Frank held in his revocable trust at his death. As discussed above, the FLP consisted exclusively of cash and marketable securities, and, up to the moment of his death, Frank had unilateral control, through his attorney-in-fact, over his 88.99% limited partner interest.

In *Powell*,[71] a reviewed Tax Court opinion and, aside from *Streightoff* and *Moore*,[72] the most recent case addressing the estate tax consequences of FLP interests, the court ruled that the entire, undiscounted net asset value of an FLP was to be included in the decedent's gross estate under IRC Section 2036(a)(2) because the decedent, up to the moment of her death, could have joined with all the other partners and dissolved the FLP and, through her effective control of the general partner, could have controlled FLP distributions. Frank Streightoff had an even more direct route to control because he didn't have to join with anyone. One is left to wonder whether *Streightoff* is an outlier. Astoundingly, IRC Section 2036(a)(2), which should have been dispositive of the case, is not mentioned in either the Tax Court's opinion or the Fifth Circuit's opinion. If IRC Section 2036(a)(2) was irrelevant in *Streightoff*, how was it relevant in *Powell*?

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[71] *Id.*

[72] *Moore v. Commissioner*, T.C. Memo. 2020-40 (April 29, 2020).

G. Speculation as to Possible Future Events is Impermissible in Valuing Gifts
Grieve v. Commissioner, T.C. Memo. 2020-28 (March 2, 2020)

1. *Facts*

Pierson Grieve made gifts of a 99.8% member interest in Rabbit 1 LLC to a GRAT on October 9, 2013 and a 99.8% member interest in Angus MacDonald LLC to the Grieve 2012 Family Irrevocable Trust on November 1, 2013. These gifted member interests were non-voting. PMG, a management company that was the general partner of the Grieve Family Limited Partnership, owned the 0.2% voting member interests in both LLCs. Pierson's eldest child, Margaret, was the sole owner of PMG. The IRS issued a notice of deficiency regarding the donor's 2013 gifts. The taxpayer's valuations and the IRS' determinations of value differed by an aggregate of about $11,000,000.00.

2. *Analysis*

The Tax Court's opinion contains a great deal of analytical data that the taxpayer's and IRS' respective valuation experts compiled and presented to the Tax Court. In the end, however, the case boiled down to whether the IRS' expert, Mr. Mitchell, when valuing the gifted non-voting member interests, properly took into consideration the theoretical possibility that the holder of those interests would purchase the voting member interests. The lynchpin of Mitchell's analysis was that a hypothetical willing buyer of the gifted non-voting member interests would consider the likelihood of purchasing the voting interests and that such a buyer would reasonably believe he or she would be able to acquire the voting interests by paying a 5% premium for them. To support that point, Mitchell said "economic realities have to be taken into consideration," and the economic stake of the non-voting member interest holder "dwarfs" that of the voting member interest owner. Margaret testified, however, that she had no intention of selling the voting member interests and that, if she were ever to consider selling them, she would require a far higher premium than 5%.

The Tax Court ruled that the non-voting member interests couldn't be valued by hypothesizing that the holder of those interests would buy the voting interests. Such a valuation methodology would involve engaging in impermissible speculation concerning an event that was by no means certain to occur. The opinion states: "The facts do not show that it is reasonably probable that a willing seller or a willing buyer of the [non-voting member interests] would also buy the [voting member interests] and that the [voting member interests] would be available to purchase." The Tax Court ruled that the value of the gifted interests should be based on the entities' underlying net asset values, and the Tax Court accepted the taxpayer's expert's proposed discounts: lack of control: 13.4% for Rabbit and 12.7% for Angus MacDonald; and lack of marketability: 25% for both Rabbit and Angus MacDonald.

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H. Unusual Valuation of Publicly-Traded Stock for Gift Tax Purposes

Chief Counsel Advice 201939002 (September 27, 2019)

CCA 201939002 addressed how properly to value for gift tax purposes publicly-traded stock transferred to a GRAT. This would seem to be a rather straight-forward exercise, following the formula set out in Treas. Reg. Section 25.2512-2(b)(1),[73] but the IRS didn't see it that way.

1. *Facts*

The donor (D) was a co-founder and board chairman of a corporation (A) whose stock was publicly-traded. D conveyed shares of the stock to a GRAT.[74] Thereafter, A announced it was merging with another corporation (B). The value of A's stock increased substantially after the merger was announced. CCA 201939002 states as a fact that, on the date the GRAT was funded, a hypothetical willing buyer of the stock would've reasonably foreseen the merger and anticipated the stock would trade at a premium.

2. *Analysis*

The sole issue addressed in CCA 201939002 was the fair market value of the stock for gift tax purposes as of the date D transferred it to the GRAT. The OCC acknowledged that Treas. Reg. Section 25.2512-2(b)(1) provides "…if there is a market for stocks or bonds, on a stock exchange, in an over-the-counter market or otherwise, the mean between the highest and lowest quoted selling prices on the date of the gift is the fair market value per share or bond." That principle, standing alone, would seem dispositive. The OCC, however, then invoked Treas. Reg. Section 25.2512-2(e), which states that, "[i]n cases in which it is established that the value per bond or share of any security determined on the basis of the selling or bid and asked prices as provided under § 25.2512-2(b) does not represent the fair market value thereof, then some reasonable modification of the value determined on that basis or other relevant facts and elements of value shall be considered in determining fair market value." The OCC also took note of the "hypothetical willing buyer-willing seller" principle of valuation and cited and quoted from Treas. Reg. Section 25.2512-1, which, along with Rev. Rul. 59-60,[75] established that principle.[76]

CCA 201939002 concludes the fair market value of the stock as of the date of GRAT funding couldn't be determined without taking A's "pending merger" with B into account. The OCC reached this conclusion for two reasons. First, said the OCC, the hypothetical willing buyer and willing seller, as of the date the GRAT received the stock, would be reasonably informed during the course of merger negotiations and would have knowledge of relevant facts – including the pending merger. Second, according to the OCC, the merger was "practically certain to go through."

[73] The general rule of Treas. Reg. Section 25.2512-2(b)(1) is that the fair market value of stock traded on a stock exchange is the mean between the highest and the lowest quoted selling prices on the date of the gift.

[74] The terms of the GRAT weren't disclosed.

[75] Rev. Rul. 59-60, 1959-1 C.B. 237.

[76] Treas. Reg. Section 25.2512-1 states that "the value of [gifted] property [at the date of the gift] is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts."

Neither of these justifications for CCA 201939002's conclusion withstands scrutiny.[77] The OCC applied the "hypothetical willing buyer-willing seller" principle without considering the probability that the "seller," D, would've been prohibited by securities law[78] from disclosing the merger discussions with the "buyer," the GRAT Trustee. The result of that prohibition would've been that the "buyer" couldn't have had any knowledge of the possible merger and so couldn't have considered it in formulating (theoretically) a purchase offer. Thus, applying the "hypothetical willing buyer-willing seller" principle to the facts of CCA 201939002, while apparently assuming the hypothetical willing seller could and would proceed illegally, was inherently unfair and inappropriate. Moreover, the OCC cites no facts supporting its assertion that, on the date the GRAT was funded, it was "practically certain to go through." Until a definitive agreement was in place, innumerable events could've occurred and/or circumstances developed that would've cratered the merger.

I. Large Undervaluation of Stock Transferred to GRAT Leads to Disqualification Under IRC Section 2702

Chief Counsel Advice 202152018 (December 30, 2021)

1. *Facts*

The donor (D) was the founder of a very successful closely-held company (X). On "Date 1," D received offers from five corporations to buy his X stock. Three days later, on "Date 2," D established a two-year GRAT and conveyed X stock into the GRAT. The governing instrument provided that the annual annuity payments would be a fixed percentage of the GRAT's initial fair market value and in all respects "appeared to satisfy the requirements for a qualified interest under § 2702 and the corresponding regulations." For gift tax purposes, D valued the stock transferred to the GRAT based on an appraisal: (a) dated as of seven months before it was transferred to the GRAT; and (b) that had been prepared for IRC Section 409A purposes. On "Date 3," about three months after Date 1, D received revised, higher offers from four of the five corporations. On "Date 4," an unspecified amount of time after Date 3, D gifted X stock to a separate charitable remainder trust. About three months after Date 3, and several weeks after D's transfer to the charitable remainder trust, D accepted one of the revised offers to purchase the X stock. The initial cash tender offer was at a price nearly three times higher than the X stock value as determined in the IRC Section 409A appraisal. For income tax purposes, D valued the stock that had been transferred to the charitable remainder trust at the initial cash tender offer price. Roughly six months after termination of the GRAT, the successful bidder to buy the X stock purchased the remaining shares at a price almost quadruple the value of X stock as determined in the IRC Section 409A appraisal.

2. *Issues and Analysis*

Two issues were identified and addressed in CCA 202152018. First, in a gift tax valuation analysis involving the CCA's facts, should it be assumed that the hypothetical willing buyer and willing seller of company stock would consider X's pending merger? Second, on

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[77] CCA 201939002 is, in fact, a docketed Tax Court case. *Daniel R. Baty v. Comm'r*, Docket No. 12216-21.

[78] Specifically, 17 C.F.R. §230.144 (commonly known as Rule 144).

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creation and funding of the GRAT, did D retain a "qualified annuity interest" under IRC Section 2702?

In light of CCA 201939002, the OCC's discussion and resolution of the first issue is unsurprising. In fact, the portion of CCA 202152018 addressing the first issue is lifted almost verbatim from CCA 201939002. Suffice it to say CCA 202152018 concludes the pending merger must be considered.

The OCC's handling of (even taking up) the second issue is what has caused CCA 202152018 to reverberate ominously in the estate planning world. The CCA states that, by paying an annuity whose amount was "intentionally" based on the IRC Section 409A appraisal, the GRAT Trustee triggered an "operational failure" and that this failure resulted from "deliberately using an undervalued appraisal…to artificially depress the required annual annuity."[79] This "operational failure" led the OCC to conclude that D hadn't retained a qualified annuity interest under IRC Section 2702.[80] To support its conclusion, the OCC cited and discussed *Atkinson*,[81] in which the Eleventh Circuit ruled that a charitable remainder annuity trust failed to qualify as such for tax purposes because, although the governing instrument wasn't technically defective, the required annuity payments in fact weren't made.

The OCC obviously found the facts of CCA 202152018 upsetting, and it's not hard to understand why. It seems as if D may have been playing the gift tax audit lottery. If D's gift tax return hadn't been selected for examination, D would've created a successful GRAT and received annuity payments very likely far lower in amount than would've been the case had a properly dated appraisal obtained for gift tax purposes been used. Conversely, D could've expected that, if D's gift tax return were examined and the value of the X stock were increased, the amount of each of the required annuity payments would increase but no additional gift tax would result. Put another way, heads I win; tails you lose!

That said, the GRAT instrument presumably contained the provision mandated by Treas. Reg. Section 25.2702-3(b)(2) regarding incorrect valuations of trust property.[82] If such is the case, it would seem D adopted the resolution of the CCA 202152018 valuation issue precisely as mandated by the Service's own regulations and ought to be able to rely on those regulations.

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[79] The CCA also refers to the IRC Section 409 appraisal as "outdated" and misleading."

[80] Of course, if D's retained interest in the GRAT wasn't a qualified interest, the value of D's retained interest was zero. IRC Section 2702(a)(2)(A). Thus, all the X stock D transferred to the GRAT constituted a taxable gift, and the whole point of using the GRAT strategy was eviscerated.

[81] *Atkinson v. Comm'r*, 115 T.C. 26, 32 (2000), *aff'd* 309 F.3d 1290 (11th Cir. 2002).

