BESSEMER TRUST

Washington Update: Pending and Potential Administrative and Legislative Changes

November 2021

Excerpted from Estate Tax Changes Past, Present, and Future (November 2021) available at http://www.bessemertrust.com/for-professional-partners/advisor-insights.

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Table of Contents

1. **The 117th Congress and Potential Legislative Agenda in the Biden Administration 1**
   a. Insights from President Biden's Campaign 1
   b. "For the 99.5 Percent Act" Introduced by Senator Sanders 2
   c. Deemed Realization Proposals in Congress 7
   d. Estate Tax Repeal Bills 11
   e. Treasury's Explanation of Fiscal Year 2022 Budget Proposals ("Greenbook") 11
2. **Fiscal 2022 Budget Reconciliation 15**
   a. Budget Resolution 15
   b. Ways and Means Committee Action 15
   c. Administration's "Build Back Better Framework" 18
   d. House Rules Committee Version 18
   e. Senator Wyden's Mark-to-Market "Billionaires Income Tax" 19
   f. Other Suggestions 20
3. **Requirements of the Regulatory Process 20**
4. **2021-2022 Priority Guidance Plan 22**
   a. Item 1: User Fee for Estate Tax Closing Letters 22
   b. Item 2: The Consistent Basis Rules 24
   c. Item 3: "Anti-Abuse" Amendment to the "Anti-Clawback" Regulations 31
   d. Item 4: Effect of Events Between Death and the Alternate Valuation Date 36
   e. Item 5: Effect of Guarantees and Present Value Concepts on Estate Tax Deductions 38
   f. Items 6 and 7: Allocation of GST Exemption 39
   g. Item 8: Taxation of Transfers from Certain Expatriates 41
   h. Item 9: Actuarial Tables 44
   i. Notable Omissions from the Priority Guidance Plan 44

November 3, 2021

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1. The 117th Congress and Potential Legislative Agenda in the Biden Administration

a. Insights from President Biden's Campaign

(1) In General

President Biden desires to reverse or roll back many of the 2017 changes. Beginning in his campaign, he has spoken of his desire to "Build Back Better" by increasing the corporate income tax rate from 21% to 28% and increasing individual income taxes for annual incomes over $400,000, including an increase in the top rate from 36% to 39.6% and taxation of capital gains at the same rates as ordinary income for individuals with taxable incomes over $1 million.

(2) Estate, Gift, and GST Taxes

His campaign website (**https://joebiden.com/plans-to-support-women-duringcovid19/**), under the topic of "Highlights of Joe Biden's Plans to Support Women During the COVID-19 Crisis," stated:

> **Permanently provide family, medical, and safe leave as well as sick and safe days.** As President, Biden will work to provide the type of comprehensive 12 weeks of paid family and medical leave envisioned in the FAMILY Act sponsored by Senator Kristen Gillibrand and Representative Rosa DeLauro. Biden will pay for this proposal by returning the estate tax to 2009 levels.

Similarly, the "Greenbook" revenue proposals of the Obama Administration, beginning in 2013, had proposed to return the estate, gift, and GST taxes to their 2009 levels, which included a top 45 percent rate and non-indexed but portable exemptions of $3.5 million for the estate and GST taxes and $1 million for the gift tax.

(3) Treatment of Appreciation at Death

In connection with the taxation of capital gains as ordinary income, President Biden has also referred to the step-up in basis, likely meaning the step-up for appreciated assets that pass from a decedent. Although, again, he has offered few details, insight may be gained from the final two Greenbooks of the Obama Administration, in 2015 (pages 156-57) and 2016 (pages 155-56), which, under the general heading of "Reforms to Capital Gains Taxation, Upper-Income Tax Benefits, and the Taxation of Financial Institutions," include a proposal labeled simply "Reform the Taxation of Capital Income." In addition to increasing the rate of tax on capital gains in general (although not as high as the rate on ordinary income), that proposal would treat the transfer of appreciated property at death (as well as by lifetime gift) as a realization event, subjecting the appreciation to income tax. That proposal was even featured in President Obama's State of the Union Address on January 20, 2015.

Additional details of the Obama Administration's 2015 and 2016 proposals included:

(a) Gifts or bequests to a spouse or charity would not be taxed, but the spouse or charity would take a carryover basis in the asset.

(b) Tangible personal property such as household furnishings and personal effects, but not collectibles, would be exempt.

(c) The gain would be taxable to a donor in the year a gift is made, and to a decedent either on the final individual return or on a separate capital gains return.

(d) Each taxpayer would be allowed an additional exclusion of capital gains at death of up to $100,000 (indexed for inflation), and each person's $250,000 exclusion of capital gain on a principal residence would be extended to all residences. Both of these exclusions would be portable to the decedent's surviving spouse "under the same rules that apply to portability for estate and gift tax purposes."

(e) Taxation of the appreciation in the value of certain small family-owned and operated businesses (no further details given) would be deferred until the business is sold or ceases to be family-owned and operated.

(f) A "15-year fixed-rate payment plan" would be allowed for the tax on appreciated illiquid assets transferred at death.

(g) The Greenbooks clarified that the income tax on capital gains deemed realized at death would be deductible for estate tax purposes.

(h) Showing acknowledgment of the complexities involved, the Greenbooks added the following:

> The proposal also would include other legislative changes designed to facilitate and implement this proposal, including without limitation: the allowance of a deduction for the full cost of appraisals of appreciated assets; the imposition of liens; the waiver of penalty for underpayment of estimated tax if the underpayment is attributable to unrealized gains at death; the grant of a right of recovery of the tax on unrealized gains; rules to determine who has the right to select the return filed; the achievement of consistency in valuation for transfer and income tax purposes; and a broad grant of regulatory authority to provide implementing rules.
>
> To facilitate the transition to taxing gains at death and gift, the Secretary would be granted authority to issue any regulations necessary or appropriate to implement the proposal, including rules and safe harbors for determining the basis of assets in cases where complete records are unavailable.

b. **"For the 99.5 Percent Act" Introduced by Senator Sanders**

(1) **The "For the 99.5 Percent Act."** On March 25, 2021, Senator Bernie Sanders (I-Vermont) introduced S. 994, titled "For the 99.5 Percent Act," an updated compilation of legislative proposals he and Democrats have been offering for many years regarding the estate, gift, and GST taxes and related grantor trust income tax issues. Senator Sanders has introduced a bill like this in every Congress since 2010, when he named it the "Responsible Estate Tax Act" (S. 3533, 111th Cong., June 24, 2010). In this Congress he has changed the name from the "For the 99.8 Percent Act" he introduced on January 31, 2019. The bill includes, but is not limited to, adaptations of proposals in the Treasury Department's "General Explanations" (popularly called "Greenbooks") of revenue provisions in the budget proposals of the Obama Administration and even the Clinton Administration. A companion bill (H.R. 2576) was introduced in the House of Representatives on April 15, 2021, by Congressman Jimmy Gomez (D-California).

(a) Senator Sanders' proposals will be important to his Democratic colleagues as a source for ideas if comprehensive estate tax reform becomes a priority and political possibility. One reason for that is simply that his proposals have been written – that is, reduced to statutory wording – and they are "out there" or "on the shelf" for lawmakers to incorporate into whatever other legislation happens to be popular at the time. These proposals are distinguished in that respect from some other more fundamental ideas that are offered from time to time, such as a "wealth tax" that would have to be analyzed, modeled, written, and refined and might still face years of uncertainty about its scope, operation, and constitutionality.

(b) Senator Sanders' bill is important for another reason. Drafted legislation like this can be the source for fillers in the legislation of the day, for Republicans as well as Democrats, particularly a revenue-raiser that has just the right revenue estimate to "pay for" other legislation. That is exactly what happened when "Consistent Basis Reporting Between Estate and Person Acquiring Property from Decedent" was added to the Surface Transportation and Veterans Health Care Choice Improvement Act (Public Law 114-41) by a Republican-controlled Congress in July 2015. It raised just the right amount of money to fund a desired extension of the Highway Trust Fund that was scheduled to expire on the day President Obama signed the Act into law. Significantly, the first introduced statutory wording for the consistent basis provision had been section 6 of Senator Sanders' "Responsible Estate Tax Act" of 2010. See Part 4.b(5)(b)i below.

(2) **Modifications to Rates and Exemptions.** Section 2 of the "For the 99.5 Percent Act" would raise rates and lower exemptions.

(a) The marginal estate and gift tax rate would be increased to

i. 45 percent (the top rate in 2007 through 2009 under the 2001 Tax Act signed by President George W. Bush), from $3.5 million to $10 million,

ii. 50 percent (the top rate in 2002 under the 2001 Tax Act), from $10 million to $50 million,

iii. 55 percent (the top rate achieved in 1984 through 2001 under the 1981 Act signed by President Reagan), from $50 million to $1 billion, and

iv. 65 percent (the top estate tax rate in effect in 1982; this is down from 77 percent in Senator Sanders' 2019 bill) over $1 billion.

(b) The basic exclusion amount would be reduced to

i. $3.5 million, not indexed, for estate tax purposes and

ii. $1 million, not indexed, for gift tax purposes.

(c) Portability would be retained for both estate and gift tax purposes.

(d) A detailed set of "anti-clawback" rules that had been included in Senator Sanders' 2019 bill is omitted, perhaps simply in recognition of the fact that the anti-clawback regulations have now been finalized, with an "anti-abuse" refinement (which Senator Sanders would presumably favor) in progress. See Part 4.c(7) below.

(e) The bill says nothing about the GST tax, which apparently would make the GST tax rate 65 percent and the GST exemption $3.5 million.

(f) These proposals would "apply to estates of decedents dying, and generation-skipping transfers and gifts made, after December 31, 2021." This is consistent with the effective dates in Senator Sanders' previous bills and reflects a long-observed drafting principle (or at least drafting preference) for estate and gift tax changes. Presumably, pursuant to that preference, if this legislation were enacted, for example, in 2022, the reference to 2021 would be changed to 2022, making the effective date January 1, 2023.

(3) **Value of Farm, etc. Real Property.** Section 3, like section 4 of the 2010 "Responsible Estate Tax Act," would, effective January 1, 2022, increase the cap on the reduction in value under the special use valuation rules of section 2032A from $750,000 ($1.19 million in 2021, after indexing since 1998) to $3 million, indexed for inflation going forward from 2022.

(4) **Land Subject to Conservation Easements.** Section 4, like section 5 of the 2010 "Responsible Estate Tax Act," would, effective January 1, 2022, increase the maximum exclusion from the gross estate under section 2031(c) by reason of a conservation easement from the lesser of $500,000 or 40 percent of the net value of the land to the lesser of $2 million or 60 percent of the net value of the land.

(5) **No Step-up in Basis for Assets in Grantor Trusts.** Section 5 would add a new section 1014(f) (redesignating the current section 1014(f) as 1014(g)), providing that property "held in a trust of which the transferor is considered the owner under subpart E of part I of subchapter J" would not receive a new basis at the deemed owner's death if "such property is not includible in the gross estate of the transferor for purposes of chapter 11." Although subpart E includes section 678, which treats "[a] person other than the grantor" as the owner of part or all of a trust, it seems that the reference in this bill to "the transferor" is intended to exclude section 678 deemed owners.

(a) This amendment would "apply to transfers after the date of the enactment of this Act." That would evidently apply to grantor trusts created and funded after enactment. It is less clear how it would apply to transfers to a trust after its initial funding, including perhaps transfers involving sales or exchanges with an existing trust.

(b) Section 5 of Senator Sanders' 2019 bill would have extended the "consistent basis" rules of section 1014(f) and the accompanying reporting rules of section 6035(a) (discussed in Part 4.b below) to property received by gift. That provision is omitted from this year's bill, although it presumably would be moot to the extent other legislation taxes unrealized appreciation upon gift or death.)

(6) **Valuation of Nonbusiness Assets; Limitation on Minority Discounts.** Section 6 is titled "Valuation Rules for Certain Transfers of Nonbusiness Assets; Limitation on Minority Discounts." It is almost identical to section 7 of Senator Sanders' 2010 "Responsible Estate Tax Act."

(a) Section 6 is also similar to section 276 of H.R. 3874, introduced in March 2000 by Rep. Charles Rangel of New York, the Ranking Democrat on the House Ways and Means Committee, to implement a legislative proposal in the 1998 Clinton Administration's "Greenbook." And it is almost identical to section 303 of H.R. 1264, introduced by Rep. Rangel in March 2001 as an alternative to the Republican proposals that became the 2001 Tax Act, and to three bills subsequently introduced by Rep. Earl Pomeroy (D-North Dakota): H.R. 5008 in June 2002, H.R. 1577 in April 2005, and H.R. 4242 in November 2007.

(b) The bill would add a new section 2031(d) to the Code, applicable to transfers after the date of enactment. Section 2031(d)(1) would read as follows:

> (d) Valuation Rules for Certain Transfers of Nonbusiness Assets—For purposes of this chapter and chapter 12—
>
> (1) In General—In the case of the transfer of any interest in an entity other than an interest which is actively traded (within the meaning of section 1092) [*see* Reg. §1.1092(d)-1(a) & (b)]—
>
> (A) the value of any nonbusiness assets held by the entity with respect to such interest shall be determined as if the transferor had transferred such assets directly to the transferee (and no valuation discount shall be allowed with respect to such nonbusiness assets), and
>
> (B) such nonbusiness assets shall not be taken into account in determining the value of the interest in the entity.

The bill includes detailed rules about "passive assets" that might be used in a business and "look-thru rules" for entities that are at least 10 percent owned by another entity.

(c) The bill would also add a new section 2031(e), to read as follows:

> (e) Limitation on Minority Discounts—For purposes of this chapter and chapter 12, in the case of the transfer of any interest in an entity other than an interest which is actively traded (within the meaning of section 1092), no discount shall be allowed by reason of the fact that the transferee does not have control of such entity, or by reason of the lack of marketability of the interest, if the transferor, the transferee, and members of the family (as defined in section 2032A(e)(2)) of the transferor and transferee—
>
> (1) have control of such entity, or
>
> (2) own the majority of the ownership interests (by value) in such entity.

The words "or by reason of the lack of marketability of the interest" are new in this year's version. Simply stated, the objectives of the proposed new section 2031(e) are to attribute control among family members and to presume control from majority ownership, without exception, apparently not even an exception for an active trade or business. Both objectives will undoubtedly be viewed as unrealistic in many contexts, especially in the context of an active trade or business.

(7) **Grantor Retained Annuity Trusts.** Section 7 mirrors the proposals of the Obama Administration's Greenbooks regarding GRATs, generally in the form in which those proposals solidified in the 2015 and 2016 Greenbooks.

(a) Like the 2015 and 2016 Greenbooks, the bill, applicable to transfers after the date of enactment, would require any GRAT to

i. have a term no shorter than 10 years (the proposal in the original 2009 Obama Administration Greenbook),

ii. prohibit any decrease in the annuity during the GRAT term (a proposal added in the 2010 Greenbook),

iii. have a term no longer than the life expectancy of the grantor plus 10 years (a proposal added in the 2012 Greenbook), and

iv. have a remainder interest with a value for gift tax purposes when the GRAT is created equal to at least 25 percent of the value of the assets contributed to the GRAT or $500,000, whichever is greater (but not greater than the total value of the assets contributed) (a proposal added in the 2015 Greenbook).

(b) Section 8 of Senator Sanders' 2010 "Responsible Estate Tax Act" had included only the minimum 10-year term and the prohibition on decreases in the annuity, reflecting only the 2009 and 2010 Greenbooks that had been published before then.

