



WASHINGTON UPDATE: Transfer Tax Agenda

**Prepared for the ACTEC
Heart of America Fellows Institute
Oklahoma City, Oklahoma, May 3, 2019**

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**2018-2019 TREASURY-IRS PRIORITY
GUIDANCE PLAN (November 8, 2018)
AND
SECOND QUARTER UPDATE (April 5, 2019)**

https://www.irs.gov/pub/irs-utl/2018-2019_pgp_2nd_quarter_update.pdf

Part 1: “Implementation of Tax Cuts and Jobs Act (TCJA)”

64 Items (25 last year)

Item 3: Guidance on the deductibility of expenses described in §67(b) and (e) [pp. 2-3] [Page numbers refer to the written material.]

67(e) [1986] DETERMINATION OF ADJUSTED GROSS INCOME IN CASE OF ESTATES AND TRUSTS.— For purposes of this section, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that—

- (1) the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which **would not have been incurred** if the property were not held in such trust or estate, and
- (2) the deductions allowable under sections 642(b), 651, and 661, shall be treated as **allowable in arriving at adjusted gross income ...**

67(g) [2017] SUSPENSION FOR TAXABLE YEARS 2018 THROUGH 2025.— Notwithstanding subsection (a), **no miscellaneous itemized deduction shall be allowed** for any taxable year beginning after December 31, 2017, and before January 1, 2026.

Notice 2018-61, 2018-31 IRB 278 (July 13, 2018) [p. 2]

- Regulations should clarify that trust and estate administration expenses continue to be deductible because of section 67(e).
- What about, say, fiduciary investment advisory fees, including the portion of a “bundled” fiduciary fee attributable to investment advice? See Reg. §1.67-4(b)(4) and (c)(2)?
 - “Nothing in section 67(g) impacts the determination of what expenses are described in section 67(e)(1).”
- Regulations will also address the availability of “excess deductions” to individual beneficiaries under section 642(h) on termination of a trust or estate, and the Notice asks for comments on that issue.

2018 Form 1041 Instructions (Feb. 5, 2019) [pp. 2-3]

- **Page 26 (line 22):** “If the estate or trust has for its final year deductions (excluding the charitable deduction and exemption) in excess of its gross income, the excess is allowed as an itemized deduction to the beneficiaries succeeding to the property of the estate or trust.”
- **Page 36 (K-1):** “Note. Section 67(g) suspends miscellaneous itemized deductions subject to the 2% floor for tax years 2018 through 2025. See Notice 2018-61 for information about allowable beneficiary deductions under section 67(e) and 642(h).”
- **Page 39 (K-1):** “If this is the final return of the estate or trust, and there are excess deductions on termination (see the instructions for line 22), enter the beneficiary’s share of the excess deductions in box 11 [final year deductions], using code A. Figure the deductions on a separate sheet and attach it to the return.”

Item 13: Final regulations under new §199A and §643(f)” (Deduction of 20% of “Qualified Business Income”) [pp. 3-8]

- Response to the mismatch in top income tax rates:
 - Corporate rate lowered **from 35% to 21%**.
 - Individual (and passthrough) rate lowered **from 39.6% to 37%**.
- Many computational nuances:
 - “W-2 wages” to target **job creation**.
 - “UBIA* of qualified property” to target **capital formation**.
 - But also, it seems, to comply with **budget rules and targets**.
- Regulations (§§1.199A-0 through -6 & 1.643(f)-1):
 - Proposed: Released Aug. 8, published Aug. 16, 2018.
 - Final: Released Jan. 18, corrected Feb. 1, published Feb. 8, 2019.

* “Unadjusted basis immediately after the acquisition”

Multiple Trust Rules [pp. 7-8]

- Section 643(f) [1984]: “For purposes of this subchapter [subchapter J], under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if ... (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) **a principal purpose of such trusts** is the avoidance of the tax imposed by this chapter. For purposes of the preceding sentence, a husband and wife shall be treated as 1 person.”
- Reg. §1.643(f)-1 elaborates “a principal purpose of such trusts” as “a principal purpose for **establishing one or more of such trusts or for contributing additional cash or other property to such trusts.**”
- Contrast **Proposed** Reg. §1.643(f)-1(b): “A principal purpose for establishing or funding a trust will be **presumed** if it results in a **significant** income tax benefit **unless** there is a significant non-tax (or non-income tax) purpose that **could not have been achieved** without the creation of these separate trusts.”