[82] Treas. Reg. Section 25.2702-3(b)(2) states: If the annuity is stated in terms of a fraction or percentage of the initial fair market value of the trust property, the governing instrument must contain provisions meeting the requirements of § 1.664-2(a)(1)(iii) of this chapter (relating to adjustments for any incorrect determination of the fair market value of the property in the trust). Treas. Reg. Section 1.664-2(a)(1)(iii) states: The stated dollar amount may be expressed as a fraction or a percentage of the initial net fair market value of the property irrevocably passing in trust as finally determined for Federal tax purposes. If the stated dollar amount is so expressed and such market value is incorrectly determined by the fiduciary, the requirement of this subparagraph will be satisfied if the governing instrument provides that in such event the trust shall pay to the recipient (in the case of an undervaluation) or be repaid by the recipient (in the case of an overvaluation) an amount equal to the difference between the amount which the trust should have paid the recipient if the correct value were used and the amount which the trust actually paid the recipient.

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Cautious estate planners should redouble their efforts to ensure GRATs they design don't fall within the scope of CCA 202152018. Certainly, any appraisal used to support the value of property contributed to a GRAT should be dated as of the date the property was contributed to the GRAT or as close to that date as possible and should be prepared for gift tax purposes. In addition, planners should consider funding GRATs using documentation containing a defined value clause such as that which received judicial approval in *Wandry*.[83]

J. Tax Court Approves Tax-Affecting in Valuation of Timber Business

Estate of Jones v. Commissioner, T.C. Memo. 2019-101 (August 19, 2019)

1. *Facts*

Aaron Jones established Seneca Sawmill Co. ("SSC") in 1954. SSC was a lumber manufacturer. In 1996, SSC elected to be taxed as an S Corporation. In 1992, Jones formed Seneca Jones Timber Co. ("SJTC"), a limited partnership, to own and manage timberlands. SSC and SJTC were interdependent companies. The entities had the same management teams. SSC was the sole general partner of SJTC. The vast majority of the timber harvested by SJTC was sold to SSC. SSC obtained financing by using SJTC's timber as collateral. Financing utilized by SSC was treated as a loan from SJTC. SSC would pay back SJTC or loan money to SJTC when SSC generated enough revenue to do so. The loans between SSC and SJTC did not require collateral and SSC was charged the same interest charged by its third-party lender.

Jones owned most of the shares in SSC and the limited partner units in SJTC, while Jones's daughters owned small interests in both entities. SSC issued both voting and nonvoting stock. Transfers of interests in either entity were subject to a buy-sell agreement. Proposed transfers to a non-family member were subject to rights of first refusal held by the entity at issue and the other interest holders. The buy-sell agreements required that fair market value be determined after considering cash distributions allocable to the interests and discounts for lack of marketability, lack of control and lack of voting rights.

On May 28, 2009 (notably, right after the 2008 new construction-housing market collapse), Jones transferred limited partner units in SJTC as well as voting and nonvoting stock in SSC to several trusts for the benefit of his descendants.

Jones entered into net-net gift agreements with each of his daughters in which his daughters assumed liability for the gift tax and estate tax associated with the transfers. The IRS ultimately conceded that these agreements were valid.

The IRS issued a notice of deficiency in 2013 challenging the valuation of each of the transfers made in 2009. Jones then died in 2014.

The estate submitted a valuation report for the transferred SSC shares as well as the transferred SJTC units. The estate relied on an income approach, the discounted cash flow ("DCF") method, and a market approach in valuing all the transfers. In addition, the estate's valuation reports for SJTC and SSC tax-affected their earnings by using a 38% tax rate to adjust their net cash flow and the cost of debt capital. The valuation reports then applied a premium to

[83] *Wandry v. Comm'r*, T.C. Memo. 2012-88.

reflect the benefit of the dividend tax avoided by not being a C Corporation. The estate claimed values of $390 per share of SSC voting stock, $380 per share of SSC nonvoting stock and $380 per limited partner unit in SJTC.

The IRS submitted a valuation report for the transferred SJTC units. The IRS relied on an asset-based approach, the net asset value ("NAV") method, and a market approach in valuing the transferred units. The IRS' position on tax-affecting was that, in applying the willing buyer, willing seller test, it inappropriately favors the hypothetical buyer over the hypothetical seller and that an assumed zero tax rate better reflects the entities' flow-through status for income tax purposes. The IRS asserted a value of $2,530 per limited partner unit. The IRS did not submit a valuation report for the SSC shares transferred but did provide a rebuttal to the estate's valuation report.

2. *Analysis*

The Tax Court first concluded that SJTC should be valued based on the DCF method of valuation rather than the NAV method asserted by the IRS. The estate asserted that since SJTC was an operating company that sold products to consumers, an income-based approach like the DCF method was most appropriate. The IRS asserted that SJTC was an investment company, and so an asset-based approach like the NAV method should be utilized. The court stated that SJTC had characteristics of both an operating company and an investment company. However, the NAV method would be appropriate only if it was likely that SJTC would sell its timberlands, as opposed to its timber, and the court found that there was no indication that SJTC would do so.

The Tax Court agreed with the estate's tax-affecting in its valuations. The Court reviewed three of its own cases, all of which rejected the use of tax-affecting.[84] The Court stated that those cases did not reject tax-affecting but rather rejected how tax-affecting was applied in those cases. The Court added, "[t]he question in those cases, as here, was not whether to take into account the tax benefits inuring to a flowthrough entity but how." The Court found that the estate's valuation reports have "more accurately taken into account the tax consequences of [the entities'] flowthrough status."

Of particular interest is the Tax Court's chiding of the IRS' rejection of tax-affecting:

> While respondent objects vociferously in his brief to petitioner's tax-affecting, his experts are notably silent. The only mention comes in [the IRS' expert's] rebuttal report, in which he argues that [the estate's expert's] tax-affecting was improper, not because SJTC pays no entity level tax, but because SJTC is a natural resources holding company and therefore its "rate of return is closer to the property rates of return". They do not offer any defense of respondent's proposed zero tax rate. Thus, we do not have a fight between valuation experts but a fight between lawyers.

[84] *Gross v. Commissioner*, T.C. Memo. 1999-254; *Estate of Giustina v. Commissioner*, T.C. Memo. 2011-141; *Estate of Gallagher v. Commissioner*, T.C. Memo. 2011-148, *supplemented by* T.C. Memo. 2011-244.

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The Tax Court accepted the estate's treatment of the intercompany loans from SSC to SJTC and SSC's general partner interest in SJTC as operating assets. The estate's treatment of these items properly reflected the fact that SSC and SJTC were "interdependent parts of a single business enterprise" rather than separate business entities.

Finally, the Tax Court concluded that a 35% discount for lack of marketability, claimed by the estate, was reasonable.

K. Court Values Family–Owned S Corporation Stock to Determine Refund of Gift Tax Overpayment

Kress v. United States, 372 F. Supp.3d 731 (E.D. Wis. March 26, 2019)

1. *Facts*

The taxpayers were shareholders in Green Bay Packaging, Inc. ("GBP"), a family-owned subchapter S corporation, and they gifted minority interests in GBP stock to their children and grandchildren in 2006, 2007 and 2008. The taxpayers filed gift tax returns for those years, and the IRS challenged the amounts reported on the gift tax returns. The taxpayers paid the gift tax deficiencies and filed amended gift tax returns seeking refunds for the additional taxes and interest they paid. The IRS denied the taxpayers' requests for refunds, and the taxpayers sued for the refunds in U.S. District Court in Wisconsin.

2. *Analysis*

The sole issue before the District Court was the fair market value of the GBP stock the taxpayers gifted to their children and grandchildren in 2007, 2008 and 2009. Part of the analysis contained in the taxpayers' valuation expert's reports involved valuing GBP shares in relation to comparable C corporation stock and then adjusting the values of the GBP shares to account for the fact that GBP's earnings, while not subject to income tax at the corporate level, is not tax-free but, rather, is taxable at the shareholder level. This adjustment is commonly referred to among valuation experts as "tax-affecting." The government's valuation expert also engaged in tax-affecting," but, in addition, he also applied an adjustment, a "subchapter S premium," to account for the tax characteristics associated with subchapter S status.

The District Court not only accepted the concept of tax-affecting but also rejected application of a "subchapter S premium." In so doing, the Court stated: "The court finds GBP's subchapter S status is a neutral consideration with respect to the valuation of its stock. Notwithstanding the tax advantages associated with subchapter S status, there are also noted disadvantages, including the limited ability to reinvest in the company and the limited access to credit markets. It is therefore unclear if a minority shareholder enjoys those benefits."

The *Kress* court's willingness to adopt tax-affecting in valuing equity in an S corporation (the form in which countless family businesses exist) is significant. Taxpayers have been striving for many years to validate use of tax-affecting in the valuation of equity in pass-

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through entities, and the battle has at times seemed almost useless.[85] The taxpayers in *Kress* are to be congratulated for their perseverance.[86]

In addition to tax-affecting, the District Court addressed whether certain provisions contained in GBP's bylaws restricting the ability of GBP shareholders to transfer their shares could be taken into account for purposes of valuing the gifted stock. The District Court first observed that the general rule embodied in IRC Section 2703(a)[87] applied, and so resolution of this issue would turn on the applicability of IRC Section 2703(b).[88] All three exceptions set out in IRC Section 2703(b) must apply to supersede IRC Section 2703(a). The District Court had no difficulty concluding that the bylaws provisions in question constituted a "bona fide business arrangement" and that they were not a "device" within the meaning of IRC Section 2703(b)(2). Unfortunately for the taxpayers, the District Court was not convinced that restrictions' terms were "comparable to similar arrangements entered into by persons in an arms' length transaction." The good news for the taxpayers is that their failure to prevail under IRC Section 2703 caused them to forfeit a mere 3% lack of marketability valuation discount.

VII. INCOME TAX MATTERS

A. No Grantor Trust Basis Adjustment at Settlor's Death Without Gross Estate Inclusion

Rev. Rul. 2023-2, I.R.B. 2023-16 (April 17, 2023)

A created an irrevocable trust and funded it in a transaction that was a completed gift by A for federal gift tax purposes. A retained a power over the trust that caused A to be treated as its owner for income tax purposes. A didn't hold a power over the trust that would result in the value of the trust's assets being included in A's gross estate for estate tax purposes. The trust held an asset that had appreciated in value since the date on which it was transferred to the trust. At A's death, the trust's liabilities didn't exceed its basis in the asset.

The question presented was whether, under IRC Section 1014, the trust's basis in the asset would be adjusted to its fair market value as of A's date of death. The IRS answered with a resounding "no." The analysis started by pointing out the general rule of IRC Section 1014(a), which is that the basis of property is its cost and then moved to the rule under IRC Section

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[85] *See Gross v. Commissioner*, T.C. Memo. 1999-254, *aff'd* 272 F.3d 333 (6th Cir. 2001).

[86] *See*, *also*, *Estate of Jones v. Commissioner,* T.C. Memo. 2019-101 (August 19, 2019), summarized beginning at page 53.

[87] IRC Section 2703(a) provides:

> (a) GENERAL RULE.--For purposes of this subtitle, the value of any property shall be determined without regard to—
>
> > (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or
> >
> > (2) any restriction on the right to sell or use such property.

[88] IRC Section 2703(b) provides:

> (b) EXCEPTIONS.--Subsection (a) shall not apply to any option, agreement, right, or restriction which meets each of the following requirements:
>
> > (1) It is a bona fide business arrangement.
> >
> > (2) It is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth.
> >
> > (3) Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction.

1014(a)(1) that the basis of property in the hands of a person acquiring property from a decedent is its fair market value at the decedent's date of death. Next, the IRS observed that there are seven types of property under IRC Section 1014(b) that may be considered to have passed or been acquired from a decedent and that, among those seven types of property, only one could even arguably be understood as property held in a "grantor trust" at the settlor's death but whose value isn't included in his or her gross estate. That one type of property would be property "bequeathed," "devised" or "inherited" within the meaning of IRC Section 1014(b)(1). The IRS recited the precise, legal definition of each of the terms "bequeathed," "devised" and "inherited" and concluded that property transmitted via the vehicle of an irrevocable trust can't be a "bequest," a "devise" or an "inheritance."