(c) The 2015 Greenbook had also added that "the proposal … would prohibit the grantor from engaging in a tax-free exchange of any asset held in the trust." That would diminish the availability of some techniques for managing long-term GRATs. The "For the 99.5 Percent Act" omits that proposal.

(8) **Grantor Trusts in General.** Similarly, section 8 mirrors the proposals of the Obama Administration's Greenbooks regarding grantor trusts and provides proposed statutory language for those proposals, also generally following the 2015 and 2016 Greenbooks.

(a) The bill would add to the Code a new chapter 16 (titled "Special Rules for Grantor Trusts"), containing a single section 2901 (titled "Application of Transfer Taxes").

(b) Section 2901 would apply to any portion of a trust if

i. the grantor is the deemed owner of that portion under subchapter J, or

ii. a person other than the grantor is the deemed owner of that portion under subchapter J, if that person "engages in a sale, exchange, or comparable transaction with the trust that is disregarded for purposes of subtitle A [the federal income tax subtitle]," to the extent of "the portion of the trust attributable to the property received by the trust in such transaction, including all retained income therefrom, appreciation thereon, and reinvestments thereof, net of the amount of consideration received by the deemed owner in such transaction." (This second category appears to target the techniques known as "BDITs" and perhaps some "BDOTs," whether as a matter of tax policy or simply to crack down on techniques known to be in use.)

(c) Tracking the Obama Administration Greenbooks, section 2901 would

i. include the value of the assets of such portion in the gross estate of the deemed owner for estate tax purposes,

ii. subject to gift tax any distribution from such portion to one or more beneficiaries [presumably beneficiaries other than the grantor] during the deemed owner's life, and

iii. treat as a gift by the deemed owner, subject to gift tax, all assets of such portion at any time during the deemed owner's life if the deemed owner ceases to be treated as the owner of such portion for income tax purposes.

(d) Section 2901 would reduce the amount thereby subject to estate or gift tax by "the value of any transfer by gift by the deemed owner to the trust previously taken into account by the deemed owner under chapter 12." This is not an exception for the **portion** of the trust attributable to such a taxable gift; it is a "reduction" by the amount reported as a gift. In other words, section 2901 would "freeze" the amount excluded from its reach at its initial gift tax value (thus targeting "leveraged" transfers).

(e) Section 2901 provides that it "shall not apply to any trust that is includible in the gross estate of the deemed owner (without regard to [section 2901])." (An additional exception in Senator Sanders' 2019 bill for "any other type of trust that the Secretary determines by regulations or other guidance does not have as a significant purpose the avoidance of transfer taxes" is omitted from his 2021 bill.)

(f) Section 2901 would provide that "[a]ny tax imposed by [section 2901] shall be a liability of the trust." It does not specify whether any such tax, especially estate tax, would be calculated at the average or marginal tax rate, or in some other way.

(g) Section 2901 would apply to

i. trusts created on or after the date of enactment,

ii. any portion of a trust attributable to a contribution on or after the date of enactment to a trust created before the date of enactment, and

iii. any portion of a trust created before the date of enactment if a sale, exchange, or comparable transaction referred to in paragraph (b)ii above occurs on or after the date of enactment.

(h) There is considerable overlap in the effects of sections 5 and 8 of this bill. In general, section 5 appears to provide that there is no stepped-up basis at death for assets in a grantor trust if the value of those assets is not included in the decedent's gross estate, while section 8 appears to ensure that there are no such trusts by including the value of the assets of all grantor trusts in the gross estate. There are some differences, such as the application to section 678 deemed owners, the exception for "any trust that is includible in the gross estate of the deemed owner (without regard to [section 2901])," the possible application to foreign trusts, the effect of transactions between the trust and the deemed owner after the effective date, and even a one-day difference in the effective date itself (section 5 would apply "after" the date of enactment while section 8 would apply "**on or** after" the date of enactment). But, in the main, it appears that there is a lot of redundancy between these two sections, which tends to reinforce the narrative that this bill has been put together with a view toward making it easy for one or more, but not all, of the individual provisions of this bill to be "pulled off the shelf" to serve a targeted policy or revenue purpose in the consideration of legislation on almost any subject.

(9) **Elimination of GST Exemption for Certain Long-Term Trusts.** Section 9 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) This recalls a similar proposal in the Obama Administration's Greenbooks, but would be significantly more aggressive. It would use a period of 50 years (rather than 90 years as in the Greenbooks) and would mandate an inclusion ratio of one from the beginning of a trust (rather than resetting the inclusion ratio to one on the 90th anniversary), thus apparently without any "wait and see" relief.

(b) 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 after enactment, and then the inclusion ratio would be reset to one.

(c) Special rules would be provided for portions of trusts treated as separate trusts (see section 2654(b)(1) and Reg. §26.2654-1) and for transfers between trusts.

(10) **"Simplifying" Gift Tax Exclusion for Annual Gifts.** Section 10 would significantly limit the availability of the gift tax annual exclusion, effective January 1, 2022. It would implement a similar proposal in the Obama Administration Greenbooks, from which it borrows the characterization of "simplifying."

(a) Like the Greenbooks, the bill would introduce a **per-donor** limit on the annual exclusion, as a further limitation on the $10,000 (indexed for inflation since 1998) **per-donee** exclusion of current law.

(b) While the per-donor limit in the Greenbooks would have been $50,000 (indexed for inflation), the "For the 99.5 Percent Act" would set the annual per-donor limit at twice the per-donee limit, currently $30,000 (also indexed for inflation).

(c) Like the Greenbooks, the bill would impose this new limitation on transfers in trust (without an exception for trusts described in section 2642(c)(2)), transfers of interests in passthrough entities, transfers of interests subject to a prohibition on sale, and other transfers of property that, without regard to withdrawal, put, or other such rights in the donee, cannot immediately be liquidated by the donee.

(d) Like the Greenbooks, the bill would leave in place the per-donee annual exclusion (currently $15,000), for example for outright gifts of cash or marketable securities.

(e) The bill would repeal section 2503(c), which now provides a special way that a trust for a minor can qualify as a present interest.

(f) As in the Greenbook proposals, the new $30,000 per-donor limit would apply to all transfers in trust, but apparently would not include a present-interest requirement at all, although it apparently would still require identification of donees to apply the $15,000 per-donee limit.

(g) The bill would not change the unlimited exclusion in section 2503(e) for tuition and medical expenses paid directly to the provider.

(h) The bill would not change the gift-splitting rules in section 2513.

c. **Deemed Realization Proposals in Congress**

(1) **Legislation Introduced and Under Discussion.** On March 29, 2021, Ways and Means Committee Member Bill Pascrell, Jr. (D-New Jersey) introduced H.R. 2286, described as a bill "to amend the Internal Revenue Code of 1986 to treat property transferred by gift or at death as sold for fair market value, and for other purposes." On the same day, Senator Chris Van Hollen (D-Maryland), joined by Senators Cory Booker (D-New Jersey), Bernie Sanders (I-Vermont), Sheldon Whitehouse (D-Rhode Island), and Elizabeth Warren (D-Massachusetts), issued a statement calling "the Stepped-Up Basis Loophole" "one of the biggest loopholes in the U.S. tax code, which subsidizes America's wealthiest heirs," citing a Joint Committee on Taxation estimate that it will cause a loss of $41.9 billion of tax revenue in 2021 alone. The statement was accompanied by a 32-page "discussion draft" of statutory language titled the "Sensible Taxation and Equity Promotion ("STEP") Act of 2021," with the acronym of "STEP" evidently designed to recall the "step-up" in basis that it attacks.

(2) **Effective Dates.** A conspicuous and significant difference between Congressman Pascrell's H.R. 2286 and Senator Van Hollen's "discussion draft" of the "STEP Act" is their effective dates.

H.R. 2286 would apply to gifts and transfers made, including transfers from decedents dying, after December 31, 2021. As discussed in the context of section 2 of Senator Sanders' "For the 99.5 Percent Act" in Part 1.b(2)(f) above, that is the typical effective date for broad changes in the taxation of transfers by gift and at death, although other provisions of the Sanders bill itself show how the date of enactment can be a typical effective date for changes to the tax treatment of particular transactions or structures.

For the Senate discussion draft, the corresponding date would be December 31, 2020. In other words, it would be uncharacteristically retroactive to the beginning of 2021. This could be a portent of less deference to conventional effective-date norms in the political climate of the current Congress. Or it could mean only that Congressman Pascrell, as a member of the Ways and Means Committee, has received more technical assistance from staff members who understand the historical and practical preferences for avoiding retroactivity. Or it could mean that a "discussion draft" is only that.

Both proposals would tax past appreciation, not just appreciation following enactment. This contrasts with the 1969 proposed "Taxation of Appreciation of Assets Transferred at Death or by Gift," which stated that "[o]nly appreciation occurring after the date of enactment would be subject to tax." "Tax Reform Studies and Proposals, U.S. Treasury Department," Joint Publication of the House Committee on Ways and Means and Senate Committee on Finance, at 335 (91st Cong., 1st Sess., Feb. 5, 1969). It also contrasts with the 1976 enactment (which

proved to be temporary) of carryover basis, which provided a "fresh start" valuation on December 31, 1976, and a proration of appreciation over the entire holding period of nonmarketable assets acquired before that date. Section 1023(h), added by section 2005(a)(2) of the Tax Reform Act of 1976, Public Law 94-455 (94th Cong., 2d Sess., Oct. 4, 1976). Interestingly, it does not contrast as sharply with the "aggregate basis increase" and "spousal property basis increase" provided by the second (also temporary) enactment of carryover basis in 2001, taking effect in 2010, which was not as clearly tailored to sheltering pre-enactment appreciation. Section 1022(b) and (c), added by section 542(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (107th Cong., 1st Sess., June 7, 2001).

(3) **Deemed Sale Rule of New Section 1261.** The proposals would add a new section 1261 to the Code, generally treating any property transferred by gift or at death as sold for its fair market value on the date of the gift or death. Both proposals appear to contemplate that the gain on deemed sales at death would be reported on the decedent's final income tax return (Form 1040), or a supplement to it, but they do not say that.

(4) **Exception for Tangible Personal Property.** The deemed sale rules would not apply to transfers of tangible personal property other than collectibles (including coins and bullion) and property held in connection with a trade or business. H.R. 2286 adds property held for investment, and the STEP Act adds property related to the production of income under section 212, to the coverage of the deemed sale rules.

(5) **Exception for Transfers to Spouses.** A transfer to the spouse of a transferor or surviving spouse of a decedent would be exempt from this deemed sale treatment if the spouse is a U.S. citizen (or long-term resident under the STEP Act), essentially deferring sale treatment until the spouse disposes of the asset.

Under H.R. 2286, this exemption is extended to a "qualifying spousal trust," which is defined as a qualified domestic trust ("QDOT") of which the transferor's spouse or surviving spouse is the sole current income beneficiary and has the power to appoint the entire trust. Under the STEP Act, this exemption is extended to a QTIP trust. Awkwardly, the STEP Act describes a QTIP trust as "qualified terminal [*sic*, not "terminable"] interest property." Also awkwardly, H.R. 2286 incorporates the QDOT definition of section 2056A, even though the spouse must be a U.S. citizen to qualify for the deemed sale exception in H.R. 2286 in the first place. That could conceivably even require any ordinary QTIP trust for a U.S. citizen spouse to mandate the withholding under section 2056A(a)(1)(B) of estate tax payable with respect to distributions, for example (or, channeling it into the deemed sale context, withholding the income tax on unrealized appreciation avoided by the transfer to the trust), although there is no indication that such an odd result is intended or would serve any purpose of this proposed legislation. And a strict application of the "qualifying spousal trust" rules in H.R. 2286 would also require the spouse to have the power to appoint the entire trust, which is not normal in an ordinary QTIP trust.

Property transferred in such an exempt transfer to an eligible trust for the benefit of the transferor's spouse or surviving spouse would be subject to the deemed sale rules (1) upon a distribution from the trust to someone other than the spouse, (2) upon the cessation of the trust's status as an eligible trust, or (3) upon the spouse's death.

(6) **Exception for Transfers to Charity.** A transfer to a charity or another organization described in section 170(c) would not be a deemed sale. The STEP Act adds explicit exemptions for (1) a trust in which property is set aside for such an organization (subject to annuity, unitrust, and other valuation rules of section 2702), (2) a qualified disability trust defined in section 642(b)(2)(C)(ii), and (3) a cemetery perpetual care fund described in section 642(i).

(7) **Other Estate-Includible Grantor Trusts.** In the case of a transfer to a trust is that is **both** deemed owned by the transferor under subpart E of part 1 of subchapter J (commonly called generically the "grantor trust rules") **and** includible in the transferor's gross estate, **the deemed sale would occur**, not when the property is transferred to the trust, but when:

(a) a distribution is made to a person other than the deemed owner,

(b) the transferor ceases to be the deemed owner of the trust (including, apparently, upon the transferor's death), or

(c) the trust ceases to be includible in the gross estate of the transferor (oddly, in H.R. 2286, explicitly including upon the transferor's death).

(8) **Other, Non-Includible, Grantor Trusts.** Under the STEP Act, in the case of other deemed-owned trusts (except the spousal, charitable, disability, and cemetery care trusts discussed above) – that is, a deemed-owned trust that is not includible in the transferor's gross estate – the deemed sale would apparently occur:

(a) when a transfer is made to the trust,

(b) when a distribution is made to a person other than the deemed owner,

(c) when the transferor ceases to be the deemed owner of the trust, or

(d) upon the death of the transferor.

This type of trust is commonly called a "defective grantor trust." The treatment of a transfer to the trust, a distribution from the trust, the termination of grantor trust status, and the death of the transferor as deemed realization events, in effect overturning Rev. Rul. 85-13, 1985-1 C.B. 184, would likely be viewed as quite harsh.

(9) **Non-Grantor Trusts.** In the case of other trusts – that is, a trust that is not deemed owned by the transferor for income tax purposes – the transfer to the trust would be treated as a sale, and property held in a long-term trust would be deemed sold at specified intervals. In H.R. 2286, property that has been held in trust for **30 years** without being subject to section 1261 would be deemed sold, or, if it has been continuously held in trust for more than 30 years on the effective date (January 1, 2022), it is treated as sold on that date. In the STEP Act, **all** property held by such a trust would be treated as sold every **21 years**, with property in a trust created before January 1, 2006, first treated as sold on December 31, 2026. Thus, H.R. 2286 would apparently require tracking the holding period of each individual asset, while the STEP Act would apparently subject all trust assets to tax every 21 years regardless of the asset's holding period.

In addition, H.R. 2286 would treat a modification of the direct or indirect beneficiaries of a trust (or the beneficiaries' rights to trust assets) or the transfer or distribution of trust assets (including to another trust) as a deemed sale, unless Treasury and the IRS determine "that any such transfer or modification is of a type which does not have the potential for tax avoidance." This apparently is intended to include some decantings.

(10) **Other Exclusions.** H.R. 2286 would exclude annual exclusion gifts and up to $1 million of net capital gain at death. The $1 million amount would be indexed for inflation after 2022. Thus, lifetime exclusions would be measured by the total value transferred (and the number of donees), while the exclusion at death would be measured by the net gain. Among other complications, the exclusion of gifts to the extent of the dollar amount of the annual exclusion would present the challenge of allocating that exclusion when gifts to any individual of assets with different bases exceed the annual exclusion amount in any year, as well as the challenge of applying that allocation in the case of gift-splitting by spouses.