Item 37: “Anti-Clawback” Regulations [pp. 8-12]

- Described as “Regulations under § 2010 addressing the computation of the estate tax in the event of a difference between the basic exclusion amount applicable to gifts and that applicable at the donor’s date of death.”
- Amplification of Item 16 in the 2017-2018 Plan: “Guidance on computation of estate and gift taxes to reflect changes in the basic exclusion amount.”

Issue

- **Context: The “doubling” of the basic exclusion amount (“estate tax exemption”) in the 2017 Tax Act “sunsets” January 1, 2026.**
- **Issue: If a donor makes a gift before 2026 and dies in 2026 or later, will the lower exemption at the time of death mean that the gift (as an “adjusted taxable gift” added to the taxable estate under section 2001(b)(1)) will in effect be subject to that lower exemption anyway?**

Section 2001(g), added in 2010 [now Section 2001(g)(1)]

(1) MODIFICATIONS TO GIFT TAX PAYABLE TO REFLECT DIFFERENT TAX RATES.—For purposes of applying subsection (b)(2) with respect to 1 or more gifts, the **rates** of tax under subsection (c) in effect at the decedent's death shall, in lieu of the rates of tax in effect at the time of such gifts, be used **both** to compute—

(A) the tax imposed by chapter 12 with respect to such gifts, and

(B) the credit allowed against such tax under section 2505, including in computing—

(i) the applicable credit amount under section 2505(a)(1), and

(ii) the sum of the amounts allowed as a credit for all preceding periods under section 2505(a)(2).

New Section 2001(g)(2), added in 2017

(2) MODIFICATIONS TO ESTATE TAX PAYABLE TO REFLECT DIFFERENT BASIC EXCLUSION AMOUNTS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this section with respect to any difference between—

(A) the **basic exclusion amount** under section 2010(c)(3) applicable at the time of the decedent's death, and

(B) the **basic exclusion amount** under such section applicable with respect to any gifts made by the decedent.

Illustration of How “Clawback” Might Work

- **Assumptions (simplified):**
 - Unindexed exclusion amount of \$10 million in 2019.
 - Reverting to \$5 million in 2026.
 - No portability.
 - Gift in 2019 of \$10 million (donor’s only lifetime gift).
 - No change in law.
 - Donor dies in 2026 with a taxable estate of \$20 million.
- **Intuitively correct estate tax: $40\% \times \$20 \text{ million} = \8 million .**

Calculation

Using Estate Tax Return (Form 706) as a Template

Line 3	Taxable estate	20,000,000
Line 4	Adjusted taxable gifts	10,000,000
Line 5	Add lines 3 and 4	30,000,000
Line 6	Tentative tax on amount on line 5	11,945,800
Line 7	Total gift tax paid or payable*	0
Line 8	Gross estate tax (subtract line 7 from line 6)	11,945,800
Line 11	Allowable applicable credit amount	1,945,800
Lines 12 & 16	Net estate tax (subtract line 11 from line 8)	10,000,000

*** Using “the rates of tax ... [but not the exclusion amount] in effect at the decedent’s death” under section 2001(g)(1).**

Intuitively correct result is \$8,000,000. “Clawback” penalty is \$2,000,000.

Original Expectation (this time last year)

Using Estate Tax Return (Form 706) as a Template

Line 3	Taxable estate	20,000,000	
Line 4	Adjusted taxable gifts	10,000,000	
Line 5	Add lines 3 and 4	30,000,000	
Line 6	Tentative tax on amount on line 5	11,945,800	
Line 7	Total gift tax paid or payable*	0	2,000,000
Line 8	Gross estate tax (subtract line 7 from line 6)	11,945,800	9,945,800
Line 11	Allowable applicable credit amount	1,945,800	1,945,800
Lines 12 & 16	Net estate tax (subtract line 11 from line 8)	10,000,000	8,000,000

Compute line 7 using \$5,000,000 exclusion.