Finally, apparently (but not explicitly) relying on IRC Section 1015(b), the IRS stated that the basis of the asset immediately after A's death would be the same as its basis immediately before A's death.

B. Proposed Regulations on Certain Deductions for Partnerships Forthcoming

Notice 2020-75, 2020 I.R.B. 252 (November 9, 2020)

1. *Background*

The 2017 Tax Act added paragraph (6) to IRC Section 164(b). Paragraph (6) imposes a limitation (the "SALT deduction limitation") of $10,000.00 ($5,000.00 in the case of a married individual filing a separate return) for the aggregate amount of the following state and local taxes paid during the calendar year: (a) real property taxes; (b) personal property taxes; (c) income, war profits, and excess profits taxes; and (d) general sales taxes. The SALT deduction limitation explicitly applies only to individuals and is effective with respect to taxable years beginning after December 31, 2017 and before January 1, 2026.

The Notice observes:

> Certain jurisdictions described in section 164(b)(2) have enacted, or are contemplating the enactment of, tax laws that impose either a mandatory or elective entity-level income tax on partnerships and S corporations that do business in the jurisdiction or have income derived from or connected with sources within the jurisdiction. In certain instances, the jurisdiction's tax law provides a corresponding or offsetting, owner-level tax benefit, such as a full or partial credit, deduction, or exclusion.

The obvious motivation for enactment of these tax laws is to enable individuals who own equity in partnerships and S corporations at least partially to avoid the SALT deduction limitation by shifting state income tax arising from partnership and S corporation income from the individuals (who would be subject to the SALT deduction limitation) to the entity itself (which would not be subject to the SALT deduction limitation). In turn, the entities' taxable income passed through to its owners is effectively reduced, in whole or in part, by the amount of such state income tax.[89]

[89] *See* IRC Sections 702(a) and 1366(a)(1) and Rev. Rul. 58-25, 1958-1 CB 95.

2. *Operative Provisions of the Notice*

To address and resolve any uncertainty regarding the federal income tax results flowing from the above-described tax laws, the Notice states that the Treasury Department and the IRS expect to propose regulations providing that a "Specified Income Tax Payment" by a partnership or S corporation shall be allowed to such partnership or S corporation as an income tax deduction for the taxable year in which the payment is made. The term "Specified Income Tax Payment" is defined as "any amount paid by a partnership or an S corporation to a State, a political subdivision of a State, or the District of Columbia (Domestic Jurisdiction) to satisfy its liability for income taxes imposed by the Domestic Jurisdiction on the partnership or the S corporation." Excluded from the definition are income taxes described in IRC Section 164(b)(2) for which a deduction by a partnership is not disallowed under IRC Section 703(a)(2)(B) and income taxes for which a deduction by an S corporation is not disallowed under IRC Section 1363(b)(2).

C. Income Tax Deductions for Estates and Trusts

Treasury Regulation Sections 1.67-4, 1.642(h)-2 and 1.642(h)-5, REG-113295-18, 85 Fed. Reg. 66219 (October 19, 2020)

1. *Background*

The 2017 Tax Act added subsection (g) to IRC Section 67. Subsection (g) says, notwithstanding subsection (a), which allows miscellaneous itemized deductions to an individual, subject to the 2% floor, miscellaneous itemized deductions are no longer allowed until after December 31, 2025. IRC Section 67(e) provides that the adjusted gross income of an estate or trust is to be determined in the same way as for an individual except that expenses that wouldn't have been incurred outside the context of fiduciary administration are to be treated as allowable in arriving at an estate or trust's adjusted gross income. Thus, those expenses can't be itemized deductions, and so, obviously, IRC Section 67(g) doesn't impede IRC Section 67(e) at all.

Nevertheless, there was wailing and gnashing of teeth when some trusts and estates professionals first saw new IRC Section 67(g) and irrationally jumped to the conclusion that estates and trusts could no longer deduct any administration expenses. Calming the waters, the IRS issued Notice 2018-61 confirming that unique fiduciary administration expenses would indeed remain deductible by estates and trusts and promising that regulations would be forthcoming.[90] Proposed regulations under IRC Sections 67(g) and 642(h) followed a couple of years thereafter.[91]

2. *Final Regulations*

On October 19, 2020, just slightly more than five months after the proposed regulations were published, the IRS promulgated final regulations. The final regulations, largely following the proposed regulations, not only reiterate that estates and trusts may continue to deduct expenses unique to estate and trust administration but go even farther in saying that, in the year of an estate or trust's termination, if there are excess deductions that are passed out to the beneficiaries under IRC Section 642(h)(2), depending on their character (as an amount used in determining adjusted gross income, a non-miscellaneous itemized deduction or a miscellaneous itemized

[90] Notice 2018-61, I.R.B. 2018-31, July 13, 2018.

[91] Prop. Reg. Sections 1.67-4, 1.642(h)-2 and 1.642(h)-5, REG-113295-18, 85 Fed. Reg. 27693 (May 11, 2020).

deduction), the beneficiaries may be able to use them. A helpful refinement to Prop. Reg. Section 1.642(h)-5(b), *Example 2*, clarifies that a fiduciary has discretion to decide which deductions to allocate to estate or trust income and which ones to carry out to the beneficiaries.

D. The Last Hurrah for "ING" Trusts?

Private Letter Ruling 202017018 (April 24, 2020)

1. *Facts*

In PLR 202017018, a settlor established an irrevocable trust to benefit himself, his spouse, his descendants, his parents and his parents' descendants (in addition to himself and his own descendants). A corporate fiduciary was the sole Trustee. The trust instrument mandated establishment of a "distribution committee." The distribution committee was to consist of at least two individuals other than the settlor and the settlor's spouse but could also include the settlor. The distribution committee was initially composed of the settlor, the settlor's parents and the settlor's sister. An elaborate mechanism was set forth in the trust instrument to ensure that, throughout the settlor's life, the distribution committee remained intact.[92] At the settlor's death, the distribution committee was to cease operations, and all powers previously held by the distribution committee were thereafter to be held and exercised by the Trustee.

The trust instrument set forth an intricately designed discretionary distribution power-sharing arrangement between the settlor and the distribution committee, and prescribed detailed rules for discretionary distributions, as follows:

- Income or principal could be distributed to or for any beneficiary (other than the settlor's spouse) as determined by a majority of the distribution committee, other than the settlor or the settlor's spouse, acting in a non-fiduciary capacity, with the written consent of the settlor;
- Income or principal could be distributed to or for any beneficiary as determined unanimously by the distribution committee, other than the settlor or the settlor's spouse, acting in a non-fiduciary capacity; and
- Principal could be distributed to or for any beneficiary (other than the settlor or the settlor's spouse) as determined by the settlor, acting in a non-fiduciary capacity, for the health, education or support of any one or more of such beneficiaries.

Consistent with the above rules, distributions could be made in equal or unequal amounts among concurrent beneficiaries. During the settlor's life, the Trustee was not permitted to make any distributions except as directed in accordance with the above rules.

In addition, the settlor held a testamentary power of appointment that could be exercised in favor the settlors' parents' descendants (except the settlor, his estate, his creditors or his estate's creditors), the settlor's spouse or any one or more charitable organizations.

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[92] To avoid the settlor's having a reversionary interest triggering IRC Section 673(a). *See* Private Letter Ruling ("PLR") 201642019 (June 20, 2016), *revoking* PLR 201426014 (February 24, 2014).

2. *IRS Rulings*

The IRS ruled as follows with respect to the above-described trust:

- Neither the settlor nor any member of the distribution committee will be considered the grantor or owner of the trust for income tax purposes[93];
- The settlor's transfer of property to the trust will be considered not to be a completed gift for gift tax purposes[94];
- Discretionary distributions won't be considered gifts for gift tax purposes by any distribution committee member[95]; and
- A distribution committee member's gross estate for estate tax purposes won't include the value of any trust property.[96]

3. *Commentary*

What is described above is often referred to as an "ING" trust.[97] PLR 202017018 is the one and only ING trust ruling given by the IRS in 2020 and the most recent such ruling to date. ING trusts have played an important role in estate planning for the last several years.[98] The acronym "ING" stands for "incomplete [gift], nongrantor," and the unique purpose of an ING trust is to enable avoidance of state income tax on transactions occurring inside the trust without causing the settlor to be considered as having made a taxable gift when the settlor funds the trust. Using an ING trust may be an attractive technique for an individual who owns an asset the individual wishes to sell but which, if sold, would generate a large capital gain. If instead of selling the asset,

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[93] The IRS so ruled under IRC Sections 673, 674, 676, 677, 678 and (for so long as the trust remained a domestic trust) 679. The IRS reserved judgment regarding whether, in any taxable year, the settlor would be considered the trust's owner under IRC Section 675.

[94] The IRS so ruled under Treasury Regulations Sections 25-2512-2(e) & (c) and 25.2514-3(b)(2). *See*, *also*, *Estate of Sanford v. Commissioner*, 308 U.S. 39, 60 S.Ct. 51, 84 L.Ed. 20 (1939).

[95] Citing IRC Section 2514(b), the IRS ruled that distribution committee members wouldn't hold general powers of appointment.

[96] Citing IRC Section 2041(a)(2), the IRS ruled that distribution committee members wouldn't hold general powers of appointment.

[97] "ING" trusts created in Delaware, Nevada and Wyoming are often referred to, respectively, as "DING," "NING" or "WING" trusts.

[98] The IRS began issuing ING trust rulings in late 2001. The wellspring of ING trusts was PLR 200148028 (November 30, 2001). The IRS has issued numerous favorable private letter rulings since then. *See*, *e.g.*, PLRs 200247013 (November 22, 2002), 200502014 (January 14, 2005), 200612002 (March 24, 2006), 200647001 (November 24, 2006), 200715005 (April 13, 2007), 200731019 (August 3, 2007), 201310002-201310006 (March 8, 2013), 201410001-201410010 (March 7, 2014), 201426014 (June 27, 2014), 201430003- 201430007 (July 25, 2014), 201436012-201436032 (September 5, 2014), 201636027-201636032 (September 2, 2016), 201650005 (December 9, 2016), 201729009 (July 21, 2017), 201742006 (October 20, 2017), 201744006-201744008 (November 3, 2017), 201832005-201832009 (August 10, 2018), 201836006 (September 7, 2018), 201848002 (November 30, 2018), 201848009 (November 30, 2018), 201850001-201850006 (December 14, 2018), 201852009 (December 28, 2018), 201852014 (December 28, 2018), 201908003-201908005 (February 22, 2019), 201925005-201925010 (June 21, 2019). *See*, *also*, McCouch, Grayson M.P., *Adversity, Inconsistency, and the Incomplete Nongrantor Trust* (August 5, 2020), 39 Va. Tax Rev. 419 (2020), University of Florida Levin College of Law Research Paper No. 20-33, Available at SSRN: https://ssrn.com/abstract=3667897.

the individual conveys the asset to a properly designed ING trust and the Trustee sells the asset, state income tax on the sale may be avoided. The transfer to the trust may avoid gift tax consequences as well.