The STEP Act would provide what amounts to a "lifetime exclusion" of $100,000 of gain, expressed as "the excess of … $100,000, over … the aggregate amount excluded under this subsection for all preceding taxable years." For transfers at death, the exclusion would be $1 million, less the amount of the $100,000 exclusion applied to lifetime gifts. Both the $100,000 and $1 million amounts would be indexed for inflation.

The proposals would not change the exclusion for sales of a principal residence.

(11) **Netting of Gains and Losses.** In the case of deemed sales occurring upon death, the proposals would exempt the sales from the disallowance of related-party losses under section 267, which would allow losses on deemed sales to offset gains.

(12) **Coordination with Basis Rules.** The basis rules for property acquired from a decedent (section 1014) or upon gift or transfer to a trust (section 1015) would be amended to more or less coordinate with the new deemed sale rules, generally providing a stepped-up (or stepped-down) basis if there is a deemed sale. Apparently, under H.R. 2286, that would mean that even annual exclusion gifts excluded from deemed sale treatment would receive a new basis equal to the fair market value at the time of the gift. Spouses and surviving spouses would receive a carryover basis in all cases.

(13) **Extension of Time for Payment of Tax.** The proposals would add a new section 6168, providing an election to pay the income tax on deemed sales in installments, similar to the rules in section 6166 for estate taxes. Like section 6166, section 6168 would apply only with respect to transfers at death, not during life. In contrast to section 6166, however, section 6168 would apply not only to closely held business interests that exceed 35 percent of the gross estate, but to all assets other than "actively traded" personal property (such as securities traded on an exchange).

The STEP Act would mirror section 6166 by allowing payment of the additional income tax in up to 10 equal annual installments beginning no later than five years after the prescribed due date. H.R. 2286 would allow up to seven equal annual installments, with no deferral of the first installment.

Both proposals would provide for payment of interest (at 45 percent of the normal rate as in section 6601(j)(1)(B) for estate tax extended under section 6166, but with no "2-percent portion" as in section 6601(j)(1)(A)), and the STEP Act would make that interest nondeductible for estate tax purposes. Both proposals, like section 6166, would also include provisions for a special lien (which the STEP Act would allow to be partially replaced by a bond), extensions of the period of limitations on assessment, and proration of deficiencies to installments.

The STEP Act, but apparently not H.R. 2286, would provide for acceleration of the payment of deferred tax if the subject property is disposed of or is used in whole or in part to secure nonrecourse indebtedness.

(14) **Information Reporting.** H.R. 2286 would add a new section 6050Z requiring that, except in the case of securities transactions reported by brokers under section 6045(g), the donor or executor must report to the IRS the name and taxpayer identification number of the recipient of each transfer and information describing the property and stating its fair market value and basis. The donor or executor must also report that fair market value and basis to the recipient of the property. These requirements are similar to the rules currently in section 6035 regarding the consistent basis of property transferred at death, except that section 6050Z would require this information reported to the IRS to be shared only with "the person to whom such transfer was made" (not, for example, to all beneficiaries who might receive an asset, as with Schedule A of Form 8971) and only "at such time and in such form and manner as the Secretary shall by regulations prescribe."

The STEP Act omits such a reporting requirement, but, seeming to step off-topic somewhat, it would add a new section 6048A requiring any trust (not already reporting under section 6034(b) or 6048(b)) with assets of more than $1 million or gross income for the year of more than $20,000 to report annually to the IRS "(1) a full and complete accounting of all trust activities and operations for the year, (2) the name, address, and TIN of the trustee, (3) the name, address, and TIN of the grantor, (4) the name, address, and TIN of each beneficiary of the trust, and (5) such other information as the Secretary may prescribe."

(15) **Miscellaneous Matters.** In addition, the STEP Act would provide that the costs of appraising property deemed sold under new section 1261 would be deductible for income tax purposes and would not be a "miscellaneous itemized deduction" subject to section 67.

The STEP Act also would waive penalties for underpayment of estimated tax related to income tax on deemed realized gains at death (which, of course, would not have been foreseeable).

d. **Estate Tax Repeal Bills**

(1) On March 9, 2021, joined by several of his Republican colleagues, Senator John Thune (R-South Dakota) introduced the "Death Tax Repeal Act of 2021" (S. 617). The bill resembles repeal bills that have been introduced over the last two or three decades.

(a) S. 617 would permanently repeal the estate and GST taxes, effective for estates of decedents dying, and generation-skipping transfers, after the date of enactment. As in past bills, it would retain the estate tax under section 2056A(b)(1)(A) on distributions from qualified domestic trusts for spouses of decedents who died before the date of enactment, but only for 10 years after the date of enactment. It would immediately eliminate the estate tax under section 2056A(b)(1)(B) on the value of property remaining in QDOTs at the deaths of surviving spouses after the date of enactment.

(b) S. 617 would retain the gift tax with a 35% rate for cumulative gifts over $500,000 and would make permanent the current gift tax exclusion amount of $10 million indexed for inflation since 2011 (that is, $11.7 million for 2021), effective for gifts made on or after the date of enactment.

i. S. 617 would deal with the issue currently posed by the phrase "as of the end of the calendar year" in section 2505(a)(1) by treating the year in which the bill is enacted as two separate calendar years, one ending on the day before the date of enactment and the other beginning on the date of enactment.

ii. It would also restore the 2001 Tax Act's enigmatic section 2511(c), providing that "[n]otwithstanding any other provision of this section and except as provided in regulations, 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." (It ignores the 2002 amendment, which changed "taxable gift under section 2503" to "transfer of property by gift.")

a. This provision appears to perpetuate the 2001 lore that the retention of the gift tax is needed to back-stop the income tax by subjecting to gift tax any transfer that would be "income-shifting," but, as in 2001, it is hard to be sure or to fully understand such a policy.

b. In any event, such a provision would presumably shut down the advantages of so-called incomplete-gift non-grantor trusts (or "ING trusts").

c. More perplexing, as in 2001, the use of the word "unless" in this provision could create the impression that a taxable gift is **avoided** by simply making the transfer to a trust that **is** a wholly-owned grantor trust as to the grantor or the grantor's spouse. That would certainly be different from the treatment of "intentionally defective" grantor trusts for which current funding is a completed gift but which normally include no features that would subject the trust to estate tax upon the grantor's death.

(2) A companion bill, H.R. 1712, was introduced in the House of Representatives on the same day by Congressman Jason Smith (R-Missouri).

e. **Treasury's Explanation of Fiscal Year 2022 Budget Proposals ("Greenbook")**

The Treasury Department released its "General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals" (popularly called the "Greenbook") on May 28, 2021. See **https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf**. It proposes no changes to the estate and gift taxes.

Following up proposals announced in the Administration's "American Families Plan" on April 28, 2021, and citing the need to "reduce economic disparities among Americans," the Greenbook (at

pages 60-62) includes proposals to increase the top marginal individual income tax rate to 39.6 percent (as it was before the 2017 Tax Act), effective January 1, 2022, and to tax capital gains at the same rate as ordinary income for taxpayers with adjusted gross income greater than $1 million, effective "for gains required to be recognized after the date of announcement" (presumably April 28, 2021).

The Greenbook (at pages 62-64) also provides details focusing and clarifying the proposal for the "deemed realization" of capital gains foreshadowed by the Obama Administration's Greenbooks for Fiscal Years 2016 (Feb. 2, 2015, pages 156-57) and 2017 (Feb. 9, 2016, pages 155-56), by President Biden's campaign, and by Representative Bill Pascrell's H.R. 2286 and Senator Van Hollen's "discussion draft" of the Sensible Taxation and Equity Promotion ("STEP") Act of 2021 discussed in Part 1.c above. That Greenbook proposal is summarized as follows:

(1) **Effective Date.** The proposal would take effect on January 1, 2022, like H.R. 2286. But it would apply to pre-2022 appreciation; there would be no "fresh start" as, for example, in the 1976 carryover basis legislation.

(2) **Realization Events.** Gain would be explicitly recognized on transfers by gift or at death, equal to the excess of an asset's fair market value on the date of the gift or death over the donor's or decedent's basis in that asset. Losses obviously would also be recognized if basis exceeds fair market value because the Greenbook refers to "the use of capital losses … from transfers at death" as an offset. The Greenbook does not mention holding periods or distinguish short-term and long-term gain. The Greenbook also does not specifically incorporate the alternate valuation date for transfers at death, although it does state generally that a transfer "would be valued using the methodologies used for gift or estate tax purposes."

(3) **Taxpayer, Return, and Deductibility.** The Greenbook states that the gain would be reported "on the Federal gift or estate tax return or on a separate capital gains return." Reassuringly, however, the Greenbook confirms that the gain "would be taxable income to the decedent" and, consistently with that characterization, explicitly adds that "the tax imposed on gains deemed realized at death would be deductible on the estate tax return of the decedent's estate (if any)."

(4) **Exclusion for Tangible Personal Property.** "[T]angible personal property such as household furnishings and personal effects (excluding collectibles)" would be exempt. There is no mention of explicit application to property held for investment as in H.R. 2286 or property related to the production of income as in the STEP Act.

(5) **Exclusion for Transfers to Spouses.** The Greenbook would exempt "[t]ransfers by a decedent to a U.S. spouse," without explicitly exempting lifetime gifts to a spouse as both H.R. 2286 and the STEP Act do. There is no elaboration of the term "U.S. spouse" (for example, citizen or resident), and there are no special provisions targeted to spousal trusts. Typically the effect of exempting transfers to spouses will be simply to defer the application of the deemed realization rules until the spouse's disposition of the asset or the spouse's death.

(6) **Exclusion for Transfers to Charity.** The Greenbook would exempt transfers to charity. But it adds that "[t]he transfer of appreciated assets to a split-interest trust would generate a taxable capital gain, with an exclusion allowed for the charity's share of the gain based on the charity's share of the value transferred as determined for gift or estate tax purposes." This will require further elaboration.

(7) **Other Exclusions.** The Greenbook proposes a single unified exclusion of capital gains for transfers both by gift and at death of $1 million per person, indexed for inflation after 2022 and "portable to the decedent's surviving spouse under the same rules that apply to portability for estate and gift tax purposes." The Greenbook adds that this would "mak[e] the exclusion effectively $2 million per married couple," without explaining exactly how that would be accomplished for lifetime gifts when there has been no "decedent" or "surviving spouse." The Greenbook does not address whether the use of the exclusion for lifetime gifts is mandatory or elective.

To the extent that exclusion applies, the Greenbook proposes to retain the current basis rules under sections 1014 and 1015. Thus, to that extent, "[t]he recipient's basis in property received by reason of the decedent's death would be the property's fair market value at the decedent's death" (presumably subject to the consistent basis rules of section 1014(f) added in 2015), and the basis of property received by gift would be the donor's basis in that property at the time of the gift. To the extent the exclusion does not apply, the recipient, whether of a gift or at death, will receive a basis equal to the fair market value used to determine the gain. The Greenbook leaves for further elaboration the manner in which those adjustments to basis would be allocated among multiple assets in a case of a lifetime gift or gifts where some but not all of the gain realized under this proposal is sheltered by the exclusion.

In addition, the Greenbook confirms that the exclusion of $250,000 per person of gain from the sale or exchange of a taxpayer's principal residence under section 121 would apply to the gain realized under this proposal with respect to all residences, and it adds that that exclusion would be made "portable to the decedent's surviving spouse." In this case the application to lifetime gifts may be less of an issue, because section 121(b)(2) itself doubles the exclusion to $500,000 for joint returns involving jointly used property. The Greenbook also confirms that the exclusion under current law for capital gain on certain small business stock under section 1202 would apply.

(8) **Netting of Gains and Losses.** For transfers at death, capital losses and carry-forwards would be allowed as offsets against capital gains and up to $3,000 of ordinary income, mirroring the current income tax rules in sections 1211 and 1212. There is no mention of relaxing the related-party loss rules of section 267 as there is in both H.R. 2286 and the STEP Act, but it seems very unlikely that it would be omitted from any provision for taking losses into account at death, where transfers to related parties are the norm.

(9) **Valuation.** As noted above, the Greenbook contemplates that a transfer generally "would be valued using the methodologies used for gift or estate tax purposes." But the Greenbook adds that "a transferred partial interest would be its proportional share of the fair market value of the entire property." In other words, no discounts. The Greenbook does not indicate whether "partial interest" is meant to be limited to undivided interests such as in tenancies-in-common, or whether it might include nonmarketable interests in entities like partnerships, limited liability companies, and corporations. Surely it would not include, for example, publicly traded stock, but attention in drafting might be required to confirm that.

(10) **Special Rules for Trusts and Entities.** Generally mirroring H.R. 2286 and the STEP Act, the Greenbook provides that transfers into, and distributions in kind from, a trust would be recognition events, unless the trust is a grantor trust deemed wholly owned and revocable by what the Greenbook calls "the donor." There is no mention of exempting irrevocable trusts in existence on the date of enactment, and therefore this Greenbook feature would apparently apply to distributions of appreciated assets to both current and successive or remainder beneficiaries of preexisting trusts, including, for example, both the grantor and the remainder beneficiaries of a pre-2022 GRAT. With regard to revocable trusts, the deemed owner would recognize gain on the unrealized appreciation in any asset distributed (unless in discharge of the deemed owner's obligation) to anyone other than the deemed owner or the deemed owner's "U.S. spouse" (again undefined), and on the unrealized appreciation in all the assets in the trust when the deemed owner dies or the trust otherwise becomes irrevocable.

But the Greenbook goes a lot farther. The rules about transfers into and distributions in kind from a trust also apply to a "partnership" or "other non-corporate entity." This looks like a far reach, but the Greenbook does not explain further.

The Greenbook also states:

> Gain on unrealized appreciation also would be recognized by a trust, partnership, or other noncorporate entity that is the owner of property if that property has not been the subject of a recognition event within the prior 90 years, with such testing period beginning on January 1, 1940. The first possible recognition event for any taxpayer under this provision would thus be December 31, 2030.

Ninety years for periodic "mark-to-market" treatment of trust assets is a surprising departure from the somewhat similar rules in H.R. 2286 (30 years) and the STEP Act (21 years), but it again would apply to assets of partnerships and other entities. And again the Greenbook does not explain further. Because 90 years from January 1, 1940, is January 1 (not December 31), 2030, it appears that the Greenbook contemplates recognition only at the end of the year, but the Greenbook does not clarify that.

(11) **Deferral of Tax.** The Greenbook reprises the Obama Administration's Fiscal Year 2016 and 2017 proposals that "[p]ayment of tax on the appreciation of certain family-owned and -operated businesses would not be due until the interest in the business is sold or the business ceases to be family-owned and operated." Providing that the payment of tax is not "due" (rather than merely providing for a section 6166-like "extension of time for payment") implies at a minimum that there would be no interest charged (which can otherwise be a big problem, even for the no-more-than-14-year deferral of section 6166). The implementing statutory language might also provide that the realization event itself is deferred until ownership or operation of the business passes outside the family. That could increase the amount of tax if there is more appreciation, but it could also prevent the payment of tax to the extent the value of the business declines (which sometimes happens after the death of a key owner). That approach would apparently also tax the realization event at whatever the tax rates happen to be at the time. But if the cessation of family ownership results from the family's sale of the business, that postponed realization approach would be the same as current law in subjecting any sale like that to tax, except apparently for the loss of a stepped-up basis at intervening deaths.

The enactment of this proposal or any close variation of it in a tightly divided Congress is by no means certain, and the long-term durability of such a provision enacted in such a political climate would not be guaranteed. That could create special challenges in cases where a tax on the succession of the family businesses is nominally imposed, but is suspended for many years, decades, or even generations.