Proposed Reg. §20.2010-1(c) (Nov. 20, 2018)

- Unlike the 2010 fix in section 2001(g)(1), the proposed regulation does not change the hypothetical gift tax that “would have been payable” under section 2001(b)(2), subtracted on **line 7** of Part 2 of the estate tax return.
- Instead, the proposed regulation increases the allowable credit on **line 9a** of Part 2 to the total amount of unified credit taken into account in computing gift taxes.
- Because the amount on line 9a also becomes a subtraction, the effect on the tax owed will be the same.

Proposed Reg. §20.2010-1(c) (Nov. 20, 2018)

Line 3	Taxable estate	20,000,000		
Line 4	Adjusted taxable gifts	10,000,000		
Line 5	Add lines 3 and 4	30,000,000		
Line 6	Tentative tax on amount on line 5	11,945,800		
Line 7	Total gift tax paid or payable*	0	2,000,000	0
Line 8	Gross estate tax (line 6 minus line 7)	11,945,800	9,945,800	11,945,800
Line 9a	Basic exclusion amount	5,000,000	5,000,000	10,000,000
Line 9b	DSUE amount	0	0	0
Line 9c	Restored exclusion amount	0	0	0
Line 9d	Applicable exclusion amount (Add lines 9a, 9b, and 9c)	5,000,000	5,000,000	10,000,000
Line 9e	Applicable credit amount (tax on 9d)	1,945,800	1,945,800	3,945,000
Line 10	Adjustment	0	0	
Line 11	Allowable applicable credit amount (Subtract line 10 from line 9e)	1,945,800	1,945,800	3,945,800
Lines 12 & 16	Net estate tax (line 8 minus line 11)	10,000,000	8,000,000	8,000,000

*Compute line 7
using
\$5,000,000
exclusion.*

*Use basic
exclusion
amount of
\$10,000,000 on
line 9a.*

Proposed Reg. §20.2010-1(c) (Nov. 20, 2018)

- The Preamble to the proposed regulations describes this line 9a approach as **“the most administrable solution.”** [p. 11]
- Does not permit the 2018-2025 “bonus” exemption to be used first (“off the top”), preserving the full \$5,000,000 exemption (indexed) for use after 2025, as some had hoped. [p. 12]
- Still allows DSUE amount to be added on **line 9b.**
- But does not make it clear whether the DSUE amount is limited to the possibly smaller basic exclusion amount in effect when the surviving spouse dies. [p. 10]

Part 3: “Burden Reduction”

14 Items (20 last year) (nothing new)

Item 4: Final regulations under §§1014(f) and 6035 regarding basis consistency” [pp. 14-25]

- Section 1014(f) requires in general that the basis of property received from a decedent, “whose inclusion in the decedent’s estate **increased the liability for the tax,**” may not exceed the finally determined estate tax value.
- Section 6035 requires every executor (including anyone in possession of property with the statutory duties of an executor) **who is required to file an estate tax return** to furnish to the IRS and “to each person acquiring any interest in property included in the decedent’s gross estate” a statement setting forth **the value of those property interests reported on the estate tax return.**

[*i.e.*, Form 8971 and its Schedule A]

- Enacted July 31, 2015.

Proposed Reg. §1.6035-1(b)(1) (March 4, 2016) [p. 21]

- Excludes from the reporting requirement:
 - Cash (other than a coin collection or other coins or bills with numismatic value).
 - Tangible personal property for which an appraisal is not required under Reg. §20.2031-6(b) – generally household and personal effects other than “articles having marked artistic or intrinsic value of a total value in excess of \$3,000.”
 - Income in respect of a decedent.
 - Property that is sold in a transaction in which capital gain or loss is recognized.

Proposed Reg. §1.6035-1(c)(3) [p. 22]

- “If, by the due date [of Form 8971] [30 days after the estate tax return is filed], the executor has not determined what property will be used to satisfy the interest of each beneficiary, the executor must report on the Statement for each such beneficiary **all of the property that the executor could use to satisfy that beneficiary’s interest**. Once the exact distribution has been determined, the executor may, but is not required to, file and furnish a supplemental Information Return and Statement.”
- Even though section 6035(a)(1) itself attaches only “to each person **acquiring** any interest in property.”