For an ING trust to succeed in its state income tax elimination objective, at minimum, it must be established in a jurisdiction whose laws won't impose income tax on the trust.[99] Also, it mustn't be a "grantor trust" for federal income tax purposes.[100] The path to achieving nongrantor trust status, while the settlor retains powers over the trust sufficient to cause the settlor's transfer to the trust not to be a completed gift for federal gift tax purposes, is very narrow and can be treacherous.[101] Assuming the settlor's funding of the trust doesn't constitute a completed gift, it follows that the value of the trust's assets will be included in the settlor's gross estate for federal estate tax purposes.[102]

Although a settlor's retaining a beneficial interest in an irrevocable trust isn't necessary to cause the settlor's transfers to the trust to be incomplete gifts, nearly all ING trust settlors want to be a discretionary beneficiary of their ING trusts. An often sought-after ancillary benefit of an ING trust is that it may facilitate asset protection if set up in a state in which it's possible for the assets of an irrevocable trust of which the settlor is a beneficiary not to be subject to claims of the settlor's creditors.[103]

At first blush, it might appear that ING trusts should be regarded as an indispensable tax-minimization tool for any client who needs or wants to sell an asset having a large, unrealized gain. Such a conclusion is unfounded, however, for several reasons.

First, there's no judicial decision that supports the propositions that ING trusts are nongrantor trusts and that transfers to such trusts are incomplete gifts.[104] The efficacy of ING trusts hangs on private letter rulings. For some clients, that may be good enough. For others, it won't be.

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[99] There are several such jurisdictions depending on the circumstances. The laws of the following states never impose income tax on trusts: Alaska, Florida, Nevada, New Hampshire, South Dakota, Texas, Washington and Wyoming. The laws of the following jurisdictions don't impose income tax on a nongrantor trust if the settlor wasn't a resident when it was created: Alabama, Arkansas, Connecticut, Delaware (if a majority of the Trustees aren't Delaware resident for more than half the year or there are no Delaware beneficiaries), District of Columbia, Illinois, Maine, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, New Jersey, New York, Ohio, Oklahoma, Pennsylvania, Rhode Island, Vermont, Virginia, West Virginia and Wisconsin. *See* Steve Oshins, *6th Annual Non-Grantor State Income Tax Chart*, July 2020, www.oshins.com. The cost of trust administration in a given jurisdiction should also be considered.

[100] Because, generally, if the trust is a grantor trust under federal law, it will be a grantor trust under state tax law, and so its income tax consequences won't be eliminated; they'll just be shifted to the settlor. Grantor trust status is ignored, however, under Pennsylvania law.

[101] The state-of-the-art of ING trusts has evolved considerably since they were first conceived. *See*, *e.g.*, Chief Counsel Advice 201208026 (Feb. 24, 2012), which set new parameters for determining whether a settlor's transfers to an irrevocable trust are completed gifts, and PLR 201642019 (June 20, 2016), *revoking* PLR 201426014 (Feb. 24, 2014), in which the IRS ruled that an ING trust settlor had a reversionary interest in the trust because the settlor could gain access to the trust property if the distribution committee were to disband.

[102] *See* IRC Sections 2035-2038.

[103] *E.g.*, Alaska, Connecticut, Delaware, Missouri, Ohio, South Dakota and Wyoming.

[104] *See* McCouch.

Second, while it's true the IRS has issued numerous private letter rulings sanctioning ING trusts over the last 20 years,[105] the IRS has lately become increasingly apprehensive about ING trusts. Last year, the IRS indicated it wouldn't issue ING trust rulings with respect to ING trusts with somewhat narrow characteristics.[106] Even more recently, the IRS completely put the brakes on all ING trust rulings.[107] All but the most aggressive clients will think twice before proceeding with the creation of ING trusts until this environment changes.

Third, the law-making bodies of states that believe tax revenue may be slipping away because of ING trusts have taken, or are starting to take, action. The New York State Legislature enacted a statutory revision in 2014 stating, essentially, that the taxable income of a New York settlor of an ING trust shall include the taxable income of the trust.[108] The California Franchise Tax Board has asked the California State Legislature to consider passing similar legislation.[109]

Fourth, it's of utmost importance to remember that, even if a trust is established in and under the laws of a state that doesn't impose its income tax on the trust and works flawlessly as a nongrantor trust, state income tax on trust transactions may nevertheless not be avoided. A critical element of ING trust planning is that the trust must avoid being characterized as a resident, for income tax purposes, of the jurisdiction in which the settlor resides. Otherwise, although the ING trust may not be subject to income tax by the laws of the jurisdiction in which it was established and operates, it will be subject to income tax in the settlor's home jurisdiction, and so the ING trust will serve no purpose at all. The income tax statutes of numerous jurisdictions[110] treat any irrevocable trust as a resident trust for income tax purposes if the settlor was a resident of the jurisdiction when the trust was created.[111] For any resident of these jurisdictions, setting up an ING trust is a useless exercise.[112]

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[105] *Supra*, *note* 98.
[106] *See* Rev. Proc. 2020-3, 2020-1 I.R.B. 131, Section 3.01(93) (Jan. 2, 2020).
[107] Rev. Proc. 2021-3, 2021-1 I.R.B. 153, Section 5.01(9) & (17) (Jan. 4, 2021).
[108] N.Y. Tax Law § 612(b)(41) (McKinney 2018). The effect of this legislation is to treat an ING trust created by a New York resident as a grantor trust for New York state income tax purposes. Presumably, a New Yorker could set up and fund a nongrantor trust with a completed gift in one of the many states whose laws wouldn't impose income tax on the trust and obtain the same state income tax avoidance result as an ING trust is expected to produce.
[109] The Franchise Tax Board's "Legislative Proposal C," unveiled on November 10, 2020, would treat any ING trust established by a California resident as grantor trust for California income tax purposes.
[110] District of Columbia, Illinois, Maine, Maryland, Michigan, Minnesota, Nebraska, Oklahoma, Pennsylvania, Vermont, Virginia, West Virginia and Wisconsin. *See* Oshins.
[111] The laws of several other states, *i.e.*, Alabama, Connecticut, Delaware, Missouri, Ohio and Rhode Island, impose their income tax on any irrevocable trust created by a state resident if, in a given tax year, one or more beneficiaries of the trust are residents of the state. *See* Oshins.
[112] *But cf. Linn v. Department of Revenue*, 2013 IL App. (4th) 121055 (Dec. 18, 2013), and *Fielding v. Commissioner of Revenue*, 916 N.W.2d 323 (Minn. July 18, 2018), *aff'g*, 2017 Minn. Tax LEXIS 28 (Minn. T.C. 2017), *cert. denied* 588 U.S. __ (2019), WL 2649873 (June 28, 2019).

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E. Income Tax Consequences of Premature Trust Termination Private Letter Ruling 201932001 (August 9, 2019)

Private Letter Ruling ("PLR") 201932001[113] responds to the requests of the Co-Trustees of an irrevocable trust that the IRS rule on the gift, generation-skipping transfer and income tax consequences of a proposed premature termination of the trust. The IRS' conclusions regarding the gift and GST tax results that would flow from the proposed trust termination are as would be expected and wholly uninteresting. The income tax analysis is another story.

1. *Facts*

The trust instrument conferred on the settlor's son ("Son") a mandatory income interest for his life. At his death, his descendants were to receive the remainder. No distributions of principal were allowed during Son's life. A relevant state statute allowed termination of an irrevocable trust pursuant to a nonjudicial settlement agreement ("NJSA"), with court approval, if the court concluded continuance of the trust was no longer required to achieve any material purpose of the trust.[114] Son, the then living remainder beneficiaries who would take if the trust were then to terminate by its terms (the Current Remaindermen) and the then living remainder beneficiaries who would take if the trust were then to terminate by its terms and none of the Current Remaindermen were then living (the Successor Remaindermen) all entered into an NJSA, presumably compliant with the statute, providing for immediate termination of the trust and distribution of all trust property among Son, the Current Remaindermen and the Successor Remaindermen in accordance with their respective actuarial interests in the trust. Under the NJSA, the Trustees were to effectuate distribution among the distributees, in their sole discretion, "on a pro rata or in kind basis."[115]

2. *Analysis*

The IRS ruled that the termination distributions were, in substance, a sale of Son's and the Successor Remaindermen's beneficial interests to the Current Remaindermen giving rise to long-term capital gain treatment for Son and the Successor Remaindermen under IRC Section 1222(3). This is the income tax ruling the Co-Trustees requested.

Note that Son, the Current Remaindermen and the Successor Remaindermen all received amounts equal to their actuarial interests in the trust. Son and the Successor Remaindermen didn't convey, by sale or otherwise, anything at all to the Current Remaindermen.[116] All the trust's beneficiaries received nothing more and nothing less than the

[113] Dated April 9, 2019 and released August 9, 2019. There were actually ten virtually identical rulings. Private Letter Rulings 201932001-010.
[114] Undoubtedly, an iteration of Uniform Trust Code §411(b).
[115] A distribution of trust assets "pro rata" is generally understood to entail division and distribution of each asset, insofar as possible, on a percentage basis among the recipients based on the relative values of their respective interests in the trust.
[116] The IRS explicitly acknowledged this fact in the gift tax ruling portion of Private Letter Ruling ("PLR") 201932001: "[W]e conclude that no transfer of property will be deemed to occur as a result of the termination and Proposed Distribution."

true value of their respective interests. The possession of their interests was accelerated, but no value was shifted among them.

Rev. Rul. 72-243[117] and *McAllister*,[118] cited and discussed in PLR 201932001, would appear to support the conclusion that the amounts received by Son and the Successor Remaindermen were amounts received from the sale or exchange of a capital asset. It seems curious that, in Rev. Rul. 72-243 and *McAllister*, as in PLR 201932001, all involving premature trust terminations, the taxpayers apparently conceded without a whimper that the lump sum distributions to the life tenants/income beneficiaries were taxable sales or exchanges instead of arguing there was no sale, exchange or transfer of any kind. Rev. Rul. 72-243, *McAllister* and PLR 201932001 all hang on the demonstrably incorrect proposition that the life tenant/income beneficiary received his or her distribution ***in exchange for*** the transfer of his or her beneficial interest to the remainder beneficiaries.

Rev. Rul. 69-486,[119] also cited and discussed in PLR 201932001, holds that a non-pro rata distribution of trust property, where neither the trust instrument nor local law allows the Trustee to make a non-pro rata distribution, was equivalent to a pro rata distribution followed by an exchange between the beneficiaries, an exchange that required recognition of gain under IRC Section 1001. No facts are recited in PLR 201932001, however, that would bring it within the purview of Rev. Rul. 69-486. PLR 201932001 contains nothing to suggest that the Trustees actually made non-pro rata distributions. The NJSA said the Trustees had discretion to distribute "on a pro rata or in kind basis,"[120] but the Trustees may well have made ratable distributions among all beneficiaries. To the extent ratable distributions were made, Rev. Rul. 69-486 has no application. In addition, the trust instrument and/or local law may have allowed for the making of non-pro rata distributions. If so, Rev. Rul. 69-486 is easily distinguishable on that ground alone.

It has been suggested that the income tax conclusion in PLR 201932001 is supportable on the theory that, on termination of the trust and distribution of its assets among the beneficiaries in accordance with their respective actuarial interests, they received something "materially different," within the meaning of *Cottage Savings*[121] and Treas. Reg. Section 1.1001-1(a), from what they possessed before such termination and distribution. This argument is not persuasive. First, the IRS, presumably well aware of *Cottage Savings*, didn't mention or cite it in PLR 201932001, and didn't say anything in PLR 201932001 about "material differences," and so it would seem the IRS didn't think *Cottage Savings* applied. In fact, in the gift tax portion of the ruling, the IRS as much as concedes the point:

> In the present case, the beneficial interests, rights, and expectancies of the beneficiaries will be substantially the same, both before and after the

[117] Rev. Rul. 72-243, 1972-1 C.B. 233.
[118] *McAllister v. Commissioner*, 157 F.2d 235 (2d Cir. 1946).
[119] Rev. Rul. 69-486, 1969-2 C.B. 159.
[120] The meaning of this phrase is indecipherable. A distribution of trust assets "in kind" is a distribution of trust assets themselves as opposed to a distribution of proceeds from a pre-distribution sale of assets. Thus, "in kind" is not an alternative to or the opposite of "pro rata." In fact, the only way to make pro rata distributions is to make in kind distributions.
[121] *Cottage Savings Association v. Commissioner*, 499 U.S. 554, 111 S. Ct. 1503, 113 L. Ed. 2d 589, 1991 U.S. LEXIS 2224 (1991).

termination and Proposed Distribution, as long as the actuarial values of the trust accurately represent the actuarial value of each beneficiary's interest.