And of course the statutory language implementing this Greenbook proposal should be expected to include definitions of a "business," "family-owned," and "family-operated," as well as rules for the identification of assets that should be excluded from the deferral because they are not used in the business, and such rules might also create or aggravate challenges over a long-term suspension.

In addition, like the STEP Act and the Obama Administration Greenbooks (and broader than H.R. 2286), the Greenbook proposal would allow "a 15-year fixed-rate payment plan for the tax on appreciated assets transferred at death, other than liquid assets such as publicly traded financial assets and other than businesses for which the deferral election is made." Details about start dates and interest rates are not provided, but the proposal might resemble the STEP Act's proposed section 6168, which in turn resembles section 6166 without the 35-percent-of-gross-estate requirement to qualify, with an interest rate equal to 45 percent of the normal annual rate as in section 6601(j)(1)(B), but without the "2-percent portion" as in section 6601(j)(1)(A).

As in H.R. 2286 and the STEP Act, the IRS would be authorized to require reasonable security at any time from any person and in any form acceptable to the IRS.

(12) **Administrative Provisions.** Following the Obama Administration Greenbooks, with a few additions, the Greenbook envisions (but without details) a number of other legislation features, covering topics such as a deduction for the full cost of related appraisals, the imposition of liens, the waiver of penalties for underpayment of estimated tax attributable to deemed realization of gains at death (which, of course, could not have been foreseeable), a right of recovery of the tax on unrealized gains, rules to determine who selects the return to be filed, consistency in valuation for transfer and income tax purposes, and coordination of the changes to reflect that the recipient would have a basis in the property equal to the value on which the capital gains tax is computed.

(13) **Regulations.** Treasury would be granted authority to issue any regulations necessary or appropriate to implement the proposal, including reporting requirements that could permit reporting on the decedent's final income tax return, which would be especially useful if an estate tax return is not otherwise required to be filed. In a tacit acknowledgment of the harshness of proceeding with such a proposal without a "fresh start" for basis as in 1976, the Greenbook explicitly contemplates that the regulations will include "rules and safe harbors for determining the basis of assets in cases where complete records are unavailable."

(14) **Revenue Estimate.** Taxing capital gains at the same rate as ordinary income for taxpayers with adjusted gross income greater than $1 million and the proposed "deemed realization" of capital gains together are estimated to raise $322.485 billion over the next 10 fiscal years. This includes $1.241 billion estimated for Fiscal Year 2021, which ends September 30, 2021. That presumably results from the proposed retroactive effective date for taxing capital gains at the same rates as ordinary income, but evidently also contemplates increased estimated income tax payments by September 30. (This is the only proposal in the Greenbook that is estimated to have an effect on revenues in Fiscal Year 2021.)

Overall, the tax increases proposed by the Greenbook are estimated to raise revenue over the next 10 fiscal years by about $3.6 trillion.

2. Fiscal 2022 Budget Reconciliation

a. Budget Resolution

On August 24, 2021, the House of Representatives agreed to the Senate-approved Concurrent Resolution on the Budget for Fiscal Year 2022 (S. Con. Res. 14), establishing spending priorities of about $3.5 trillion for the fiscal year beginning October 1, 2021, and ending September 30, 2022. The votes were strictly partisan. In the Senate on August 11 the vote was 50-49, with all Democrats in favor and all Republicans opposed except Senator Mike Rounds (R-SD), who did not vote. In the House on August 24 the vote was 220-212, with all Democrats in favor and all Republicans opposed. The resolution left the House Ways and Means Committee and the Senate Finance Committee with flexibility to develop tax changes to pay for the contemplated expenditures.

b. Ways and Means Committee Action

On September 15, 2021, the House Ways and Means Committee approved the "Build Back Better Act" (H.R. 5376), a package of tax changes pursuant to the budget resolution. Only one Democratic member of the Committee, Rep. Stephanie Murphy (D-FL), joined all the Republicans in voting against it. The bill now is headed to the House floor, while we wait for formal action by the Senate Finance Committee. The Ways and Means Committee's bill includes the following:

(1) **No Deemed Realization.** The Ways and Means Committee omitted any deemed realization proposals like those made in the current Congress and in the Administration's Fiscal Year 2022 Greenbook (see Parts 1.c and 1.e above).

(2) **Early Sunset for Doubled Basic Exclusion Amount.** The sunset of the 2017 Tax Act's doubling of the $5 million basic exclusion amount (indexed for inflation since 2012) would be accelerated **from January 1, 2026, to January 1, 2022**. Thus, the basic exclusion amount would return to $5 million, indexed for inflation since 2012, which the Joint Committee on Taxation (JCT) staff projects would be $6,020,000 for 2022. This is estimated to raise $54 billion over 10 years (mostly in the first five years before the original 2026 sunset).

(3) **Closer Alignment of Grantor Trust and Transfer Tax Rules.** The bill approved by the Ways and Means Committee would create a new chapter 16, consisting solely of a new section 2901, effectively linking the grantor trust rules and the transfer tax rules so that a trust designed as a grantor trust would continue to be exposed to gift or estate tax with respect to the grantor. Thus the bill picks up, with some significant changes, the proposals in section 8 of Senator Sanders' "For the 99.5 Percent Act" (discussed in Part 1.b(8) above), which in turn track the Obama Administration Greenbooks. With respect to a trust or portion of a trust that is not otherwise

includable in the grantor's gross estate and is funded **on or after the date of enactment** (either upon initial formation or by a contribution to an existing trust), section 2901 would

(a) include the value of such portion in the grantor's gross estate for estate tax purposes,

(b) subject to gift tax any distribution from such portion during the grantor's life, other than distributions to the grantor or the grantor's spouse or in discharge of an obligation of the grantor, and

(c) treat as a gift by the grantor, subject to gift tax, all of such portion at any time during the grantor's life if the grantor ceases to be treated as the owner of such portion for income tax purposes.

Unlike the "For the 99.5 Percent Act," this proposal would apply only to "any portion of a trust with respect to which **the grantor** is the deemed owner." It omits the additional explicit application in the "For the 99.5 Percent Act" to the extent a deemed owner engages in a leveraged "sale, exchange, or comparable transaction with the trust" that appears to have been aimed at the technique known as a "Beneficiary Defective Inheritor's Trust" ("BDIT"). (Compare Part 1.b(8)(b)ii above.)

The creation of, or addition to, such a grantor trust would not escape gift tax, but, in determining future gift or estate taxes upon one of the events described in paragraphs (a), (b), and (c) above, "amounts treated previously as taxable gifts" would be "account[ed] for" with a "proper adjustment."

(4) **Certain Sales Between Deemed Owned Trust and Deemed Owner.** Going a step beyond the "For the 99.5 Percent Act," the bill would add a new section 1062 providing:

> In the case of any transfer of property between a trust and a person who is the deemed owner of the trust (or portion thereof), such treatment of the person as the owner of the trust shall be disregarded in determining whether the transfer is a sale or exchange for purposes of this chapter.

The result would be that gain would be recognized by the deemed owner or by the trust, as the case may be, or possibly by both of them (in the case of a substitution of assets or other in-kind exchange, for example). Rev. Rul. 85-13, 1985-1 C.B. 184, the hinge on which almost all grantor trust planning swings, would be nullified. The new rule would not apply to a trust that is fully revocable by the deemed owner.

The bill would also amend section 267 to disallow losses between "[a] grantor trust and the person treated as the owner of the trust (or portion thereof)."

Like the closer alignment of grantor trust and transfer tax rules in section 2901, this rule, as written, would apparently apply only to a trust created, and any portion of an existing trust attributable to a contribution made, **on or after the date of enactment**. The Ways and Means Committee report states that it "is intended to be effective for sales and other dispositions after the date of enactment" – that is, regardless of when the trust was created or funded – but it adds in a footnote (footnote 935) that "[a] technical correction may be necessary to reflect this intent."

This provision and section 2901 together are estimated to raise $8 billion over 10 years.

(5) **Valuation of Certain Nonbusiness Assets in Entities.** In a proposal traceable at least to the Reagan and Clinton Administrations and virtually identical to section 6 of Senator Sanders' "For the 99.5 Percent Act" (see Part 1.b(6) above), the Ways and Means Committee bill would in effect require the valuation of nonbusiness assets in an entity by **a look-through method**. The proposal would add a new section 2031(d) to the Code, **applicable to transfers (by gift or upon death) after the date of enactment**. Section 2031(d)(1) would read as follows:

> (d) VALUATION RULES FOR CERTAIN TRANSFERS OF NONBUSINESS ASSETS—For purposes of this chapter [estate tax] and chapter 12 [gift tax]—
>
>> (1) IN GENERAL—In the case of the transfer of any interest in an entity other than an interest which is actively traded (within the meaning of section 1092) [*see*, *e.g.*, Reg. §1.1092(d)-1(a) & (b)]—

(A) the value of any nonbusiness assets held by the entity with respect to such interest shall be determined as if the transferor had transferred such assets directly to the transferee (and no valuation discount shall be allowed with respect to such nonbusiness assets), and

(B) such nonbusiness assets shall not be taken into account in determining the value of the interest in the entity.

Like the "For the 99.5 Percent Act," the proposal includes a detailed list of what are considered "passive assets," detailed rules about passive assets that might be used in a business, and "look-thru rules" for entities that are at least 10 percent owned by another entity. The proposal also adds a broad grant of regulatory authority, specifically including the issues of whether a passive asset is used in the active conduct of a trade or business or is held as part of the reasonably required working capital needs of a trade or business.

Unlike the "For the 99.5 Percent Act," however, the proposal does not also include a general prohibition on "minority discounts" in family owned or controlled entities, a prohibition that in the "For the 99.5 Percent Act" (see Part 1.b(6)(c) above) is not limited to "nonbusiness" entities or assets and thus would arguably have a much broader and harsher impact on family businesses.

In addition, new section 2031(d)(2)(A) would provide that "[t]he term 'nonbusiness asset' means any passive asset which (i) is held for the production or collection of income, and (ii) is not used in the active conduct of a trade or business." That implies that, for example, a vacation home that is not rented would not be valued under the proposed look-through rule, which is a bit surprising.

Also surprising, despite that broad definition of a "nonbusiness asset" (which is repeated in the Ways and Means Committee's report), a summary titled "Tax Changes for Estates and Trusts in the Build Back Better Act (BBBA)," published by the Congressional Research Service on October 22, 2021, limits its description of the proposal to only "cash and readily marketable securities," without explanation.

This proposal is estimated to raise $20 billion over 10 years.

(6) **Increased Benefit of Special Use Valuation.** In contrast to the preceding provisions that would make the estate and gift tax more burdensome, the Ways and Means Committee bill, **effective January 1, 2022**, would increase the limit on the reduction under section 2032A in the estate tax value of real property used in a family farm or other family business resulting from valuing the real property in that farm or business use, even if that is not its "highest and best use." Currently the limit on that reduction is $750,000, indexed for inflation since 1998 ($1,190,000 in 2021). Such an increase in the limit has often been offered by lawmakers opposed to across-the-board repeal or reduction of the estate tax as a way to target relief to the family farms and businesses that are often cited as justifications for such repeal or reduction. Unlike section 3 of Senator Sanders' "For the 99.5 Percent Act" (see Part 1.b(3) above), which would increase the limit to only $3 million, indexed for inflation going forward, the Ways and Means Committee proposal would raise the limit to $11.7 million (which happens to be the current basic exclusion amount), indexed going forward. Even so, the proposal would not really reduce the estate tax on a family farm or business as such; it would merely prevent a tax, for example, on a speculative prospect of development that is faced by such businesses very unevenly. Thus, this proposal should not be expected to be viewed by owners of family farms and businesses as much of a consolation. It is estimated to decrease revenues by $317 million over 10 years.

(7) **Other Income Tax Proposals**

(a) **Individual Income Tax Rates.** Beginning **January 1, 2022**, the 39.6 percent top individual income tax rate, suspended for eight years by the 2017 Tax Act, would be reinstated for taxable incomes over $400,000 ($450,000 for joint returns and surviving spouses) and $12,500 indexed (projected by the JCT staff to be $13,450 in 2022) for trusts and estates. In addition, a **new section 1A** would apply a 3 percent surcharge to "modified adjusted gross income" (defined as AGI minus any investment interest deducted "below the line," not deducted in determining AGI) over $5 million for individual returns, including joint returns of married couples (half that amount in the case of married individuals filing separately). For

trusts and estates the threshold is $100,000, and AGI is determined as provided in section 67(e) (that is, after deducting certain unique fiduciary expenses, the personal exemption of section 642(b), and the distribution deduction of section 651 or 661), with a further deduction for charitable payments and set-asides under section 642(c) that was helpfully added in the November 3 update mentioned in Part 2.d below.

(b) **Capital Gain Tax Rates.** The rate of income tax on capital gains would be increased from 20 percent to 25 percent to the extent the taxpayer is subject to the reinstated 39.6 percent top rate – that is, for taxable incomes over $400,000 ($450,000 for joint returns and surviving spouses and $12,500 indexed for trusts and estates). Notably, this provision was designed to take effect **on September 14, 2021**, with an exception for gains recognized in 2021 pursuant to written binding contracts entered into before September 14, 2021.

(c) **Corporate Income Tax Rates.** Beginning **January 1, 2022**, the 21 percent corporate income tax rate would be retained for taxable income from $400,000 to $5 million, but it would be lowered to 18 percent on the first $400,000 of taxable income and raised to 26.5 percent on the amount of taxable income in excess of $5 million.

(d) **Expansion of Tax on Net Investment Income.** Beginning **January 1, 2022**, the 3.8 percent tax on net investment income would be expanded by effectively eliminating the "trade or business" exception in section 1411(c)(1)(A) for individuals with "modified adjusted gross income" (in this case already defined in section 1411(d) as AGI plus, in effect, net foreign earned income excluded under section 911) over $400,000 ($500,000 for joint returns and surviving spouses) and for trusts and estates with adjusted gross income in excess of the threshold for the highest income tax bracket for trusts and estates (projected by the JCT staff to be $13,450 in 2022).

(e) **Limitation of Qualified Business Income Deduction.** Beginning **January 1, 2022**, the qualified business income deduction of section 199A (added by the 2017 Tax Act) would be capped at $400,000 for individuals ($500,000 for joint returns and surviving spouses) and $10,000 for trusts and estates.

c. **Administration's "Build Back Better Framework"**

On October 28, 2021, the White House released a short document titled "Build Back Better Framework." It was widely viewed as reflecting negotiations among the Administration and members of Congress in both parties. The Framework added that its spending proposals would be "more than fully paid for by asking the wealthiest Americans and most profitable corporations to pay their fair share," including a "new surtax on multi-millionaires and billionaires." But it omitted any reference to many of the proposals that had been in the Ways and Means Committee's version of H.R. 5376, including changes to the basic exclusion amount, the treatment of grantor trusts, and the valuation of nonbusiness assets in entities.

d. **House Rules Committee Version**

On the same day, October 28, 2021, the House Rules Committee released a new version of H.R. 5376, mirroring the White House Framework and omitting the transfer tax and grantor trust provisions the Ways and Means Committee had previous approved. An updated version, with both technical and substantive additions, was released on November 3, 2021.