Proposed Reg. §1.1014-10(c)(3) [pp. 22-23]

- After-discovered and omitted property that is not reported on an (initial or supplemental) estate tax return before the estate tax statute of limitations runs given a value, and therefore an initial basis, of **zero**.
- If the after-discovered or omitted property would have increased the gross estate enough to cause an estate tax return to be required, but no estate tax return was filed, the estate tax value of **all property** subject to the consistency rule considered to be **zero**.
- Even though such property is **neither**
 - “property the final value of which **has been determined** for purposes of the [estate] tax” within the meaning of section 1014(f)(1)(A) nor
 - property “with respect to which **a statement has been furnished** under section 6035(a)” within the meaning of section 1014(f)(1)(B).

Proposed Reg. §1.6035-1(f) [p. 23]

- An open-ended requirement for a recipient of a Schedule A to in turn file a Schedule A when making **any gift or other retransfer of the property** that results wholly or partly in a carryover basis for the transferee.
- Even though section 6035 imposes the reporting requirement only on an **“executor.”**
- Now basis consistency appears in the context of “near-term **burden reduction**”?
- Perhaps Treasury and the IRS will address the foregoing problems.

Predictions

- **More exceptions and more effective exceptions.**
- **Walk-back of the 30-day deadline.**
- **Maybe relaxation of the retransfer rule.**
- **Possibly even addressing the zero basis rule.**

Item 8: Final regulations under §2642(g) – Allocation of GST exemption [pp. 25-28]

- Proposed Reg. §26.2642-7 (REG-147775-06) (April 16, 2008) would **oust Reg. §301.9100-3** (which Notice 2001-50 now allows to be used) and become the exclusive basis for seeking these extensions of time.
- The proposed regulations resemble Reg. §301.9100-3, but with some important differences.
- Proposed Reg. §26.2642-7(d)(2) and (3) each set forth a **“nonexclusive list of factors”** and invite **more deliberate weighing** of all those factors than the identification of one or two dispositive factors as under Reg. §301.9100-3.
- This arguably is consistent with the mandate of section 2642(g)(1)(B) to **“take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant.”**

Item 8: Final Regulations Under §2642(g), Continued

- Proposed Reg. §26.2642-7(h)(3)(i)(D) requires a request for relief to be accompanied by “detailed affidavits” from “[e]ach tax professional who advised or was consulted by the transferor or the executor of the transferor’s estate with regard to **any aspect** of the transfer, the trust, the allocation of GST exemption, and/or the election under section 2632(b)(3) or (c)(5).”
- This item last appeared in the 2015-2016 Plan, was removed in 2016, and now is revived as a **“burden reduction”** project.
- Perhaps the extensive experience of the IRS with ruling requests under Notice 2001-50 and Reg. §301.9100-3 has shown that less onerous requirements may be sufficient.

Predictions

- **Substantive requirements (addressing more factors) probably survive.**
- **Procedural requirements (a lot more affidavits) probably walked back somewhat.**

Part 5: General Guidance

“Gifts and Estates and Trusts” (4 items, 1 new)

Item 1: Guidance on basis of grantor trust assets at death under §1014 [pp. 28-30]

- Apparently derived from the no-rule policy announced in Rev. Proc. 2015-37, 2015-26 I.R.B. 1196 (published **June 29, 2015**), for “[w]hether the assets in a grantor trust receive a **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...”
- Apparently aimed at trusts created by non-U.S. persons and therefore not subject to U.S. estate tax, as in Letter Ruling 201544002 (issued **June 30, 2015**).
- First appeared in the 2015-2016 Plan (published **July 31, 2015**).
- But possibly the focus will be expanded in the Trump Administration.