Second, *Cottage Savings* involved facts "materially different" from the facts of PLR 201932001. *Cottage Savings* addressed an exchange of mortgage participation interests – hardly comparable to beneficial interests in a trust. Although the values of the exchanged mortgage participation interests were equal, the underlying substance of the interests was not at all the same because, after the exchanges, the parties ended up having security interests in different properties. By contrast, in PLR 201932001, no facts are recited to indicate the beneficiaries ended up with interests in different trust assets than the trust assets in which they had interests before trust termination.

VIII. CHARITABLE PLANNING

A. Estate Denied Charitable Deduction Where Trust Failed to Qualify as a CRAT and Trust Was Not Judicially Reformed

Estate of Block v. Commissioner, T.C. Memo. 2023-30 (March 13, 2023)

1. *Facts*

Susan Block created the Susan Rubin Block Revocable Trust in 1997 and amended and restated it in 2015. Within the that trust, Susan created a subtrust, the Katz Trust, to come into existence at her death, for the benefit of her sister Harriet Katz, then for the benefit of I.W. Katz (Harriet's spouse), and then for the Jewish Community Foundation of Greater Hartford, Inc. The trust instrument specified that the Katz Trust was to be a charitable remainder annuity trust (CRAT) and that an annuity amount was to be paid to Harriet during her life (and then to I.W. if he survived Harriet) in an amount equal to the greater of all net income or $50,000. The Trust was irrevocable; however, the instrument permitted the Trustee to amend the Katz Trust provisions as needed to ensure it continued to qualify as a CRAT within IRC Section 664(d)(1). The Trustee, though, could not change the annuity period, the annuity amount or the recipient of the annuity amount.

In 2016, Susan's co-executors filed a Form 706 deducting from the value of the gross estate the present value of the charitable remainder interest of the Katz Trust, which the estate calculated using the annuity amount of $50,000 and the life expectancies of Harriet and I.W. The IRS reviewed and issued a notice of deficiency, disallowing the claimed charitable deduction of $352,085 connected to the Katz Trust. Thereafter, the Co-Trustees of the Katz Trust amended its terms to provide for an annuity payment of $50,000 at least annually (and removed the "all net income" option for payment of the annuity amount).

2. *IRS' Position and Tax Court Holding*

The IRS asserted, and the Tax Court agreed, that the Katz Trust did not qualify as a CRAT because it violated the IRC Section 664 requirement that a CRAT annuity be a sum certain.

The charitable remainder of the Katz Trust was not a reformable interest under the default rules. The estate first attempted to argue that the amendment (changing the annuity amount

to $50,000) was a qualified reformation. However, because the amendment did not qualify under the default rules, the only possibility was to qualify as a judicial reformation. However, that argument failed as the amendment was executed beyond the 90-day period following the estate tax return due date, and the amendment was not instituted by the court (rather, it was instituted by the Co-Trustees alone).

The estate also argued that Revenue Procedure 2003-57[122] and Revenue Procedure 2003-59[123] permit a "Limited Power of Amendment" to allow a Trustee to act alone, without court involvement, to amend the terms of a trust at any time to ensure it both qualifies as a CRAT and retroactively qualifies for an estate tax charitable deduction. The estate also noted that the Revenue Procedures do not specify a time limit for amendment and do not require judicial amendment. However, one cannot discount other critical provisions of the Revenue Procedures applicable to this situation, one in particular, is that the annuity amount must be a number no less than 5 and no more than 50 percent of the initial net fair market value of all property passing to the trust as finally determined for federal estate tax purposes. The court stated that the nonjudicial reformation permitted by the Limited Power of Amendment in the Revenue Procedures did not allow for corrections to "major defects," such as the Katz Trust provision that allowed annual payments to the income beneficiary in an amount equal to the greater of all net income or $50,000. The court found that such a defect required judicial intervention. Because this violated the rule for CRATs, the Katz Trust fell outside of the Revenue Procedures' requirements regarding eligibility for a charitable deduction.

Given that it was determined the Katz Trust could not be reformed or amended, the Tax Court analyzed the original Trust instrument, calling for an annuity amount equal to the greater of all net income or the sum of $50,000. The estate took the position that the decedent intended the Katz Trust to be a CRAT and that the amendment just confirmed that notion. Essentially, the estate attempted to argue that the "all net income" provision was void from the start because that provision is incompatible with the requirement that the annuity amount be a "sum certain." Thus, because the amendment was just confirmation of the intent, it was not necessary to have a qualified reformation or a judicial proceeding to amend the Trust to be considered a CRAT. However, the court disagreed that trusts can be considered CRATs when the noncharitable payment is not definitively a "sum certain," or as the court said "certain and unmanipulable." Thus, the court concluded that under a proper interpretation of IRC Section 664(d), the original Katz Trust was not a CRAT, and, because the Co-Trustees did not effect a qualified judicial reformation, the estate tax charitable deduction was denied.

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[122] Revenue Procedure 2003-57, 2003-2 C.B. 257.
[123] Revenue Procedure 2003-59, 2003-2 C.B. 268.

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B. Contributor to Donor Advised Fund Held to Lack Standing

Pinkert v. Schwab Charitable Fund, Case No. 20-cv-076657-LB, 2021 WL 2476869 (N.D. Cal. June 17, 2021); *aff'd* No. 21-16299 (9th Cir. September 14, 2022)

1. *Facts*

Philip Pinkert set up a donor advised fund[124] ("DAF") with Schwab Charitable Fund ("Schwab"), a public charity under IRC Section 501(c)(3), and, as such, a sizable sponsor of donor advised funds. Philip was unhappy with the investments Schwab made in the DAF he established and funded. Specifically, Philip believed those investments, which were made by Schwab through Schwab's affiliate, Charles Schwab, were inappropriate because, according to him, those investments charged excessive fees to the DAF. Philip believed Schwab could have selected less expensive alternative investments or could have negotiated lower custodial and brokerage service fees with its affiliate or with competitors of its affiliate. Philip filed suit in in the federal district court for the Northern District of California, alleging his DAF (and others similarly situated) had been damaged in that the balances available to be deployed in furtherance of the DAF's charitable purposes were depleted by unnecessarily high fees. Philip accused Schwab of breach of fiduciary duty and accused Charles Schwab for aiding and abetting Schwab's breach of fiduciary duty. The Defendants, arguing that Philip had unconditionally and completely relinquished all control over the assets he contributed to the DAF and, therefore, lacked standing, moved to dismiss under Article III of the Constitution and under California law.

2. *Decision of the District Court*

The District Court granted the Defendants' dismissal motion.[125] In so doing, the District Court rejected Philip's arguments that he had standing, as follows:

- Philip argued he had standing because he directs donations and makes investment recommendations. The District Court stated that not a single case, including the two cited by Philip, supports this conclusion in view of the fact that Philip had ceded to Schwab total control over the DAF's property.

- Philip also asserted he had standing because he would suffer injury in that the value of the DAF was diminished as a result of Schwab's investment choices. The District Court countered that Philip could suffer no injury at all. If anyone would experience any injury, it would be potential charitable donees.

- Likewise, Philip's claim he would experience "reputational and expressive interest" harm flowing from a reduced financial ability to support his charitable interests was unpersuasive to the District Court. Once again,

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[124] *See* IRC Section 4966(d)(2)(A).

[125] Before issuing its ruling, the District Court offered Philip the opportunity to amend his pleadings. Philip declined the offer and informed the District Court he wished to appeal.

Philip was unable to cite any relevant cases supporting his position, and so it was doomed to fail.

- Finally, the District Court held that, under California law, the Attorney General and other statutorily specified persons have exclusive standing to bring actions for "breach of a charitable trust." Philip urged the District Court to recognize him as having standing because he had a "special interest" in the DAF. The District Court said that, without some kind of definite or retained interest in the donated property, Philip could not be seen as having any such special interest.

Most interestingly, the District Court noted (although this is clearly dicta) that, had Philip alleged and proved that Schwab made and broke specific promises to Philip resulting in damages to him, as the Plaintiffs attempted to do in *Fairbairn*,[126] a result in Philip's favor might have ensued. Moreover, *Pinkert*, coupled with *Fairbairn*, make abundantly clear that a charitable donor who wishes to retain real, substantial control over property committed to charitable causes, must establish a grant-making private foundation.[127] A DAF, despite the salesmanship of many DAF providers, simply will not suffice.

The Ninth Circuit's decision affirming the District Court adds nothing of substance but pointedly notes that none of Philip's assertions, except his claim that his right to direct charitable distributions from his DAF was infringed, amounts to an allegation of a present injury but, rather, amounts to a claim that he would suffer injury in the future. Accordingly, all such allegations fell short of establishing standing for Philip. As to Philip's alleged right to direct, the Ninth Circuit, agreeing with the District Court, noted that Philip had no such right and observed that Philip didn't claim that the right he did have, the right to advise on charitable distributions from his DAF, was in any way impaired by Schwab.

C. Donor Advised Fund Sponsor Not Liable for Losses on Sale of Contributed Stock

Fairbairn, et al. v. Fidelity Investments Charitable Gift Fund, No. 3:18-cv-04881-JSC (N.D. Cal. February 26, 2021)

1. *Facts*

Emily and Malcolm Fairbairn, successful former hedge fund managers, sought to make a charitable contribution, by means of a donor advised fund ("DAF"), of 1,930,000 shares of stock in Energous Corporation, a manufacturer of at-contact and over-the-air wireless charging devises. As the contribution was being contemplated, and at the time it was made, it appears the stock had an aggregate value of over $100,000,000.00. The Fairbairns interviewed representatives of several DAF sponsors and, following intense negotiations, settled on Fidelity Investments Charitable Gift Fund ("Fidelity"). The Fairbairns allege the Fidelity representatives orally promised, in exchange for the Fairbairns' choosing Fidelity, that Fidelity would: (a) employ sophisticated state-of-the-art methods for liquidating large blocks of stock; (b) not trade more than

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[126] *Fairbairn, et al. v. Fidelity Investments Charitable Gift Fund*, No. 3:18-cv-04881-JSC (N.D. Cal. February 26, 2021), summarized below.

[127] *See* IRC Sections 501(c)(3) and 509(a).

10% of the daily trading volume of Energous shares; (c) not liquidate any shares until the new year; and (d) allow the Fairbairns to advise on a price limit, that is, a price below which Fidelity would not liquidate the Energous shares.

The Fairbairns established a Fidelity DAF and donated the stock to it on December 28 and 29, 2017. On December 29, the last trading day of the year, Fidelity sold all of the contributed stock within the last two-and-a-half hours of trading that day. Fidelity did not consult with the Fairbairns regarding the sale in advance of the sale. At completion of the sale transactions, the Fairbairns' Energous stock had lost about 30% of its value as compared to its closing price on December 28. The losses Fidelity incurred not only reduced by about $9,600,000.00 the amount actually available in the Fairbairns' Fidelity DAF with which to make charitable contributions but also by about $3,300,000.00 the amount of the Fairbairns' corresponding income tax charitable deduction. Fidelity maintained its sale of the stock was nothing more than an act in compliance with its policy to sell stock contributed to any Fidelity DAF immediately upon receipt. The Fairbairns sued Fidelity in U.S. District Court for the Northern District of California alleging common law misrepresentation, breach of contract, promissory estoppel, violating California's unfair competition law and negligence.