The White House Framework's "new surtax on multi-millionaires and billionaires" proved to be the retention of the new section 1A of the original Ways and Means Committee version, effective January 1, 2022, with some significant changes in the numbers. The **threshold** for imposition of the surcharge would be **doubled** to $10 million for individual returns, including joint returns of married couples (half that amount in the case of married individuals filing separately) and $200,000 for trusts and estates. But the ultimate **rate** of the surtax would be **almost tripled**, beginning at that threshold at 5 percent and then increasing to 8 percent at a level of $25 million for individual returns, including joint returns of married couples (half that amount in the case of married individuals filing separately) and $500,000 for trusts and estates.

The Rules Committee version keeps the limitation on the "trade or business" exception for the 3.8 percent tax on net investment income, but it omits the limitation of the qualified business income deduction.

e. **Senator Wyden's Mark-to-Market "Billionaires Income Tax"**

Other approaches to increasing taxes on the very wealthy have also been offered or revived during this time of negotiation, adaptation, and uncertainty. An example is Finance Committee Chair Ron Wyden's "Treat Wealth Like Wages" proposal, rolled out on October 27, 2021, as the "Billionaires Income Tax." Although the proposal was not well received, including by some Democrats, and is not included in the current House Rules Committee package, it will remain "on the shelf" for possible future retrieval for its revenue-raising potential, as it appears to be a rather thorough drafting job. Indeed, the draft of statutory language is 107 pages long, and the following is just a simplified summary of how it would work in general if it ever were enacted.

Effective January 1, 2022, the Billionaires Income Tax would add a new Part IV, consisting of sections 490 through 498, to subchapter E of the Internal Revenue Code, which is titled "Accounting Periods and Methods of Accounting." The core provisions of Part IV would tax the appreciation of "**covered assets**" held by "**applicable taxpayers**." (Other provisions of the Billionaires Income Tax would, for "applicable taxpayers," tighten the rules applicable to deferred compensation, private placement life insurance or annuity contracts, qualified small business stock, and qualified opportunity funds.)

(1) **"Applicable Taxpayer."** An "applicable taxpayer" includes an individual taxpayer who has **either** modified adjusted gross income exceeding $100 million (the "income test") **or** covered assets with an aggregate value exceeding $1 billion (the "asset test") in **each** of the three preceding years. Either the income test or the asset test must be met in each of those three years; it is not necessary that the same test be met each year. In applying the income test, "modified adjusted gross income" means AGI plus tax-exempt interest, excluded social security benefits, and foreign or offshore earned income excluded under sections 911, 931, and 933. In applying the asset test, values are determined under guidelines in the proposal and reduced by the taxpayer's debt. Once acquired, "applicable taxpayer" status is not terminated until the taxpayer meets **neither** the income text **nor** the asset test (applying those tests with only one-half of their respective thresholds) for **all** of the three consecutive years and has made an election (as and when the IRS prescribes) for the first of those three years.

(a) **Married Couples.** Married couples are treated as one taxpayer, and a newly married couple is an applicable taxpayer if either spouse was an applicable taxpayer before the marriage. The thresholds of the tests are halved for a married person filing separately, but both spouses are treated as applicable taxpayers if one of them meets the tests.

(b) **Trusts.** A nongrantor trust (including a trust deemed-owned under section 678 by someone other than the grantor) is an applicable taxpayer if it likewise meets one of the two tests in each of the three preceding years, but the thresholds for those tests are one-tenth of what they are for individuals – that is, $10 million for the income test (applied before any distribution deduction) and $100 million for the asset test. There are exceptions for certain charitable trusts and other trusts favored under the Internal Revenue Code. A grantor trust cannot be an applicable taxpayer, but the assets of a grantor trust (as well as the income, of course) are taken into account in applying the asset test to the grantor.

(c) **Estates.** A decedent's estate is an applicable taxpayer if the decedent was an applicable taxpayer for the year of death or any of the three preceding years. In other words, a decedent's estate will not suddenly become subject to these rules when the decedent was not. This is in contrast to some other changes in the law under consideration, such as the 3 and 8 percent surcharge on trusts, where the threshold applicable to the estate would be $200,000 instead of the $10 million threshold applicable to the decedent. (Of course, a decedent's estate will typically receive appreciated assets, whether tradable or not, with a stepped-up basis, either under current law or under the deemed realization provisions of this

proposal (see paragraph (4) below), and therefore these rules might not have immediate significance for estates anyway.)

(2) **"Covered Asset."** A "covered asset" is basically any asset except a retirement plan or similar account favored under the Internal Revenue Code, cash or a cash equivalent, or a private placement life insurance or annuity contract (as defined in a new section 72(e)(12) that the proposal would add to the Code). There are special rules, including attribution rules and reporting requirements, regarding certain entities in which an applicable taxpayer holds an interest. A covered asset is a **"tradable covered asset"** if it is traded or tradable on an established market (or the substantial equivalent thereof) or electronic platform or if there otherwise is a reasonable basis to annually determine the asset's fair market value. Any covered asset that is not thereby considered "tradable" is viewed for purposes of the proposed legislation as a **"nontradable covered asset."**

(3) **Mark-to-Market for Tradable Covered Assets.** In general, a tradable covered asset (and, generally, at the owner's election, any nontradable covered asset) would be marked to market – that is, gain or loss would be recognized for income tax purposes – at the end of each year, or at any time during the year immediately before a nontaxable transfer such as an exchange for stock under section 351 or a like-kind exchange under section 2031.

(4) **Deemed Realization upon Gift or at Death.** Recalling other deemed realization proposals (see Parts 1.c and 1.e above), the proposal would provide that if an applicable taxpayer (or a defined related entity) transfers a covered asset "by gift, upon death, or in trust" (including specified in-kind distributions by estates or trusts), gain is recognized as if the asset had been sold at its fair market value. Loss is similarly recognized, but only for such transfers at death. There are certain exceptions for transfers to or for a spouse or charity.

(5) **Deferral Recapture for Nontradable Covered Assets.** If an applicable taxpayer transfers a nontradable covered asset either in a sale, exchange, disposition, or other transfer in which gain is recognized or in a nontaxable transfer such as an exchange for stock under section 351 or a like-kind exchange under section 2031, the taxpayer must pay a "deferral recapture amount" to generally emulate what would have been the interest on the tax owed if the asset had been marked to market annually throughout the taxpayer's holding period like a tradable covered asset, using an interest rate that is two percentage points lower than the rate on underpayments under section 6621(a)(2).

f. **Other Suggestions**

(1) **Wealth Tax.** Another suggestion, which has been in print a little longer than Senator's Wyden's Billionaires Income Tax, is the "Ultra-Millionaire Tax Act of 2021" introduced in this Congress on March 1, 2021, by Senator Elizabeth Warren of Massachusetts (S. 510) and Congressional Progressive Caucus Chair Pramila Jayapal of Washington (H.R. 1459). Beginning in 2023, the Ultra-Millionaire Tax Act would impose an annual tax on the net worth of individuals (treating married individuals as one) and trusts. The tax would be 2 percent over a threshold of $50 million and an additional 1 percent (totaling 3 percent) over a threshold of $1 billion.

(2) **"For the 99.5 Percent Act."** And then there are the proposals focusing on the transfer tax in the many editions of Senator Sanders' bill, current called the "For the 99.5 Percent Act." (See Part 1.b above.)

3. Requirements of the Regulatory Process

a. Executive Order 13789 of April 21, 2017, famous for ordering the action that led to the withdrawal in October 2017 of the August 2016 proposed section 2704 regulations, also directed the Treasury Department and the Office of Management and Budget (OMB) to "review and, if appropriate, reconsider the scope and implementation of the existing exemption for certain tax regulations from the review process set forth in Executive Order 12866 and any successor order."

b. Executive Order 12866, which was signed by President Clinton on September 30, 1993, requires generally that Treasury

(1) periodically provide the Office of Information and Regulatory Affairs (OIRA) within OMB with a list of its planned regulatory actions, including those it believes are "significant regulatory actions" (section 6(a)(3)(A) of Executive Order 12866),

(2) for each "significant regulatory action," provide to OIRA "(i) [t]he text of the draft regulatory action, together with a reasonably detailed description of the need for the regulatory action and an explanation of how the regulatory action will meet that need; and (ii) [a]n assessment of the potential costs and benefits of the regulatory action, including an explanation of the manner in which the regulatory action is consistent with a statutory mandate and, to the extent permitted by law, promotes the President's priorities and avoids undue interference with State, local, and tribal governments in the exercise of their governmental functions" (section 6(a)(3)(B) of Executive Order 12866), and

(3) for each "significant regulatory action" that is likely to have an annual effect on the economy of $100 million or more, include the following regulatory impact assessment (section 6(a)(3)(C) of Executive Order 12866, emphasis added):

> (i) An assessment, *including the underlying analysis*, of *benefits* anticipated from the regulatory action (such as, but not limited to, the promotion of the efficient functioning of the economy and private markets, the enhancement of health and safety, the protection of the natural environment, and the elimination or reduction of discrimination or bias) together with, to the extent feasible, a *quantification* of those benefits;
>
> (ii) An assessment, *including the underlying analysis*, of *costs* anticipated from the regulatory action (such as, but not limited to, the direct cost both to the government in administering the regulation and to businesses and others in complying with the regulation, and any adverse effects on the efficient functioning of the economy, private markets (including productivity, employment, and competitiveness), health, safety, and the natural environment), together with, to the extent feasible, a *quantification* of those costs; and
>
> (iii) An assessment, *including the underlying analysis*, of costs and benefits of potentially effective and reasonably feasible *alternatives* to the planned regulation, identified by the agencies or the public (including improving the current regulation and reasonably viable nonregulatory actions), and *an explanation why the planned regulatory action is preferable to the identified potential alternatives*.

c. Under section 3(f) of Executive Order 12866, a "significant regulatory action" to which the requirements described in paragraphs (2) and (3) above apply is defined as

> any regulatory action that is likely to result in a rule that may:
>
> (1) Have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities;
>
> (2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency;
>
> (3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or
>
> (4) Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive order.

d. The regulatory impact assessment, along with a draft of the proposed regulations, must be reviewed within OMB before a proposed regulation is published for public comment. In addition, the public must be informed of the content of the regulatory impact assessment and of any substantive changes made in the draft of the proposed regulations after that draft was submitted to OMB for review (section 6(a)(3)(E) of Executive Order 12866).

e. Obviously, that is not information we are accustomed to seeing in connection with tax regulations. Since a Memorandum of Agreement between Treasury and OMB in 1983, most tax regulations were viewed as exempt from rigorous OMB review, partly because they were viewed as interpreting a statute, and any burden on the economy therefore was attributable to the statute, not to the regulations.

f. A new Memorandum of Agreement, signed by the Administrator of OIRA and the General Counsel of the Treasury Department on April 11, 2018, supersedes the 1983 Memorandum of Agreement and generally affirms the application of Executive Order 12866 to tax regulatory actions.

(1) Under paragraph 3 of the new Memorandum of Agreement, the frequency of providing the list of planned tax regulatory actions referred to in paragraph b(1) above is quarterly.

(2) Under paragraph 8, the new Memorandum of Agreement was effective immediately, except that the regulatory impact assessment described in paragraph b(3) above was not required until the earlier of April 11, 2019, or "when Treasury obtains reasonably sufficient resources (with the assistance of OMB) to perform the required analysis."

(3) Under paragraph 4, the time allowed for OIRA review is generally 45 days, with the opportunity for Treasury and OIRA to agree to 10 business days "[t]o ensure timely implementation of the Tax Cuts and Jobs Act of 2017."

g. This did not work too badly in the tax context in the Trump Administration. For example, there did not appear to have been excessive delays. And there has been some bipartisan support for this type of oversight. So it is possible – but not certain – that it will continue in some form in the Biden Administration.

4. 2021-2022 Priority Guidance Plan

On September 9, 2021, the Treasury Department and the IRS released the first Priority Guidance Plan in the Biden Administration (**https://www.irs.gov/pub/irs-utl/2021-2022-pgp-initial.pdf**) for the plan year from July 1, 2021, through June 30, 2022 The introduction to the 2021-2022 Plan states:

> We are pleased to announce the release of the 2021-2022 Priority Guidance Plan.
>
> In Notice 2021-28, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (Service) solicited recommendations for items to be included in the plan from all interested parties, including taxpayers, tax practitioners, and industry groups. The Treasury Department and the Service recognize the importance of public input in formulating a Priority Guidance Plan that focuses resources on guidance items that are most important to taxpayers and tax administration. Solicitation of input on, and issuance of, this plan reflects an emphasis on taxpayer engagement with the Treasury Department and the Service through a variety of channels, consistent with the directive of the Taxpayer First Act, Pub. L. 116-25, 133 Stat. 981.
>
> The 2021-2022 Priority Guidance Plan contains 193 guidance projects that are priorities for allocating Treasury Department and Service resources during the 12-month period from July 1, 2021 through June 30, 2022 (the plan year). The projects on the plan will be the focus of our efforts during the plan year. However, the plan does not provide any deadline for completing the projects.
>
> Some projects that were on the 2020-2021 Priority Guidance Plan have not been included on the 2021-2022 plan because they are no longer considered priorities for purposes of allocating resources during the 2021-2022 plan year. Some of those projects may be considered for inclusion on a future priority guidance plan. …
>
> We intend to update the 2021-2022 plan during the plan year to reflect additional items that have become priorities, guidance that we have published during the plan year, and projects that may result from legislative developments. The periodic updates allow us flexibility throughout the plan year to consider comments received from taxpayers and tax practitioners relating to additional projects and to respond to developments arising during the plan year.

The 2021-2022 Plan abandons the multi-part format used during the Trump Administration and goes back to the traditional format of divisions only by subject. It includes the following nine items under the subject heading of "Gifts and Estates and Trusts":

a. **Item 1: User Fee for Estate Tax Closing Letters**

(1) Item 1 is described as "Final regulations establishing a user fee for estate tax closing letters. Proposed regulations were published on December 31, 2020." It was new in the 2020-2021 Plan, as Item 2 under Gifts and Estates and Trusts.

(2) Before June 1, 2015, the IRS routinely issued a closing letter (sometimes referred to as IRS Letter 627, not the same as a formal "closing agreement") when the examination of an estate tax return was closed, except returns that were not required for estate tax purposes but were filed solely to elect portability. The "Frequently Asked Questions on Estate Taxes" on the IRS

website was updated on June 16, 2015, to state that for such returns filed on or after June 1, 2015, closing letters would be issued only upon request. Notice 2017-12, 2017-5 I.R.B. 742, confirmed that, and also confirmed that an estate tax account transcript that includes the transaction code "421" and the explanation "Closed examination of tax return" can, as the Notice put it, "serve as the functional equivalent of an estate tax closing letter."

(3) Many estate planning professionals have been frustrated with efforts to obtain such transcripts and in any event have not found that a transcript has the same dignity as a closing letter for purposes of obtaining the approval of courts and the release of liens and otherwise documenting the propriety of making distributions, closing accounts, and taking other financial actions.

(4) The IRS released proposed regulations at the end of 2020 and finalized them on September 27, 2021, establishing a $67 user fee for issuing an estate tax closing letter, effective October 28, 2021. Reg. §300.13, T.D. 9957, 86 Fed. Reg. 53539 (Sept. 28, 2021), 2021-41 I.R.B. 452.

(a) The preamble to the proposed regulations acknowledged the importance of closing letters to executors, but added:

> The practice of issuing estate tax closing letters to authorized persons is not mandated by any provision of the Code or other statutory requirement. Instead, the practice is fundamentally a customer service convenience offered to authorized persons in view of the unique nature of estate tax return filings and the bearing of an estate's Federal estate tax obligations on the obligation to administer and close a probate estate under applicable State and local law.