Item 2: Final regulations regarding restrictions on estate assets during the six month alternate valuation period” [pp. 30-33]

- First appeared in the 2007-08 Plan.
- Sometimes called the “anti-Kohler” regs. (See *Kohler v. Commissioner*, T.C. Memo. 2006-152, *nonacq.*, 2008-9 I.R.B. 481.)
- Proposed regulations (April 25, 2008) would have **ignored** certain intervening events in determining alternate value **six months after death**.
- This use of “artificial assumptions” was criticized.
- Reproposed Regulations (Nov. 18, 2011) would treat certain intervening events as dispositions, triggering alternate valuation as of that date.
- Example: Post-death formation of a limited partnership. (See Proposed Reg. §20.2032-1(c)(5), Example 1.)

Item 3: Guidance under §2053 regarding personal guarantees and present value concepts [pp. 33-34]

- Outgrowth of the project that led to the amendments of the section 2053 regulations in October 2009.
- The proposed regulations provided for a deduction of the **present value** of noncontingent obligations versus a **dollar-for-dollar** deduction of contingent obligations when paid.
- Public comments criticized this distinction as inequitable.
- Treasury and the IRS agreed, said the issue “**merits further consideration,**” and reserved Reg. §20.2053-1(d)(6) for this issue. (Preamble, T.D. 9468, 74 FED. REG. 53652 (Oct. 20, 2009).)
- Could this consideration spill over into **Graegin loans?** (See *Estate of Graegin v. Commissioner*, T.C. Memo. 1988-477.)

Item 4: Regulations under §7520 regarding the use of actuarial tables [p. 34]

- This item is new this year.
- The current mortality tables, based on 2000 census data, became effective May 1, 2009.
- Section 7520(c)(2) mandates revision of the tables at least once every ten years.
- Thus, this project appears to be that routine revision, to reflect 2010 census data and to be effective as of May 1, 2019.

Predictions

- **Priority to projects with the greatest impact.**
 - Estate tax affects only a few people and therefore is not very high on the list.

- **To be completed in this Plan Year (by June 30, 2019 **or so**):**
 - Actuarial tables (section 7520).
 - Clawback (section 2001(g)).
 - Trust income tax deductions (section 67(e) and (g) and section 642(h)).
 - Maybe consistent basis (sections 1014(f) and 6035).
 - Possibly GST tax relief (section 2642(g)).

Items in Obama Administration's 2016-2017 Plan Omitted from Trump Administration's 2017-2018 Plan [pp. 34-42]

- **Definition of income for spousal support trusts under section 682 [repealed by the 2017 Tax Act].**
- **Valuation of promissory notes for transfer tax purposes.**
- **The gift tax effect of defined value formula clauses.**
- **Irregularities in the administration of split-interest charitable trusts.**
- **Tax under section 2801 on U.S. citizens and residents who receive gifts or bequests from certain expatriates (enacted June 17, 2008; proposed regulations published September 10, 2015).**
- **And, under the heading of "General Tax Issues," deletion of the project described as "Guidance regarding material participation by trusts and estates for purposes of §469."**

Other Notable Omissions [pp. 43-49]

- Decanting (dropped in 2012) [pp. 43-45]
 - A new Uniform Trust Decanting Act (UTDA) was approved by the Uniform Law Commission in July 2015.
 - Includes extensive explicit safeguards, called “tax-related limitations,” in Section 19.
 - Treasury and the IRS may still be interested.

- Private Trust Companies (dropped in 2014) [pp. 45-49]
 - After publication of a proposed revenue ruling in Notice 2008-63, 2008-31 I.R.B. 261.
 - Probably not a priority.
 - But planners are still using the “firewalls” in Notice 2008-63.

CURRENT PROPOSED LEGISLATION

More “Death Tax Repeal Acts”

H.R. 218 (Rep. Jason Smith, R-MO, Jan. 3, 2019)

S. 215 (Sen. John Thune, R-SD, Jan. 24, 2019)

“Death Tax Repeal Acts” (H.R. 218 and S. 215) [pp. 51-52]

- **Estate and GST taxes repealed.**
- **Treatment of qualified domestic trusts (QDOTs):**
 - **Distributions during surviving spouse’s life taxed for 10 years.**
 - **No tax on value remaining at spouse’s death.**
- **Gift tax rate of 35% with a \$10 million (indexed) exemption.**
- **In S. 215 only, section 2511(c) (from 2001 Tax Act) restored:**

“A transfer in trust shall be treated as a taxable gift under section 2503, unless the trust is treated as wholly owned by the donor or the donor’s spouse under subpart E of part I of subchapter J of chapter 1.”