2. *Disposition of Case*

The District Court presided over a bench trial, via Zoom, starting on October 19, 2020 and ending on December 4, 2020. According to news reports, a Fidelity executive testified concerning text messages he had written saying: "[Fidelity] Charitable botched the trades" and "[Fidelity] Charitable has been an awful biz partner [to the Fairbairns] throughout all this." He acknowledged authoring the text messages but denied he made any promises to the Fairbairns regarding post-contribution handling of the Energous stock. Malcolm Fairbairn acknowledged in his testimony that the alleged promises were not in writing and that "the ultimate decision on how to liquidate the shares was Fidelity's."

The District Court ruled that, on December 29 2017, Fidelity had not traded more than 10% of the daily trading volume of Energous shares, and so the statement by Fidelity that it would not trade more than 10% of the daily trading volume of Energous shares, assuming it was a "promise," was true. In addition, the District Court held that the Fairbairns simply did not establish by a preponderance of the evidence that Fidelity promised: (a) to allow the Fairbairns to advise on a price at which Fidelity would sell the Energous shares; (b) not to sell any such shares until 2018; or (c) to use sophisticated and state-of-the-art methods for liquidating the Energous stock, nor did the Fairbairns establish that Fidelity did not in fact employ such methods.

The District Court also noted that the Fairbairns could not reasonably have relied on any promises by Fidelity because the record reflected they had already resolved to donate the Energous stock to their Fidelity DAF before the alleged promises were made.

In addressing the Fairbairns' claims that Fidelity acted negligently in liquidating the Energous stock, the District Court first assumed that Fidelity owed the Fairbairns a duty of care (without finding that it did) due to a special relationship that existed between the Fairbairns and Fidelity. Even with that assumption in place, the District Court ruled that Fidelity did not

breach such a duty. The District Court held the Fairbairns did not meet their burden of proof that a reasonably prudent DAF would not have sold all 1,930,000 shares under the market conditions present on December 29 and instead would have spread out the liquidation over several days. Additionally, the District Court observed that the liquidation practices Fidelity implemented on December 29 were consistent with its published, written policies.

3. *Comment*

The District Court's decision could have significant impact on how DAF's are marketed going forward. There is inherent tension between a DAF's desire to attract contributions by emphasizing to potential donors their ability to give advice to the DAF sponsor and the DAF sponsor's legal obligation under tax law to assume sole legal responsibility for the making of all decision involving DAF administration. Obviously pivotal to the outcome was the District Court's determination that Fidelity did not make the promises alleged by the Fairbairns. In any event, however, while hindsight is admittedly 20/20, it seems reasonable to question the wisdom of Fidelity's liquidation strategy in this case – regardless of whether it was carried out pursuant to a "policy."

D. Failure to Satisfy Substantiation Requirements Dooms Charitable Deduction
Chiarelli v. Commissioner, T.C. Memo 2021-27 (March 3, 2021)

1. *Facts*

The Petitioner, licensed to practice law in Wisconsin and before the Tax Court, inherited numerous items of tangible personal property, including clothing, furniture and antiques, from his mother. He donated many of these items to charity and claimed noncash charitable contribution deductions of $89,110 for the tax year 2012, $93,087 for the tax year 2013 and $77,300 for the tax year 2015. He filed Form 8283, Noncash Charitable Contributions, as an attachment to his income tax return for each of the subject years, but he largely ignored the Form 8283 instructions. As an example, in cases in which the value of donated property exceeded $5,000, the instructions directed the taxpayer to provide detailed information about each item (or group of similar items). The Petitioner's Forms 8283 gave very general information about donated items, describing them as "miscellaneous household items," "clothing and household furniture" and "various household items and clothing." By way of further example, the instructions required, for gifts of property exceeding $5,000 in value, both the appraiser and a representative of the donee to sign Form 8283 certifying certain facts. The Petitioner's Forms 8283 contained no appraiser or donee signatures. The Petitioner provided a few receipts from the donee organizations, but none of them described the donated property, and, in connection with several donations, the Petitioner provided no receipts.[128] The appraisals were similarly deficient and fell far short of the required "qualified appraisal" standard.[129] In addition, the Petitioner had not received a "contemporaneous written acknowledgement" with respect to any of his contributions.[130]

[128] IRC Section 170(f)(8)(B).
[129] IRC Section 170(f)(11)(C) and Treas. Reg. Section 1.170A-13(c)(3)(ii).
[130] IRC Section 170(f)(8)(A).

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In response to the Commissioner's examination of the Petitioner's income tax returns for the years at issue, the Petitioner maintained he was in "substantial compliance" with applicable regulatory and Form 8283 requirements and that, to the extent it was determined he was not in substantial compliance, he cured that insufficiency on a timely basis.

2. *Tax Court Ruling*

The Tax Court held in favor of the IRS, and it wasn't a close call. The opinion states:

> The Forms 8283 that petitioner submitted with his returns were almost entirely incomplete and lacked signatures from the donor, the donee, and the appraiser. Petitioner did not otherwise provide reliable written records credibly identifying the individual items donated, their values or condition, the manner of acquisition, the donation dates, or his bases in the property. The updated Forms 8283 that petitioner submitted to the Office of Appeals were untimely and left Section A entirely incomplete and Section B partially incomplete and without a -19- [*19] signature from the donee. Thus, petitioner failed to provide "most of the information required" for us to evaluate whether he made the alleged charitable contributions. See Hewitt v. Commissioner, 109 T.C. at 265. Petitioner's lack of documentation also differs from the errors we listed in Mohamed v. Commissioner, 2012 WL 1937555, at *7, that we have previously excused.

Furthermore, the Tax Court sustained the IRS' proposed 20% accuracy-related penalty in relation to the 2012 and 2013 tax returns.[131] In so doing, the Tax Court stated the Petitioner "wholly failed" to comply with the substantiation requirements," failed to make any reasonable attempt to provide required information and maintain reliable written records for the donated items and acted negligently or in disregard of rules or regulations.

Chiarelli is yet another reminder that the IRS and the Tax Court take very seriously the non-cash charitable contribution substantiation requirements and that, to be safe in claiming an income tax charitable deduction for non-cash charitable gifts, Form 8283 and its instructions must be followed to the letter, and no requested information may be omitted.[132]

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[131] *See* IRC Section 6662(a).

[132] *See Campbell v. Commissioner*, T.C. Memo. 2020-41 (appraisal didn't properly reference and describe property actually donated) and *Loube v. Commissioner*, T.C. Memo. 2020-3 (basis information omitted from appraisal summary).

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E. Asset Value for Charitable Deduction Purposes Reduced Below Gross Estate Inclusion Value; Lack of Control Discount for Controlling LLC Interests Allowed

Estate of Warne v. Commissioner, T.C. Memo. 2021-17 (February 18, 2021)

1. *Facts*

Miriam Warne owned, in what was obviously a revocable trust but was called a "Family Trust," controlling, majority interests in five limited liability companies. Miriam owned 100% of the equity of Royal Gardens LLC, one of the five LLCs. The LLCs owned fee interests and leased fee interests in real estate. On December 27, 2012, Miriam gave fractional interests in three of the LLCs to her two sons and three granddaughters. She did not file a federal gift tax return for 2012. She died on February 20, 2014. The Family Trust's governing instrument directed that 75% of the equity in Royal Gardens be distributed to the Warne Family Charitable Foundation and 25% to St. John's Lutheran Church.

Miriam's estate filed a 2012 federal gift tax return reporting the 2012 gifts. The estate timely (on extension) filed a federal estate tax return claiming: (a) valuation discounts for lack of control and lack of marketability with respect to the estate's equity interests in all of the LLCs except Royal Gardens; (b) a value of $25,600,000 for Royal Gardens; and (c) charitable deductions of $19,200,000 for the disposition to the foundation and $6,400,000 for the disposition to the church. In its examination of the gift tax return, the IRS increased the value of all the gifts and imposed a failure to file penalty under IRC Section 6651(a)(1). Regarding the estate tax return, the IRS asserted increased values of all the LLC interests reported as estate assets because, said the IRS, the estate had undervalued the LLCs' underlying real estate interests and had overstated the amounts of claimed valuation discounts. The IRS also decreased the aggregate estate tax charitable deduction from $25,600,000 to $21,405,796.

2. *Analysis*

A large majority of the Tax Court's opinion consists of a laborious summary of the reports compiled by the estate's and the IRS' respective valuation expert witnesses and the Tax Court's ultimate resolutions of value. The one interesting aspect of the Tax Court's opinion regarding valuation relates to discounts for lack of control with respect to the estate's controlling, majority interests in four LLCs.[133] The Tax Court pointedly observed that ordinarily a discount for lack of control with respect to an asset that embodies control would be a non-starter, but in this case the Tax Court accepted the principle that such a lack of control discount could apply – largely because the parties agreed the estate was entitled to such a discount, although they disagreed as to the amount of the discount. The estate's valuation experts argued for a 5% lack of control discount and in so doing placed considerable weight on the possibility that minority interest holders would strongly oppose dissolution and would litigate to stop it. The IRS' valuation expert characterized the risk of litigation as "merely a hypothetical possibility" and suggested a 2% lack of control discount would be appropriate. The Tax Court agreed with the IRS's expert that the risk of litigation initiated by the minority was pure speculation and not reasonably probable and so refused

[133] As the controlling, majority interest owner, the decedent had the unilateral power to dissolve the LLCs and to appoint and remove managers.

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to consider such risk in its analysis. Nevertheless, the Tax Court found the remainder of the estate's experts' analysis superior to that of the IRS' expert and settled on a 4% discount for lack of control.

The Tax Court's handling of the charitable deduction issue is essentially a regurgitation of *Ahmanson*[134] – but with a twist. Relying on *Ahmanson*, the Tax Court applied the principle that, for gross estate inclusion purposes, the value of an asset passing in part to a charity is the asset's value as an undivided whole, but, for purposes of determining the amount of the charitable deduction, only the value of what the charity receives is deductible. *Ahmanson* is not entirely on point, however, because *Ahmanson* involved dividing an asset between the decedent's son and a charitable foundation. Here, Royal Gardens was divided between two charities, and so it passed 100% in charitable dispositions. The Tax Court nevertheless upheld the IRS' application of discounts to each charitable disposition because each charity individually received an interest with a diminished value as compared to its percentage interest in an undivided whole. The Tax Court adopted the parties' stipulations of discounts appropriate in the event the Tax Court determined discounts were proper: 27.385% for the church's interest in Royal Gardens and 4% for the foundation's interest.

The estate offered no substantive defense for the decedent's failure to file a 2012 gift tax return, so the failure to file penalty was sustained.

F. Charitable Conservation Easement Language Held Not to Reserve Mining Rights but Valuation Misstatement Penalties Upheld

Cattail Holdings, LLC v. Commissioner, T.C. No. 2023-17 (February 14, 2023)

1. *Facts*

Cattail Holdings LLC granted a conservation easement over 200 acres of property in Virginia to Foothills Land Conservancy, a nonprofit. The easement deed stated that the parties intended the land to remain undeveloped but that Cattail reserved the right to engage in activities related to forestry and recreation.

Cattail claimed a charitable deduction of over $40 million. On audit, the IRS valued the donated easement at less than $3.6 million. The IRS sent Cattail the notice of proposed penalties, which were either 40% for a gross valuation misstatement or 20% for a substantial valuation misstatement. Two months later, the IRS issued Cattail a notice of final partnership administrative adjustment (FPAA), which disallowed the charitable deduction entirely and determined penalties or, alternatively, determined that, if a deduction was allowable, Cattail hadn't established the value of the easement.

2. *IRS' Contentions and Court's Holdings*

On its motion for summary judgment, the IRS argued that (a) the easement deed reserved mineral rights in Cattail so it couldn't qualify for the charitable deduction; and (b) the

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[134] *Ahmanson Foundation v. United States*, 674 F.2d 761, 81-2 U.S.T.C. ¶ 13,438 (9th Cir. 1981).

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procedures followed for assessing the penalties were proper. The Tax Court rejected the first argument but agreed with the second argument.