That is not persuasive at all. Surely the "unique nature of estate tax return filings" includes the IRS's benefit from liens, transferee liability, priority over other creditors, and other advantages, and with such power should come some level of responsibility. The preamble to the final regulations states that the IRS received comments opposing the establishment of a user fee, but it reaffirms the notion of the previous preamble that a user fee is appropriate because an estate tax closing letter is "the provision of a service that confers special benefits, beyond those accruing to the general public," without any acknowledgment of the fact that "the general public" does not face those liens, liabilities, and other burdens.

(b) The preamble to the proposed regulations explained that the practice of issuing closing letters for every filed estate tax return was changed in 2015 primarily for two reasons – (1) the increase in the volume of filed returns since the enactment of portability and (2) the availability of the transcript alternative described in Notice 2017-12. Regarding the first reason, the preamble noted that in 2016 approximately 20,000 optional estate tax returns were filed solely to elect portability, compared to approximately 12,000 mandatory returns. (A closing letter in the case of a portability-only return is arguably not as serious a matter, because no estate tax liability is at stake, and because the return may in effect be audited under section 2010(c)(5)(B) upon the surviving spouse's death anyway.)

(c) The preamble to the proposed regulations also included a detailed description of the calculation of the user fee, based on fiscal year 2017 and 2018 data, culminating in the determination of a full annual cost to the IRS (including direct labor and non-labor costs and a 74.08% overhead factor) of $1,160,058, divided by an estimated volume of 17,249 requests to produce the proposed user fee of $67. The calculations included an average of one-half hour of quality assurance review by a senior staff member applied to 5% of mailed closing letters.

(d) The regulations do not explain how to request a closing letter and pay the user fee, but the preamble to the proposed regulations stated:

> The Treasury Department and the IRS expect to implement a procedure that will improve convenience and reduce burden for authorized persons requesting estate tax closing letters by initiating a one-step, web-based procedure to accomplish the request of the estate tax closing letter as well as the payment of the user fee. As presently contemplated, a Federal payment website, such as http://www.pay.gov, will be used and multiple requests will not be necessary. The Treasury Department and the IRS believe implementing such a one-step procedure will reduce the current administrative burden on authorized

persons in requesting estate tax closing letters and will limit the burden associated with the establishment of a user fee for providing such service.

(5) On October 6, 2021, the IRS posted frequently asked questions, confirming the use of Pay.gov and addressing other procedural issues. See **https://www.irs.gov/businesses/small-businesses-self-employed/frequently-asked-questions-on-the-estate-tax-closing-letter**.

(6) A closing letter does not preclude reopening an estate tax examination in some cases, as noted in Chief Counsel Advice 202142010 (issued April 1, 2021; released Oct. 22, 2021). That CCA also confirms that if there has not been an examination of the estate tax return at all, then an examination may be begun without complying with the "reopening" protocols of Rev. Proc. 2005-32, 2005-1 C.B. 1206, under section 7605(b), and notwithstanding the issuance of a closing letter (Letter 627).

b. **Item 2: The Consistent Basis Rules**

(1) Item 2 is described as "Final regulations under §§1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016." In the 2020-2021 Plan, this was Item 14 of Part 3, which was titled "Burden Reduction."

(2) On July 31, 2015, the day that funding for the Highway Trust Fund was scheduled to expire, President Obama signed into law the Surface Transportation and Veterans Health Care Choice Improvement Act (Public Law 114-41), extending that infrastructure funding for three months, with the $8 billion cost funded by various tax compliance measures. One of those was section 2004 of the Act, labelled "Consistent Basis Reporting Between Estate and Person Acquiring Property from Decedent," which of course has nothing to do with highways or veterans' health care other than raising money. The provision added new provisions to the Code.

(a) New 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 value as finally determined for estate tax purposes, or, if there is no final determination (as in the case of property sold while an estate tax audit is still in progress or, within the statutory period for assessments, has not begun) the value reported on the estate tax return.

(b) New section 6035 requires every executor (or person in possession of property with the statutory duties of an executor) who is required to file an estate tax return – that is, in general, if the gross estate plus adjusted taxable gifts exceeds the applicable filing threshold – to furnish to the IRS and to the recipients of property interests included in the decedent's gross estate a statement setting forth the value of those property interests reported on the estate tax return. This statement is due 30 days after the estate tax return is filed or, if the return is filed after its due date (including extensions), 30 days after that due date. Every such statement must be supplemented if a value is adjusted, for example on audit.

(c) There are also penalties for failure to file a required statement and for reporting basis inconsistently with such a statement.

(3) Previously (and **still the law** unless an estate tax return was or is filed after July 31, 2015), under section 1014(a)(1), the basis of property acquired from a decedent is simply "the fair market value of the property at the date of the decedent's death," with appropriate adjustments in section 1014 for the alternate valuation date and so forth. It is possible for the recipient of property from a decedent to claim, for income tax purposes, that the executor somehow just got the estate tax value too low, and that the heir's basis should be greater than the estate tax value. Usually, of course, such claims are made after the statute of limitations has run on the estate tax return. Such claims can be accompanied by elaborate appraisals and other evidence of the "real" date-of-death value that, long after death, is hard to refute. Invoking principles of "privity," the Service is able to insist on using the lower estate tax value when the recipient was one of the executors who signed the estate tax return, but otherwise it has had no tool to enforce such consistency.

(4) *Van Alen v. Commissioner*, T.C. Memo. 2013-235, however, created confusion about the role of a duty of consistency in determining the basis of heirs.

(a) In *Van Alen*, a brother and sister had inherited a cattle ranch from their father in 1994, with a low "special use" estate tax value under section 2032A. They were not executors; their stepmother was. The heirs sold a conservation easement on the land in 2007 and argued that their basis for determining capital gain should be higher than the estate tax value. The court held their basis to the low estate tax value.

(b) A key to the outcome was that section 1014(a)(3) describes the basis of property acquired from a decedent as "in the case of an election under section 2032A, its value *determined* under such section." This contrasts with the general rule of section 1014(a)(1), which describes the basis as merely "the fair market value of the property at the date of the decedent's death," which arguably opens up the opportunity for a non-executor heir to argue that the value "determined" for estate tax purposes was simply too low. In addition, the court pointed to the special use valuation agreement, which the two heirs (one, a minor, by his mother as his guardian *ad litem*) had signed. Consistently with this rationale for its holding, the court cited Rev. Rul. 54-97, 1954-1 C.B. 113 ("the value of the property as determined for the purpose of the Federal estate tax … is not conclusive but is a presumptive value which may be rebutted by clear and convincing evidence"), and observed that "it might be reasonable for taxpayers to rely on this revenue ruling if they were calculating their basis under section 1014(a)(1)."

(c) Surprisingly, however, the court also seemed to view heirs *who were not executors* as bound by a "duty of consistency" to use the value determined for estate tax purposes as their basis for income tax purposes. The court spoke of a "sufficient identity of interests" between the heirs and the executor and concluded that "[w]e rest our holding on the unequivocal language of section 1014(a)(3) …. And we rest it as well on a duty of consistency that is by now a background principle of tax law."

(d) While "consistency" is superficially an appealing objective, the notion that it might apply generally to the basis of an heir who was not an executor may be more novel and more troubling than the court seems to have realized. The court acknowledged that "[t]here are lots of cases that hold that the duty of consistency binds an estate's beneficiary to a representation made on an estate-tax return if that beneficiary was a fiduciary of the estate." But the court then went on to say: "But the cases don't limit us to that situation and instead say that the question of whether there is sufficient identity of interests between the parties making the first and second representation depends on the facts and circumstances of each case." The problem is that the court cited the same three cases for both propositions, and all three cases involved the basis of an heir who *was* a co-executor. Thus, *Van Alen* appears to stand alone for applying a duty of consistency to the basis of an heir who was not an executor, although the *Van Alen* holding does have the alternative ground of the word "determined" in section 1014(a)(3), applicable only in special use valuation cases.

(5) In the Obama Administration, the Treasury Department's annual "General Explanations" of revenue proposals associated with the President's budget proposals (popularly called the "Greenbook") included a provision, last found on pages 195-96 in the 2015 Greenbook (see **http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf**), to require the income tax basis of property received from a decedent or donor to be equal to the estate tax value or the donor's basis. The Greenbooks provided that the executor or donor would be required to report the necessary information to both the recipient and the Service.

(a) The Greenbook proposal would have been effective

i. "as of the date of enactment" in the 2009, 2010, and 2011 Greenbooks,

ii. "for transfers on or after the date of enactment" in the 2012 and 2013 Greenbooks, and

iii. "for transfers after the year of enactment" in the 2014 and 2015 Greenbooks.

(b) Statutory language for this proposal appeared

i. in section 6 of the Responsible Estate Tax Act, S. 3533 (introduced on June 24, 2010, by Senator Bernie Sanders (I-VT)) and H.R. 5764 (introduced on July 15, 2010, by Congresswoman Linda Sanchez (D-CA)), applicable **"to transfers for which returns are filed after the date of the enactment of this Act"** and requiring a statement by the executor or donor on or before the due date of the return;

ii. in section 5 of the "Sensible Estate Tax Act of 2011," H.R. 3467, introduced on November 17, 2011, by Congressman Jim McDermott (D-WA), also applicable "to transfers for which returns are filed after the date of the enactment of this Act" but requiring a statement by the executor or donor **within 30 days after filing the return**;

iii. in section 1422 of Ways and Means Committee Chairman Dave Camp's Discussion Draft released February 26, 2014, also applicable to transfers for which returns are filed after the date of enactment and requiring a statement by the executor or donor within 30 days after filing the return but **applicable only to estate tax values and with the changes to section 1014 (but not the reporting requirement) applicable only to property that increases the estate tax**;

iv. in section 5 of the "Sensible Estate Tax Act of 2015," H.R. 1544, introduced on March 23, 2015, by Congressman McDermott, similar to the Camp Discussion Draft except that it did not exclude property that did not increase the estate tax; and

v. then as a "pay-for" in the "Highway and Transportation Funding Act of 2015, Part II" (Public Law 114-41), endorsed by then Ways and Means Committee Chairman Ryan on July 13, 2015, which became the Surface Transportation and Veterans Health Care Choice Improvement Act (with a 10-year revenue estimate of $1.542 billion).

(6) The statute that was enacted followed the Camp Discussion Draft. As a result, compared to the 2014 and 2015 Greenbook proposals, new subsection (f) of section 1014 includes some twists.

(a) Like the Camp Discussion Draft and the 2015 "Sensible Estate Tax Act" (H.R. 1544), it applies only to property acquired from a decedent, not to gifts.

(b) Under section 1014(f)(2), like the Camp Discussion Draft, it "shall only apply to any property whose inclusion in the decedent's estate increased the liability for the tax imposed by chapter 11 (reduced by credits allowable against such tax) on such estate." In other words, these new rules apparently do not apply to property that passes to a surviving spouse or to charity, or to property that does not pass to the surviving spouse but is reported on an estate tax return filed only to elect portability. **(But, as in the Camp Discussion Draft, there is no such exception to the reporting requirement of section 6035.)**

(c) While the Greenbook versions, since 2014, would have been effective for transfers – that is, for gifts made and decedents dying – after the year of enactment, section 1014(f) (as in all the above introduced bills since the Responsible Estate Tax Act of 2010 and consistently with the 2009, 2010, and 2011 Greenbook proposals) is applicable to property with respect to which an estate tax return is filed after the date of enactment – that is, on or after August 1, 2015. A return filed after the date of enactment might have been due, and filed, on August 1, 2015, **making the statement due August 31, 2015**.

(7) In response to that accelerated application, Notice 2015-57, 2015-36 I.R.B. 294, released on August 21, 2015, extended to February 29, 2016, the due date of any statements required by section 6035 that otherwise would be due before February 29, 2016. The Notice cited section

6081(a), which allows extensions of time only for up to six months except in the case of taxpayers who are abroad. February 29, 2016, is the closest date the calendar allows to six months after August 31, 2015. So Notice 2015-57 implied that it was the only extension there would be.

(a) Notice 2015-57 also stated that "[t]he Treasury Department and the IRS expect to issue additional guidance to assist taxpayers with complying with sections 1014(f) and 6035."

(b) Notice 2016-19, 2016-9 I.R.B. 362, released on February 11, 2016, provided: "Statements required under sections 6035(a)(1) and (a)(2) to be filed with the IRS or furnished to a beneficiary before March 31, 2016, need not be filed with the IRS and furnished to a beneficiary until March 31, 2016."

i. In other words, the "due date" is not "extended" (confirming the implication of Notice 2015-57), but executors "need not" comply with any due date earlier than March 31, 2016.

ii. Indeed, Notice 2016-19 affirmatively added that "[t]he Treasury Department and IRS recommend that executors and other persons required to file a return under section 6018 wait to prepare the statements required by section 6035(a)(1) and (a)(2) until the issuance of proposed regulations by the Treasury Department and the IRS addressing the requirements of section 6035" and that "[t]he Treasury Department and the IRS expect to issue proposed regulations under sections 1014(f) and 6035 very shortly."

(c) Notice 2016-27, 2016-15 I.R.B. 576, released on March 23, 2016 (three weeks after the publication of the proposed regulations discussed in paragraph (10) below), extended the same relief through June 30, 2016. The stated rationale was that "[t]he Treasury Department and the IRS have received numerous comments that executors and other persons have not had sufficient time to adopt the systemic changes that would enable the filing of an accurate and complete Form 8971 and Schedule A."

(8) Meanwhile, the IRS developed Form 8971 (January 2016) for reporting the information for which the due date was originally August 31, 2015, then was February 29, 2016, and then "need not" be observed before June 30, 2016. Form 8971 itself is to be filed only with the IRS. It includes a Schedule A that is to be given to each respective beneficiary (like a K-1), as well as to the IRS.

(a) With respect to the biggest problem with the reporting deadline – namely, that executors, especially of estates large enough to be required to file an estate tax return, will not know just one month after filing the estate tax return which beneficiaries will receive which assets – Schedule A of Form 8971 states (emphasis in original):

> **Notice to Beneficiaries:**
>
> You have received this schedule to inform you of the value of property you received from the estate of the decedent named above. **Retain this schedule for tax reporting purposes.** If the property increased the estate tax liability, Internal Revenue Code section 1014(f) applies, requiring the consistent reporting of basis information. For more information on determining basis, see IRC section 1014 and/or consult a tax professional.

(b) The Instructions to Form 8971 candidly state (emphasis added):

> All property acquired (*or expected to be acquired*) by a beneficiary must be listed on that beneficiary's Schedule A. If the executor hasn't determined which beneficiary is to receive an item of property as of the due date of the Form 8971 and Schedule(s) A, *the executor must list all items of property that could be used, in whole or in part, to fund the beneficiary's distribution* on that beneficiary's Schedule A. (*This means that the same property may be reflected on more than one Schedule A.*) A supplemental Form 8971 and corresponding Schedule(s) A may, but aren't required to, be filed once the distribution to each such beneficiary has been made.

(c) It is striking that the Instructions refer to property "expected to be acquired" while Schedule A refers to "property you received." This interchangeability of "acquired" and "received" could have been used as the basis for regulations that construed the requirement to file Form

8971 to apply only when property had been distributed by the estate or otherwise "received." See Part 4.b(10)(b)i below.

(9) Certain regulations were explicitly contemplated and authorized by the statute.

(a) Section 1014(f)(4) states that "[t]he Secretary may by regulations provide exceptions to the application of this subsection."