“For the 99.8 Percent Act”

S. 309 (Sen. Bernie Sanders, I-VT, Jan. 31, 2019)

Section 2: Rates and Exemptions [pp. 52-53]

- Marginal estate and gift tax rates:
 - **45%** (the top rate in 2007-2009) from \$3.5 million to \$10 million.
 - **50%** (the top rate in 2002) from \$10 million to \$50 million.
 - **55%** (the top rate in 1984-2001) from \$50 million to \$1 billion.
 - **77%** (the top estate tax rate in 1941-1976) over \$1 billion.
- Basic exclusion amounts:
 - For estate tax, **\$3.5 million**, not indexed.
 - For gift tax, **\$1 million**, not indexed.
- “Anti-clawback” rules included.
- GST tax?
 - Presumably **77%** with a GST exemption of \$3.5 million.

Sections 3-5: Farm and Business Real Property, Conservation Easements, Consistent Basis [p. 53]

- Section 3: Special valuation rule for farm and business real estate:
 - Cap on reduction of value **quadrupled** from **\$750,000** (currently \$1.16 million) to **\$3 million**, still indexed from 1997 (so about \$4.6 million).
- Section 4: Land subject to conservation easement:
 - Maximum exclusion under section 2031(c) increased from the lesser of **\$500,000** or 40% of the net value to the lesser of **\$2 million** or 60% of the net value.
- Section 5: Consistent basis reporting:
 - Extended to include **gifts** too.

Section 6: Value of Nonbusiness Assets [pp. 53-54]

- For estate and gift tax purposes, upon transfer of an interest in an entity that is not actively traded:
 - Nonbusiness assets held by the entity valued as if transferred directly from the transferor to the transferee.
 - No discount for lack of control if the transferor, transferee, and members of **their famil(y)(ies)**.
 - control the entity or
 - own a majority of the entity's ownership interests (by value).

Plus Four Obama Administration Greenbook Revivals

Section 7: GRATs [pp. 54-55]

- **Minimum term of 10 years (2009 Greenbook).**
- **No decrease in annual payment allowed (2010).**
- **Maximum term of the grantor's life expectancy plus 10 years (2012).**
- **Minimum value of remainder interest for gift tax purposes of greater of**
 - **25% of the value transferred or**
 - **\$500,000,**
 - **but not greater than 100% of the value transferred (2015).**
- **No prohibition of a grantor's tax-free exchange with the GRAT, as in the 2015 Greenbook.**

Section 8: Grantor Trusts [pp. 55-56]

- A new chapter 16 with a new section 2901.
- Would apply to any portion of a trust if
 - **the grantor** is the deemed owner or
 - **another** person is the deemed owner if that person “engages in a sale, exchange, or comparable transaction with the trust that is disregarded for purposes of subtitle A.”
- Section 2901 would
 - treat any distribution during the deemed owner’s life as a **gift**,
 - treat the cessation of deemed owner status during the deemed owner’s life as a **gift**, and
 - include the value of the remaining assets in the deemed owner’s **gross estate**.

Section 9: Elimination of GST Exemption for Certain Long-Term Trusts [p. 56]

- Would mandate an inclusion ratio of one for any trust that is not a “qualifying trust.”
- A “qualifying trust” is “a trust for which the date of termination of such trust is **not greater than 50 years** after the date on which such trust is created.”
- A trust created before the date of enactment with an inclusion ratio less than one would be allowed to keep that inclusion ratio for **50 years**, and then the inclusion ratio would be reset to one.

Section 10: “Simplifying Gift Tax Exclusion for Annual Gifts” [pp. 56-57]

- Would apply to transfers in trust, transfers of interests in passthrough entities, and transfers subject to prohibitions or other restrictions on sale.
- For such transfers, there would be an annual **per-donor** limit equal to twice the current per-donee limit – that is, currently, \$30,000.
 - Apparently with **no present-interest requirement**.
- No change to gift-splitting or unlimited exclusion of certain direct payments of tuition and medical expenses.

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