The court rejected the IRS' contention that this conservation easement couldn't qualify for the charitable deduction because Cattail had reserved a mineral interest in the property. To qualify for the deduction, a conservation easement must be "protected in perpetuity."[135] If any party retains the right to extract minerals through surface mining, the Code explicitly provides that such an easement is not protected in perpetuity.[136] The court rejected this argument for three reasons:

- Nowhere in the easement deed does Cattail retain a right to exploit a mineral interest. It reserves other rights—such as farming and constructing agricultural buildings—but mineral rights are never mentioned in that provision. The only place the deed mentions mineral rights is in the paragraph explicitly *prohibiting* exploring for or extracting minerals.

- While the nonprofit can allow certain activities in its discretion, it prohibits the transportation of minerals if it impairs conservation values "in any material respect in the discretion of the Grantee." Letting the nonprofit decide what to allow is far from the same as Cattail reserving the right to mine on the property.

- It is "fanciful" to interpret the deed as permitting mining with the nonprofit's approval. The deed's language makes clear that permitting mining would be completely inconsistent with the easement's conservation purpose.

Cattail's position was that the penalties were improperly assessed because (a) the IRS agent who approved the penalties did not have the authority to do so; and (b) the IRS *appraiser* wrongly made the penalty assessment determination.

- While there was a public notice and related news release in 2019 informing the public that certain transactions risked certain penalties, these were not determinations of penalties against Cattail, as Cattail asserted. They weren't directed at any specific taxpayer, and the IRS didn't even conclude its examination of Cattail's return until 2021, so it couldn't have made a determination before that.

- The IRS appraiser couldn't have made the determination of the penalty because he didn't actually recommend any penalty and IRS appraisers don't have the authority to determine penalties. Here, in accordance with statutory requirements under IRC Section 6751(b), the agent with the appropriate authority made the penalty determination, and his supervisor approved it, which doesn't mandate a thorough explanation of a penalty.

[135] IRC Section 170(h)(1)(C).
[136] IRC Section 170(h)(5)(B)(i).

G. Eleventh Circuit Reverses Tax Court and Sanctions Changes in Conservation Easement Terms

Pine Mountain Preserve, LLLP, et al., v. Commissioner, 151 T.C. No. 14 (2018), *rev'd* No. 19-11795 (11th Cir. October 22, 2020)

1. *Facts*

In 2005, 2006 and 2007, Pine Mountain Preserve, LLLP donated a "perpetual easement in gross" in land in Alabama to the North American Land Trust ("NALT"). Each easement specified an area that was to be preserved and protected in perpetuity from any commercial or residential development, except that, in the 2005 and 2006 easements, a total of sixteen areas was reserved within each of which the taxpayer could construct a single-family dwelling along with various ancillary structures. The 2005 easement permitted the taxpayer, with the consent of NALT, to move the ten one-acre building areas subject to that easement from their originally designated locations to any other location within the 2005 conservation area so long as the total of all building areas did not exceed ten acres, and NALT determined the moves would not "result in any material adverse effect on any of the Conservation Purposes." The 2006 easement did not specify the location of the six building areas within the confines of that easement but said the locations had to be approved in advance by NALT. The 2007 easement did not reserve any residential construction privileges but did allow Pine Mountain to build a water tower subject to NALT's approval. All three easements explicitly allowed Pine Mountain and NALT to change the easement terms so long as any changes did not violate their conservation purposes.

2. *Tax Court Holding*

Regarding the 2005 easement, the Tax Court was troubled not only by the fact that, by agreement between Pine Mountain and NALT, building areas could be relocated with virtually no restrictions but also by the fact that Pine Mountain reserved the privilege to construct, anywhere within the 2005 Conservation Area, many other buildings which, collectively, would have the effect of expanding the residential development well beyond the ten acres composing the building areas alone. Accordingly, the Tax Court disallowed any deduction with respect to the 2005 easement. With respect to the 2006 easement, the Tax Court held that the lack of specificity regarding the location of the building areas at the outset was fatal to allowance of a deduction under IRC Section 170(h). The Tax Court stated that: "the easement, when granted, did not create a perpetual use restriction on a defined parcel of land, as required by section 170(h)(2)(C)" and therefore could not constitute a "qualified real property interest." The Tax Court ruled that a deduction with respect to the value of the 2007 easement was proper but reduced the value of the easement for charitable income tax deduction purposes by picking a value which was midway between what each party's expert determined.

3. *Eleventh Circuit's Decision*

On appeal by both the taxpayer and the IRS, the Eleventh Circuit U.S. Court of Appeals first addressed the questions of whether the grants of the 2005 and 2006 easements were grants of "qualified real property interests" and "exclusively for conservation purposes.[137] In

[137] *See* IRC Section 170(h)(1), (h)(2) and (h)(5)(A).

reversing the Tax Court, the Court of Appeals held "a broad limitation on the use of the property that applies to the parcel as a whole satisfies the statutory test, even if within that parcel there exist certain narrow exceptions to that limitation." As to the 2007 easement, the Eleventh Circuit upheld the Tax Court's conclusion that a deduction was proper. In its footnote 2, the Eleventh Circuit noted that the Tax Court's implicit distinction between a reserved right to build homes and barns (disqualifying) and a reserved right to build a water tower (fine and dandy) was inexplicable.

The Eleventh Circuit observed that the provisions permitting amendments by both parties did not violate the "protected in perpetuity" requirement of IRC 170(h)(2)(C). The Court of Appeals said: "Parties to a bilateral contract—which is all a conservation easement is—can always agree after the fact to amend their agreement, whether or not they expressly reserve that right to themselves in writing. If the possibility of amendment were a deal-killer, then there could be no such thing as a tax-deductible conservation easement."

The Eleventh Circuit remanded on the issue of valuation and, in so doing, rather harshly criticized the Tax Court's valuation approach, stating the Tax Court simply "split the baby" and "insist[ing] that the Tax Court apply a discernible methodology that is appropriately tied to the standard set out in the governing regulation."

H. Eleventh Circuit Rules Regulation Invalid and Reverses Tax Court's Disallowance of Conservation Easement Deduction

Hewitt v. Commissioner, 21 F.4th 1336 (11th Cir. December 29, 2021), *rev'g and remanding* T.C. Memo. 2020-89

1. *Facts*

David and Tammy Hewitt donated a conservation easement on their property in 2012. They claimed a deduction for the easement contribution on their 2012 income tax return and charitable contribution carryforward deductions on their 2013 and 2014 returns. The deed granting the easement provided for judicial extinguishment of the easement, and in such case the donee charitable organization would retain the proportional value of the easement "minus any increase in value after the date of [the] grant attributable to improvements."

In 2017, the IRS issued to the Hewitts a notice of deficiency, disallowing the charitable contribution carryforward deduction and assessing a tax deficiency and penalty for 2013 and 2014. The IRS contended that the easement deed failed to comply with Treas. Reg. Section 1.170A-14(g)(6), which governed the extinguishment of conservation easements and allocation of the proceeds.

The Hewitts challenged the deficiency and penalty by arguing that the Treasury failed to follow the Administrative Procedures Act ("APA") in promulgated the relevant regulation. Thus, the history of the regulation governing conservation easements is more relevant than the facts of the Hewitts' tax history.

2. *Applicable Law*

Congress created conservation easement deductions in the Tax Treatment Extension Act of 1980. Committee reports reveal that Congress's intent was to "preserv[e] our

country's natural resources and cultural heritage." The Committee noted that because "conservation easements now play an important role in preservation efforts…provisions allowing deductions for conservation easements should be directed at the preservation of unique or otherwise significant land areas or structures."

The statute requires that, for a contribution to be a "qualified conservation contribution," the contribution must be:

(A) of a qualified real property interest,

(B) to a qualified organization, and

(C) exclusively for conservation purposes.[138]

IRC Section 170(h)(5)(A) also provides that "[a] contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity." But the statute does not define the "protected in perpetuity" requirement.

For that reason, Treasury, in 1983, issued a notice of proposed rulemaking relating to qualified conservation contributions. The proposed regulation required that a donee retain a vested right in the value of judicial sale proceeds proportional to the value of the donation relative to the property at the time of the donation. (As described above, the Hewitts' donee retained a vested right with a value proportional to the donation *less any increase in value attributable to improvements*.) A three-year comment period followed, during which time Treasury received several comments noting that the proposed regulation created inequities and was unfair to donors who made post-donation improvements to their properties. These inequities, the comments highlighted, potentially disincentivized conservation easement donations, which was contrary to Congressional intent.

Nonetheless, Treasury adopted the proposed regulation—albeit with revisions, though those revisions were clarifications in response to comments expressing uncertainty about the regulation's meaning rather than changes to the regulation's substance. In adopting the final regulation, Treasury noted that it had "consider[ed]…all comments regarding the proposed amendments." It did not respond to any of the significant comments relating to the regulation's inhibition of Congress's intent.

3. *Eleventh Circuit's Opinion*

The United States Court of Appeals for the Eleventh Circuit held that, because Treasury failed to respond to significant comments it received during the notice and comment period, its decision to promulgate that rule violated the APA.

The APA's procedure for notice-and-comment rulemaking allows interested parties to participate in the rulemaking process. And agencies must consider and respond to significant

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[138] IRC Section 170(h)(1).

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comments in a way that articulates why the agency responded to those comments in a particular manner and in a way that gives adequate reasons for the agency's decisions.

The Court emphasized that an agency's response—its basis and purpose statement—should allow reviewing courts to see the objections raised during the public comment period and why the agency reacted to those comments as it did. That is, the agency must give adequate reasons for its decisions, including a rebuttal to significant comments.

Because the comments at issue challenged the fundamental premise underlying the proposed regulation by highlighting that the regulation's effects led to results antithetical to Congress's objective of encouraging donation of conservation easements, the Court found those comments significant. And for that reason, the APA required Treasury to respond to those comments. Though Treasury "responded," it did so only in a conclusory way: by saying that it had "consider[ed]…all comments regarding the proposed amendments." Such a superficial response, the Court held, was inadequate and did not suffice to explain Treasury's decision—it did not explicate the agency's reason for its action; it did not demonstrate that the agency had carefully considered all of the comments; and it did not convey adequate reasons for the agency's decisions. Treasury's promulgation of the regulation thus violated the APA and the Commissioner's interpretation of the qualified conservation contribution statute was arbitrary and capricious.[139]

IX. RETIREMENT ASSETS

A. Surviving Spouse Allowed to Rollover Roth IRA Payable to Her Revocable Trust

Private Letter Ruling 202136004 (June 14, 2021)

In PLR 202136004, a predeceased spouse named his wife's revocable trust as sole beneficiary of his Roth IRA. His wife was the sole Trustee and the sole beneficiary of the trust. She asked the IRS to rule that she could: (1) roll over the distribution of the Roth IRA balance to a Roth IRA in her name, pursuant to IRC Section 408(d)(3)(A)(i); (2) exclude the distribution from her gross income for federal tax purposes for the year in which the distribution was made (due to the roll over); and (3) circumvent the required minimum distribution ("RMD") requirements beginning with the year following the rollover, pursuant to IRC Section 408(A)(c)(4)(A).

The IRS concluded that the surviving spouse was effectively the only person for whose benefit the Roth IRA would be maintained. The IRS ruled that the surviving spouse could roll over the Roth IRA into one or more Roth IRAs in her own name, that she need not include the proceeds as income if she rolls the proceeds over into a Roth IRA in her own name within 60 days and that she was not required to take RMDs.