(b) Section 6035(b) states that "[t]he Secretary shall prescribe such regulations as necessary to carry out this section, including regulations relating to (1) the application of this section to property with regard to which no estate tax return is required to be filed, and (2) situations in which the surviving joint tenant or other recipient may have better information than the executor regarding the basis or fair market value of the property."

(10) Proposed regulations were released on March 2, 2016. Proposed Reg. §§1.1014-10 & 1.6035-1 (REG-127923-15).

(a) The proposed regulations provided some welcome, albeit modest, clarifications.

i. Only the "initial" basis of property received from a decedent would be subject to these rules. Proposed Reg. §1.1014-10(a)(1). Subsequent authorized adjustments are not precluded. Proposed Reg. §§1.1014-10(a)(2) & 1.6662-8(b).

ii. The consistency rules would not apply to 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." Proposed Reg. §1.1014-10(b)(2). Such assets will rarely be sold at a gain, and any loss on a sale of such personal property would be nondeductible in any event.

iii. In addition to such tangible personal property, Proposed Reg. §1.6035-1(b)(1) would exclude from the Form 8971 reporting requirement:

a. cash (other than a coin collection or other coins or bills with numismatic value), which ordinarily has no basis apart from its face amount anyway;

b. income in respect of a decedent, which ordinarily would be reported as such on the beneficiary's income tax return anyway; and

c. property that is sold (and therefore not distributed to a beneficiary) in a transaction in which capital gain or loss is recognized, which ordinarily would therefore be reported as a taxable sale on the fiduciary's income tax return anyway.

iv. The term "executor" is given its usual expanded meaning in section 2203. Proposed Reg. §1.1014-10(d).

v. Form 8971 would not be required if the estate tax return was not required for **estate tax** purposes and was filed solely to make a portability election ("notwithstanding §20.2010-2(a)(1)") or a GST tax election or exemption allocation. Proposed Reg. §1.6035-1(a)(2).

vi. If a beneficiary is a trust, estate, or business entity, Form 8971 would be furnished only to the entity and not to its beneficiaries or owners. Proposed Reg. §1.6035-1(c)(2).

vii. An executor could state on Form 8971 that a beneficiary cannot be located, although the executor must also state the efforts taken to locate the beneficiary. Proposed Reg. §1.6035-1(c)(4).

viii. A supplemental Form 8971 to report a change in value or otherwise correct or complete information on an original Form 8971 would not be required to be filed until 30 days after the property is distributed. Proposed Reg. §1.6035-1(e)(4)(ii). (That, of course, should have been acknowledged as the appropriate occasion for **any** reporting under section 6035. See paragraph (8) above.)

ix. Indeed, a supplemental Form 8971 is not needed at all merely to report a distribution of property if a previous Form 8971 included that property as property that *might* be used to

satisfy the beneficiary's interest. Proposed Reg. §1.6035-1(e)(3)(i)(B) & (ii), *Examples 1 & 2*.

(b) The proposed regulations also included some surprising or disappointing features.

i. Echoing the Form 8971 Instructions, Proposed Reg. §1.6035-1(c)(3) states:

> If, by the due date [of Form 8971], 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.

This is asserted even though a beneficiary who has not yet received (and may never receive) the property has no use for basis information and providing such information serves no discernable purpose of section 1014(f), and even though, like the Instructions, the preamble to the proposed regulations refers to "each beneficiary who has acquired (**or will acquire**) property from the decedent" and the statutory requirement of section 6035(a)(1) itself attaches only "to each person **acquiring** any interest in property." It seems that the regulations could have carried that linguistic comparison to its logical conclusion by requiring Form 8971 and Schedule A only with respect to property that is distributed – in other words, "received" – or "acquired." In that case, section 6035(a)(3) would be construed to require reporting for property **passing upon death or distributed before its value is reported on an estate tax return** within 30 days after the estate tax return is filed, whereas property **distributed after the estate tax return is filed** would be reported on a supplemented Form 8971 and Schedule A within 30 days after the distribution or perhaps on a year-by-year basis. That would be a much more workable rule.

ii. 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 (thus including all property and omissions discovered after the statute runs) would be given a value, and therefore an initial basis, of zero. Proposed Reg. §1.1014-10(c)(3)(i)(B). Moreover, 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 would be considered to be zero. Proposed Reg. §1.1014-10(c)(3)(ii). **Thus, a very innocent omission by the executor could result in a very harsh penalty for beneficiaries. The statutory support for these zero basis rules is very questionable, because such property appears to be 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).**

iii. Proposed Reg. §1.6035-1(f) would impose a seemingly open-ended requirement on 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. The preamble again cites the regulatory authority granted in section 6035(b)(2) and also a concern "that opportunities may exist in some circumstances for the recipient of such reporting to circumvent the purpose of the statute (for example, by making a gift of the property to a complex trust for the benefit of the transferor's family)." While such property does indeed continue to have a basis determined in part with reference to the value at the time of someone's death in the past, section 6035 imposes the reporting requirement only on an "executor," and section 1014(a) itself applies only to property acquired "from a decedent," creating great doubt about the statutory authority for Proposed Reg. §1.6035-1(f), especially when one of the explicit changes Congress made to Treasury's Greenbook proposal was to apply it only to transfers at death, not to lifetime gifts.

iv. The Greenbook proposals since 2009 explicitly contemplated a grant of regulatory authority "for situations in which the surviving joint tenant or other recipient may have

better information than the executor." Congress seems to have captured that notion in section 6035(b)(2). Some observers read this as authorizing Treasury to relieve the tension between an executor and beneficiaries that a strict consistency rule might otherwise create by permitting beneficiaries to prove a higher value in some cases.

a. In the preamble to the proposed regulations, Treasury recites that regulatory authority in section 6035(b)(2), but construes it in effect to apply only to a person with a legal or beneficial interest in property who is required to file an estate tax return under section 6018(b) in some cases.

b. In addition, the preamble to the proposed regulations states:

> One commenter requested the creation of a process to allow an estate beneficiary to challenge the value reported by the executor. There is no such process under the Federal law regarding returns described in section 6018. The beneficiary's rights with regard to the estate tax valuation of property are governed by applicable state law. Accordingly, the proposed regulations do not create a new Federal process for challenging the value reported by the executor.

In other words, the preamble not only confirms the potential for these rules to create tension within families (see paragraph (11) below), it documents Treasury's indifference to it.

(c) A public hearing on the proposed regulations was held on June 27, 2016, and most of the foregoing points were made.

(11) But no administrative guidance will or can address what many observers consider the fundamental flaw of the statute – it has the potential, especially when an estate tax return is audited, to pit family members and other beneficiaries against each other in an intolerable tension.

(a) The *Van Alen* opinion itself, discussed in paragraph (4) above, reveals how mischievous a "consistency" requirement might be in this context.

(b) The court describes how the audit "went back and forth" and the low value of the ranch could have been a trade for higher values of three other properties. Indeed, the court said: "The bottom line was that the IRS got an increase in the total taxable value of the estate … and an increase in the estate tax" (although later the court said, with specific reference to the ranch, that "[b]oth Shana and Brett [the heirs], and their father's estate, benefited from a reduced estate tax."

(c) If the heirs benefited from the special use valuation, it was a coincidental detail that is affected by tax apportionment rules and other factors and may not be present in every estate. And, as *Van Alen* illustrates, executors often settle estate tax audits by trade-offs and for strategic reasons that could have nothing to do with an effort to find the "true" "fair market value" for purposes of section 1014(a)(1).

(d) To bind heirs who do not participate in that audit seems quite unfair, and to give the heirs a role in the audit would be monstrously impractical. Yet, enchanted by the Siren Song of "consistency" – not to mention the temptation of a conjectural revenue gain – Congress seems not to have thought this through.

(12) The 2016 Greenbook renewed the proposal of past Greenbooks to also apply the consistency rules to property qualifying for an estate tax marital deduction and to gifts reportable on a gift tax return.

(13) Executive Order 13789 of April 21, 2017, directed the identification of tax regulations issued on or after January 1, 2016, that (i) impose an undue financial burden on United States taxpayers, (ii) add undue complexity to the Federal tax laws, or (iii) exceed the statutory authority of the Internal Revenue Service, and the recommendation of specific actions to mitigate the burdens identified. Notice 2017-38, 2017-30 I.R.B. 147, identified eight regulations that meet at least one of the first two criteria specified by the Executive Order, including the proposed section 2704 regulations, but not including the consistent basis regulations.

(14) The Trump Administration Priority Guidance Plans suggested that Treasury and the IRS would revisit the proposed basis consistency regulations in the context of "burden reduction." The Office of Management and Budget's Unified Agenda of Regulatory and Deregulatory Actions confirmed that "[t]he final regulations will provide less burdensome guidance to taxpayers enabling them to satisfy the requirements of sections 1014(f) and 6035." In light of the surprising and unnecessarily burdensome requirements of the proposed regulations identified in paragraph (10)(b) above, this placement of the regulation project under "burden reduction" provided some encouragement that some or all of those requirements would be relaxed in the final regulations. Although the 2021-2022 Priority Guidance Plan does not have a separate "burden reduction" category, there is no reason to think that the civil servants in the Treasury Department and IRS would have changed their view. **Treasury and the IRS cannot undo the ill-advised statute, but they could apply the statute in a reasonable way to provide a more practical reporting date and could reconsider the zero-basis rule and continuous reporting requirement that the statute does not appear to authorize. That would in fact be "burden reduction."**

c. **Item 3: "Anti-Abuse" Amendment to the "Anti-Clawback" Regulations**

Item 3 is described as "Regulations under §2010 addressing whether gifts that are includible in the gross estate should be excepted from the special rule of § 20.2010-1(c)."

Regulations to prevent "clawback" were proposed in November 2018 (REG-106706-18, 83 Fed. Reg. 59343 (Nov. 23, 2018)) and finalized in November 2019. Although neither the statute nor the regulations use the word "clawback," the regulations carry out the mandate of the 2017 Tax Act in new section 2001(g)(2), which provides that Treasury

> 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 ["BEA"] 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.

(1) **The Problem Under the 2017 Tax Act.** The concern that prompted that mandate for regulations is that the remedy added in 2010 as subsection (g) (now paragraph (1) of subsection (g)) addressed only changes in tax **rates**, and the 2017 Tax Act did not change any rates when it **doubled the exclusion amount**. New paragraph (2) obviously contemplated that regulations would reach a similar result for the potential sunset of the doubled exclusion amount, but left the details to the IRS and Treasury.

(a) To illustrate the concern, assume that an unmarried individual made a **$9 million gift** (the donor's only lifetime gift) in 2019 when the indexed exclusion amount was $11.4 million. With no change in the law, the donor dies in 2026 with a **taxable estate of $20 million**. Assume further – just a guess, for the sake of simplicity – that the 2026 $5 million exclusion amount (indexed) is $6.8 million. With a 40 percent rate and the exclusion amount used up, the **intuitively correct estate tax** is 40 percent of $20 million, or **$8 million**. But, as illustrated in **the table below**, without anti-clawback relief the estate tax turns out to be **$8,880,000**, producing a **"clawback penalty" of $880,000**.

(b) Other ways to look at this $880,000 million are:

i. 40 percent of the amount by which the $9 million gift exceeded the $6.8 million date-of-death exclusion amount; or

ii. the gift tax on the gift if the gift had been made in 2026; or

iii. the additional estate tax on a taxable estate of $29 million **if the gift had not been made at all**.

In other words, **all the benefit the 2017 Tax Act apparently promised this donor for making a gift before the sunset would be wiped out by the sunset**.

(2) **The Solution Under Reg. §20.2010-1(c).** Pursuant to section 2001(g)(2) and corresponding guidance projects identified in the 2017-2018, 2018-2019, and 2019-2020 Treasury-IRS Priority Guidance Plans, proposed anti-clawback regulations were published in November 2018 (REG-

106706-18, 83 Fed. Reg. 59343, Nov. 23, 2018), and final regulations were released November 22, 2019 **(T.D. 9884, 84 Fed. Reg. 64995, Nov. 26, 2019)**. New Reg. §20.2010-1(c) (with the former paragraphs (c), (d), and (e) re-lettered (d), (e), and (f)) states the heart of the anti-clawback rule, applicable to the extent the credit is based on the basic exclusion amount (emphasis added):

> If the total of the **amounts allowable as a credit in computing the gift tax** payable on the decedent's post-1976 gifts … **exceeds** the credit allowable within the meaning of section 2010(a) in computing the estate tax, … then the portion of the credit allowable in computing the estate tax on the decedent's taxable estate … is **the sum of the amounts … allowable as a credit in computing the gift tax payable** on the decedent's post-1976 gifts.

In other words, in the example above (which has the same facts as Example 1 in the regulations), because $9 million of basic exclusion amount used for the 2019 gift (the only post-1976 lifetime gift) is greater than the $6.8 million basic exclusion amount otherwise allowable in computing the 2026 estate tax, that larger amount of $9 million is used for estate tax purposes instead of the $6.8 million. (This is simplified for the sake of readability; technically, the credits based on the exclusion amounts are compared under the regulation.) The elimination of the clawback penalty under that rule is illustrated in the following table, by changing the entry on line 9a from $6.8 million (the 2026 basic exclusion amount) to $9 million (the amount of the 2019 basic exclusion amount used for computing the gift tax).

Calculation of the Estate Tax with and without Clawback
Using the Estate Tax Return, Form 706 (August 2019) as a Template

Line		Illustrating Clawback	Under Reg. §20.2010-1(c)*
3c	Taxable estate	20,000,000	20,000,000
4	Adjusted taxable gifts	9,000,000	9,000,000
5	Add lines 3c and 4	29,000,000	29,000,000
6	Tentative tax on the amount on line 5	11,545,800	11,545,800
7	Total gift tax paid or payable	0	0
8	Gross estate tax	11,545,800	11,545,800
9a	**Basic exclusion amount**	**6,800,000**	*** 9,000,000**
9b	DSUE amount [not applicable]	0	0
9c	Restored exclusion amount [not applicable]	0	0
9d	Applicable exclusion amount (add lines 9a, 9b, and 9c)	6,800,000	9,000,000
9e	Allowable credit amount (tentative tax on line 9d)	2,665,800	3,545,800
10	Adjustment [not applicable]	0	0
11	Allowable applicable credit amount	2,665,800	3,545,800
12	Subtract line 11 from line 8	8,880,000	8,000,000
16	Net estate tax [same as line 12 in this case]	8,880,000	8,000,000
	Intuitively correct tax	8,000,000	8,000,000
	Clawback penalty	880,000	0

(3) **Comment on This Approach**

(a) The approach of the 2010 explicit statutory anti-clawback rule in section 2001(g)(1) – specifically section 2001(g)(1)(A) – was that the rates in effect at the time of death would be used to calculate the hypothetical "tax imposed by chapter 12" on pre-2026 adjusted taxable gifts – in other words, the "total gift tax paid or payable" that is deducted on line 7 of the return. Before the proposed regulations were released, therefore, there was speculation that the regulations under section 2001(g)(2) would mirror the regulations under section 2001(g)(1) and provide (using the above table as an example) that line 7 would be changed from zero to $880,000 (which is what the 2019 gift tax would have been if 2026 law had applied in 2019).

After subtracting that amount, line 8, and therefore line 12, would be $880,000 smaller, which would exactly eliminate the clawback penalty.

(b) But the regulations take a different approach. The preamble to the proposed regulations implies that other approaches were considered, but concludes that "in the view of the Treasury Department and the IRS, the most administrable solution would be to adjust the amount of the credit in … the estate tax determination required to be applied against the net tentative estate tax."