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[139] *See*, *also*, *Glade Creek Partner, LLC v. Commissioner*, No. 21-11251 (11th Cir. August 22, 2022), remanding to the Tax Court in light of *Hewitt*; *Sparta Pink Property, LLC v. Commissioner*, T.C. Memo. 2022-88 (August 29, 2022), and *Thompson v. Commissioner*, T.C. Memo. 2022-80 (July 20, 2022), in both of which the Commissioner's Motion for Partial Summary Judgment was denied in light of *Hewitt* because the case was appealable to the Eleventh Circuit. *But see Oakbrook Land Holdings, LLC, et al. v. Commissioner*, No. 20-2117, 2022 BL 84909 (6th Cir. March 14, 2022), reaching the opposite conclusion on facts substantively identical to those in *Hewitt*.

B. Erroneous Transfer Out of IRA Can't Be Unwound
Private Letter Ruling 202125007 (March 26, 2021)

On the death of a predeceasing spouse, the surviving spouse became the owner of the predeceased spouse's individual retirement account. Surviving spouse named a trust as primary beneficiary of the IRA. Surviving spouse's children were Trustees and beneficiaries of the trust. At surviving spouse's death, the trust became irrevocable, and the IRA became and inherited IRA for the benefit of the trust.

To obtain investment flexibility the Trustees were told by the IRA custodian wasn't available within the inherited IRA account, the Trustees transferred the IRA proceeds to a non-IRA account. Several months later, the Trustees requested that the IRS give them a letter ruling saying they could "reverse" the transfer out of the inherited IRA and not be required to include in gross income any amount by reason of the transfer to the non-IRA account.

In ruling against the taxpayers, the IRS adhered closely to the applicable statutory language. The IRS noted that, under IRC Section 408(d)(3), the only permitted method for transferring assets between inherited IRAs is by a trustee-to-trustee transfer, and so, once the IRA funds were transferred out of an IRA vehicle, there was no legal mechanism by which to get them back in. There are no applicable "rollover" provisions. Additionally, the IRS could find no statutory basis for not including the IRA proceeds (other than any such proceeds attributable to investment in the contract) in the trust's gross income.

No surprise here other than that anyone thought there was any chance at all of a favorable ruling and that, when the taxpayers received word the requested ruling would be adverse, they didn't withdraw the ruling request.

C. Significant Changes to Qualified Retirement Plan and IRA Distribution Rules
Setting Every Community Up for Retirement Enhancement ("SECURE") Act of 2019, Pub. Law No. 116-94 (December 20, 2019)

The SECURE Act (the "Setting Every Community Up for Retirement Enhancement Act of 2019" (P.L. 116-94)) was signed by the President on December 20, 2019. Sections 114 and 401 of the SECURE Act contain a number of provisions important to estate planners primarily in connection with distributions from defined contribution plans ("plans") and individual retirement accounts ("IRAs").

1. *Required Beginning Date Change*

The term required beginning date ("RBD") refers to the date when the plan participant or IRA owner (the "employee") begins receiving RMDs from the plan or IRA. Before the SECURE Act, the RBD was April 1 of the year following the year in which the employee reached age 70½ or, if not a 5% owner, retired, whichever was later. Section 114 of the SECURE Act, amending IRC Sections 401(a)(9)(B) & (C) and 408(b), changes the RBD for employees who reach age 70½ after December 31, 2019 to April 1 of the year following the year in which the

employee reaches age 72 or, if not a 5% owner, retires, whichever is later. One result of this change is that no one had an RBD in 2021.

This was a small positive development for taxpayers because, while there was no prohibition against or penalty for starting to receive distributions a year or two earlier than one's RBD, those who could afford to defer starting to receive distributions until the new RBD may have had as much as an extra year of tax-deferred earnings on the amount of their initial RMD.

2. *Introduction of "Eligible Designated Beneficiary" Concept*

Section 401 of the SECURE Act, amending IRC Section 401(a)(9)(E), introduces the term "eligible designated beneficiary" ("EDB"). An EDB includes an employee's surviving spouse, an employee's child who has not reached majority, a "disabled" individual (within the meaning of IRC Section 72(m)(7)), a chronically ill individual (within the meaning of IRC Section 7702B(c)(2)) and an individual not more than ten years younger than the employee. An employee's child who has reached majority is no longer an EDB. EDB status is determined as of the employee's date of death.[140]

3. *Minimum Required Distribution Rules Under SECURE Act*

Before the SECURE Act, if the beneficiary of a defined contribution plan or IRA was a designated beneficiary ("DB") (very simply, an individual who is designated as a beneficiary under the plan (or IRA)), RMDs could generally be made to the DB over his or her life expectancy. The opportunity to spread RMDs over a beneficiary's life expectancy was (and is) generally considered to be a positive attribute because it usually enables accumulation and compounding of tax-deferred earnings within the plan or IRA for a relatively long period.

The SECURE Act left the defined contribution plan and IRA distribution options pertaining to a surviving spouse largely unchanged. As before, a surviving spouse may elect to treat a predeceased spouse's IRA as her or his own, implement a spousal rollover or take plan or IRA distributions over her or his life expectancy as annually recalculated. A surviving spouse may delay the start of distributions until the predeceased spouse would have reached age 72.

Also left undisturbed by the SECURE Act are the RMD rules applicable when there is no DB. In that case, if the employee dies before reaching his or her RBD, all plan or IRA proceeds must be distributed by the end of the fifth year after the year of the employee's death, and, if the employee dies on or after reaching his or her RBD, all plan or IRA proceeds must be distributed over the employee's then remaining life expectancy without annual recalculation.

However, under the SECURE Act, if and only if a plan or IRA beneficiary is an EDB, he or she may receive plan or IRA proceeds over his or her life expectancy (but, unless such beneficiary is the employee's surviving spouse, without annual recalculation). If a plan or IRA beneficiary is a DB but not an EDB, that DB must take all plan or IRA proceeds by the end of the tenth year after the year of the employee's death. These provisions are effective with respect to plans and IRAs where the employee died or dies after December 31, 2019.

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[140] IRC Section 401(a)(9)(E)(ii).

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4. *Summary of Trust Planning Under SECURE Act*

A so-called "conduit trust" is a trust whose terms **mandate** that any and all distributions the trust receives from a plan or IRA pursuant to the applicable beneficiary designation shall be immediately paid over to the current beneficiary. A conduit trust is the ultimate "see-through trust" because, when determining the amounts of RMDs distributable from a plan or IRA to the trust, one simply looks to the identity and age of the current beneficiary.

If plan or IRA benefits are payable to a conduit trust for the benefit of the employee's surviving spouse, those benefits may be paid over the annually recalculated life expectancy of the surviving spouse. Following the death of the surviving spouse, any remaining benefits will have to be paid no later than the end of the tenth year after the year of death of the surviving spouse.

If plan or IRA benefits are payable to a conduit trust for the benefit of a non-spousal EDB, those benefits may be paid over the life expectancy of the EDB without recalculation. Following the death of the non-spousal EDB, any remaining benefits will have to be paid no later than the end of the tenth year after the year of such death. The **major exception** to these rules, however, is that, if the non-spousal EDB is a minor child of the employee, the plan or IRA benefits payable to the conduit trust can no longer be paid over the EDB's life expectancy (without recalculation) from and after the point when that child has reached majority. From and after that time, any remaining benefits will have to be paid no later than the end of the tenth year after the year in which the child reached majority.

If plan or IRA benefits are payable to a conduit trust for the benefit of a DB who is not an EDB, those benefits will have to be paid no later than the end of the tenth year after the year of the employee's death.

A so-called "accumulation trust" is a "see-through trust"[141] whose terms **do not require** that any and all distributions the trust receives from a plan or IRA pursuant to the applicable beneficiary designation shall be paid over to any trust beneficiary at any particular time.

In general, if plan or IRA benefits are payable to an accumulation trust, those benefits will have to be paid no later than the end of the tenth year after the year of the employee's death. The exceptions to this general rule are as follows:

- If the accumulation trust is for the benefit of a disabled individual or a chronically ill individual, (two categories of EDB as defined in amended IRC Section 401(a)(9)(E)) and has multiple beneficiaries, it is an "applicable multi-beneficiary trust" ("AMBT"). Plan or IRA benefits payable to an AMBT may be paid using the life expectancy method, but it is not entirely clear whether the measuring life is that of the disabled or chronically ill individual or another beneficiary.

[141] A trust which is valid under state law, irrevocable, has identifiable, human beneficiaries and as to which certain documentation is provided to the plan or IRA custodian or trustee by October 31 of the year after the employee's death. Treas. Reg. Section 1.401(a)(9)-4, A-5(b).

- If one or more beneficiaries of the accumulation trust are non-DBs:
  - If the employee dies before his or her RBD, plan or IRA benefits will have to be paid no later than the end of the fifth year after the year of the employee's death.
  - If the employee dies on or after his or her RBD, plan or IRA benefits may be paid over the employee's then remaining life expectancy without recalculation.

D. Treasury Moves to Conform Qualified Plan and IRA Distribution Rules to SECURE Act
Proposed Regulation Section 1.401(a)(9), REG-105954-20, 87 Fed. Reg. 10504 (February 24, 2022); Notice 2022-53, 2022-___ I.R.B. ___ (October 7, 2022)

Prop. Reg. Section 1.401(a)(9) constitutes an extensive revision of Treas. Reg. Section 1.401(a)-9, which has been in place since 2002. It appears the primary impetus for the development of Prop. Reg. Section 1.401(a)(9) was enactment of the SECURE Act because that legislation rendered material components of Treas. Reg. Section 1.401(a)(9) obsolete or irrelevant, but these new rules also clarify some existing features of Treas. Reg. Section 1.401(a)(9) that have long been in need of clarification.

Notice 2022-53 states that, when final regulations are issued under IRC Section 401(a)(9), they will apply no earlier than the 2023 distribution calendar year. Notice 2022-53 also provides IRC Section 401(a)(9) guidance applicable for 2021 and 2022.

Among the most important provisions of, or results that would flow from, Prop. Reg. Section 1.401(a)(9) are the following:

- If the employee dies before the employee's RBD, the minimum required distribution rules are satisfied if the employee's entire interest is distributed by the end of the calendar year that includes the tenth anniversary of the employee's death.

- If the employee dies on or after the employee's RBD, the minimum required distribution rules are satisfied only if RMDs (based on the employee's life expectancy) are made annually starting in the year following the year of the employee's death *and* the employee's entire interest is distributed by the end of the calendar year that includes the tenth anniversary of the employee's death. However, pursuant to Notice 2022-53: (1) a defined contribution plan that didn't make such annual distributions in 2021 or 2022 won't be treated as failing to satisfy IRC Section 401(a)(9) solely for that reason; and (2) a DB who fails to take such an annual distribution in 2021 or 2021 won't be subject to the 50% excise tax under IRC Section 4974.

- The age of majority is age 21. From and after the time an EDB has reached age 21, he or she is no longer an EBD but, rather, a DB, and all the minimum required distribution rules applicable to DBs apply.

- The terms "see-through trust," "conduit trust" and "accumulation trust," developed and used over the years by practitioners but not officially recognized by Treasury, are defined.

- Beneficiaries of a trust are determined to be DBs, or not, as follows:

    - Current beneficiaries are DBs.

    - "First-line" successor beneficiaries are DBs.

    - Those who would become beneficiaries at the death of "first-line" successor beneficiaries are DBs.

    - More remote beneficiaries are not considered.

    - Potential appointees under a power of appointment are not considered.

    - Actual appointees under a power of appointment are DBs.

- For a disabled individual to be considered an EDB, that individual must have been disabled at the employee's death.

- An accumulation trust of which a disabled or chronically ill individual is a beneficiary may receive RMDs based on that individual's life expectancy only if that individual is the only beneficiary of the trust who has any right to the employee's interest in the qualified plan or IRA until that beneficiary's death.

- An accumulation trust of which the employee's surviving spouse is a beneficiary (which would include a typical QTIP trust) may *not* receive RMDs based on the surviving spouse's life expectancy. Under these circumstances, a surviving spouse's status as an EDB is useless.

- A conduit trust may have multiple beneficiaries.

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