(c) By increasing the amount on line 9a, rather than the amount on line 7, the regulations achieve the same result, of course, because both line 7 and line 9a are subtractions in the estate tax calculation. But line 7 already required two pages of instructions, including a 24-line worksheet, to complete. An incremental increase of complexity in what already had a reputation for being a challenge might have been easier to process than adding a new challenge to line 9a, which previously required only 21 words of instructions. Needless to say, IRS personnel see more returns than any member of the public does, they see the mistakes, and they hear the complaints. Presumably – hopefully – they contributed to the assessment that the line 9a approach is "the most administrable solution."

(d) That approach should work fine if the law is not changed and sunset occurs January 1, 2026 (or 2022). But, although the examples in Reg. §20.2010-1(c)(2) assume that the donor's "date of death is after 2025," the substantive rule in Reg. §20.2010-1(c) applies by its terms whenever "changes in the basic exclusion amount … occur between the date of a donor's gift and the date of the donor's death." It is not limited to 2026 or to any other particular time period. The 2010 statutory rule in section 2001(g)(1) and the 2017 statutory rule in section 2001(g)(2) are not limited to any time period either. Therefore, if Congress makes other changes in the law, particularly increases in rates or decreases in exemptions, and doesn't focus on the potential clawback issue in the context of those changes, the generic anti-clawback regime of section 2001(g)(1) and (2) and these regulations could produce a jigsaw puzzle of adjustments going different directions that may strain the notion of administrability cited in the preamble.

(4) **The "Off the Top" Option.** There had also been speculation that the regulations might address the option of making, for example, a $5 million gift during the 2018-2025 period (assuming no previous taxable gifts) and treating that gift as using only the temporary "bonus" exclusion resulting from the 2017 Tax Act, which is sometimes described as using the exclusion "off the top," still leaving the exclusion of $5 million (indexed) to generate a credit to be used against the estate tax after 2025. Example 2 was added to the final regulations to illustrate what the preamble to the final regulations acknowledges is the **"use or lose"** nature of the doubled exclusion amount when a donor uses some but not all of the exclusion amount available from 2018 through 2025.

(5) **Preservation of Portability Elections**

(a) The text of the regulations and the examples (particularly the original Example (1) of the proposed regulations) are painstakingly limited in all cases to the amount of the credit that is attributable to the basic exclusion amount – that is, the amount (indexed since 2012) defined in section 2010(c)(3). Regarding portability, for example, that approach makes it clear that the deceased spousal unused exclusion amount (DSUE amount) defined in section 2010(c)(4) is not affected by this special rule and is still added under section 2010(c)(2)(B), in effect thereby generating an additional credit of its own in cases in which the anti-clawback rule applies. But the proposed regulations still left open the possibility that the words "lesser of" in section 2010(c)(4) would limit the DSUE amount after 2025 (assuming no change in the law) to the sunsetted basic exclusion amount of $5,000,000 indexed for inflation in effect at the time of the death of the surviving spouse referred to in section 2010(c)(4)(A), despite the assertion in Reg. §20.2010-2(c)(1) that "the DSUE amount of a decedent with a surviving spouse is the lesser of the following amounts – (i) The basic exclusion amount in effect in the year of the death of the decedent" (presumably the predeceased spouse), and despite the

statement in the preamble to the June 2012 temporary regulations that "the temporary regulations in § 20.2010-2T(c)(1)(i) confirm that the term 'basic exclusion amount' referred to in section 2010(c)(4)(A) means the basic exclusion amount in effect in the year of the death of the decedent whose DSUE amount is being computed." The limiting words "lesser of" in section 2010(c)(4) reflect the notion held by congressional drafters that portability should not be allowed to more than double what would otherwise be the survivor's exemption, although that limitation might be viewed as unfair and inapplicable in the case of a predeceased spouse whose estate plan and executor's election forgo the immediate use of the larger exemption allowed before 2026.

(b) In that light, it is not particularly reassuring, standing alone, that the preamble to the final regulations stated:

> The regulations in §§ 20.2010-1(d)(4) and 20.2010-2(c)(1) confirm that the reference to BEA is to the BEA in effect at the time of the deceased spouse's death, rather than the BEA in effect at the death of the surviving spouse.

or even that the preamble to the 2012 temporary regulations (T.D. 9593) rather logically explained:

> The temporary regulations in § 20.2010-2T(c)(1)(i) confirm that the term "basic exclusion amount" referred to in section 2010(c)(4)(A) means the basic exclusion amount in effect in the year of the death of the decedent whose DSUE amount is being computed. Generally, only the basic exclusion amount of the decedent, as in effect in the year of the decedent's death, will be known at the time the DSUE amount must be computed and reported on the decedent's estate tax return. Because section 2010(c)(5)(A) requires the executor of an estate electing portability to compute and report the DSUE amount on a timely-filed estate tax return, and because the basic exclusion amount is integral to this computation, the term "basic exclusion amount" in section 2010(c)(4)(A) necessarily refers to such decedent's basic exclusion amount.

What is helpful and reassuring is that the final regulations themselves (not just the preamble) add Examples (3) and (4), which illustrate scenarios where a DSUE amount from a predeceased spouse who dies before 2026 is applied to the surviving spouse's gifts before 2026 and to the calculation of the estate tax when the surviving spouse dies after 2025.

(6) **A Possibly Surprising Collateral Result.** If large amounts of the increased credit attributable to the new doubled basic exclusion amount are used to shelter gifts from gift tax before 2026 (like the $9 million gift in the example), then after 2025 the donor might have to wait for many years or even decades for the indexed $5 million amount to catch up so there can be more credit available for gift tax purposes.

(7) **An Anti-Abuse Warning**

(a) Finally, the preamble to the final regulations adds:

> 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 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.

(b) The commenter the preamble cites is the Tax Section of the New York State Bar Association, in its February 20, 2019, letter to Treasury and the IRS available at **https://nysba.org/NYSBA/Sections/Tax/Tax%20Section%20Reports/Tax%20Section%20Reports%202019/1410%20Report.pdf**.

(c) For an in-depth discussion of this issue, see Lynagh, *Potential Anti-Abuse Rules May Limit Use of the Temporarily Increased Gift Tax Exclusion*, 45 Tax Mgmt. Est., Gifts & Tr. J. 183 (May 14, 2020).

(d) To illustrate the circumstances in which such an anti-abuse rule might apply, consider again the example above, a $9 million gift in 2019 and an otherwise taxable estate of $20 million and basic exclusion amount of $6.8 million in 2026, except that the gift is of such nature that the value of the property is included in the donor's gross estate under, for example, section 2036, thereby making the taxable estate $29 million (assuming no intervening change in value). In that case, the **intuitively correct estate tax** seems to be the tax on a taxable estate of $29 million, which is **$8,880,000** (as shown under "Illustrating Clawback" in the above table, calculated on the tax base of $29,000,000 on line 3 after adding adjusted taxable gifts in that case). Two ways of computing that are:

i. $11,545,800 (the tax on $29,000,000 under the section 2001(c) rate schedule) minus $2,665,800 (the applicable credit amount, which is the tax on the applicable exclusion amount of $6,800,000 under the section 2001(c) rate schedule) = $8,800,000, or

ii. 40% times (the taxable estate of $29,000,000 minus the applicable exclusion amount of $6,800,000) = 0.4 × $22,200,000 = $8,800,000.

Thus, application of the anti-clawback calculation in this case would not eliminate an $880,000 clawback penalty, it would in effect produce an $880,000 bonus, as the following table indicates.

Calculation of the Estate Tax with and Without the Anti-Clawback Regulations Again Using the Estate Tax Return, Form 706 (August 2019) as a Template

Line		Without Reg. §20.2010-1(c)	Under Reg. §20.2010-1(c)*
3c	Taxable estate	29,000,000	29,000,000
4	Adjusted taxable gifts	0	0
5	Add lines 3c and 4	29,000,000	29,000,000
6	Tentative tax on the amount on line 5	11,545,800	11,545,800
7	Total gift tax paid or payable	0	0
8	Gross estate tax	11,545,800	11,545,800
9a	**Basic exclusion amount**	**6,800,000**	*** 9,000,000**
9b	DSUE amount [not applicable]	0	0
9c	Restored exclusion amount [not applicable]	0	0
9d	Applicable exclusion amount (add lines 9a, 9b, and 9c)	6,800,000	9,000,000
9e	Allowable credit amount (tentative tax on line 9d)	2,665,800	3,545,800
10	Adjustment [not applicable]	0	0
11	Allowable applicable credit amount	2,665,800	3,545,800
12	Subtract line 11 from line 8	8,880,000	8,000,000
16	Net estate tax [same as line 12 in this case]	8,880,000	8,000,000
	Intuitively correct tax	8,880,000	8,880,000
	Unintended anti-clawback bonus	0	880,000

That "bonus" is probably what has prompted the IRS and Treasury to consider an "anti-abuse provision," and probably what such an amendment would curtail. Put another way, it would simply preserve the "clawback," in effect, that provisions like section 2036 have been **designed** to achieve since at least the 1930s.

(8) **Effective Date.** It is likely that the contemplated amendment of the regulations would apply only prospectively – that is, after the date it is published as a final regulation. But it should also be

noted that it would apply only to the calculation of the estate tax when a provision like section 2036 (including those in chapter 14) applies. Thus, it should be expected to first apply to the estate of someone who dies after December 31, 2025 (or 2021), when the "sunset" enacted in 2017 occurs, Thus, it would achieve the "anti-abuse" outcome described above with respect to gifts made and other lifetime actions taken since 2017 that result in estate includability, whether or not those actions are taken before the regulations are amended.

The proposal in the House of Representatives (see Part 2.b(2) above) to accelerate the "sunset" to January 1, 2022, could mean that, unless the "anti-abuse" regulations are issued before the end of 2021 (which is possible but by no means certain), some persons who have made post-2017 gifts with potential for inclusion in the gross estate will die before the regulations are effective. Those persons' estates might benefit from the anti-clawback bonus. Or the regulations might provide for retroactive application to their estates, which is sometimes done in true "abuse" cases. Such planning after December 31, 2017, by persons who die after December 31, 2021, and after the regulations are final would be caught in any event.

d. **Item 4: Effect of Events Between Death and the Alternate Valuation Date**

(1) Item 4 is described as "Regulations under §2032(a) regarding imposition of restrictions on estate assets during the six-month alternate valuation period. Proposed regulations were published on November 18, 2011." This project first appeared in the 2007-2008 Plan.

(2) The first set of proposed regulations related to this project, Proposed Reg. §20.2032-1(f) (REG-112196-07), was published on April 25, 2008. The preamble appeared to view these regulations as the resolution of "[t]wo judicial decisions [that] have interpreted the language of section 2032 and its legislative history differently in determining whether post-death events other than market conditions may be taken into account under the alternate valuation method."

(3) In the first of these cases, *Flanders v. United States*, 347 F. Supp. 95 (N.D. Calif. 1972), after a decedent's death in 1968, but before the alternate valuation date, the trustee of the decedent's (formerly) revocable trust, which held a one-half interest in a California ranch, entered into a land conservation agreement pursuant to California law.

(a) The conservation agreement reduced the value of the ranch by 88 percent. Since that reduced value was the value of the ranch at the alternate valuation date (which until 1971 was one year after death), the executor elected alternate valuation and reported the ranch at that value.

(b) Citing the Depression-era legislative history to the effect that alternate valuation was intended to protect decedents' estates against "many of the hardships which were experienced after 1929 when market values decreased very materially between the period from the date of death and the date of distribution to the beneficiaries," the court held that "the value reducing result of the post mortem act of the surviving trustee" may not be considered in applying alternate valuation.

(4) The second of these cases was *Kohler v. Commissioner*, T.C. Memo. 2006-152, *nonacq.*, 2008-9 I.R.B. 481, involving the estate of a shareholder of the well-known family-owned plumbing fixture manufacturer. The executor had received stock in a tax-free corporate reorganization that had been under consideration for about two years before the decedent's death but was not completed until about two months after the decedent's death.

(a) The court rejected the IRS's attempt to base the estate tax on the value of the stock *surrendered* in the reorganization (which had been subject to fewer restrictions on transferability), on the ground that Reg. §20.2032-1(c)(1) prevents that result by specifically refusing to treat stock surrendered in a tax-free reorganization as "otherwise disposed of" for purposes of section 2032(a)(1).

(b) The court also noted that the exchange of stock must have been for equal value or the reorganization would not have been tax-free as the parties had stipulated (although, ironically, the executor's own appraiser had determined a value of the pre-reorganization shares of

$50.115 million and a value of the post-reorganization shares of $47.010 million – a difference of about 6.2 percent). The court distinguished *Flanders*, where the post-death transaction itself reduced the value by 88 percent.

(c) The Tax Court in *Kohler* viewed the 1935 legislative history relied on in *Flanders* as irrelevant, because Reg. §20.2032-1(c)(1) (promulgated in 1958) was clear and unambiguous and because "the legislative history describes the general purpose of the statute, not the specific meaning of 'otherwise disposed of' in the context of tax-free reorganizations."

(5) The 2008 proposed regulations would have made no change to Reg. §20.2032-1(c)(1), on which the *Kohler* court relied. But they invoked "the general purpose of the statute" that was articulated in 1935, relied on in *Flanders* but bypassed in *Kohler*, to beef up Reg. §20.2032-1(f) and to clarify and emphasize, with both text and examples, that the benefits of alternate valuation are limited to changes in value due to "market conditions." The 2008 proposed regulations would specifically add "post-death events other than market conditions" to changes in value resulting from the "mere lapse of time," which are ignored in determining the alternate value under section 2032(a)(3).

(6) New proposed regulations (REG-112196-07) were published on November 18, 2011. The preamble stated:

> … Some commentators expressed concern that the proposed regulations (73 FR 22300) would create administrative problems because an estate would be required to trace property and to obtain appraisals based on hypothetical property.…
>
> …
>
> Many commentators … suggested that the IRS and Treasury Department would better serve taxpayers and address any potential abuse [of the section 2032 election] by ensuring that the regulations address the issues described in this preamble rather than finalizing the approach taken in the proposed regulations.
>
> In view of the comments, the Treasury Department and the IRS are withdrawing the proposed regulations (73 FR 22300) by the publication of these proposed regulations in the Federal Register.

(7) In contrast to the 2008 approach of ignoring certain intervening events – and thereby potentially valuing assets six months after death on a hypothetical basis – the new approach is to expand the description of intervening events that are regarding as dispositions, triggering alternate valuation as of that date. The expanded list, in Proposed Reg. §20.2032-1(c)(1)(i), includes distributions, exchanges (whether taxable or not), and contributions to capital or other changes to the capital structure or ownership of an entity, including "[t]he dilution of the decedent's ownership interest in the entity due to the issuance of additional ownership interests in the entity." Proposed Reg. §20.2032-1(c)(1)(i)(I)(*1*). But under Proposed Reg. §20.2032-1(c)(1)(ii), an exchange of interests in a corporation, partnership, or other entity is not counted if the fair market values of the interests before and after the exchange differ by no more than 5 percent (which would still subject a 6.2 percent difference as in *Kohler* to the new rules).

(a) If the interest involved is only a fraction of the decedent's total interest, an aggregation rule in Proposed Reg. §20.2032-1(c)(1)(iv) values such interests at a pro rata share of the decedent's total interest.

(b) The proposed regulations also include special rules for coordinating with annuities and similar payments (§20.2032-1(c)(1)(iii)(B)) and excepting qualified conservation easements (§20.2032-1(c)(4)), and also many more examples (§20.2032-1(c)(5), (e) *Example (2)*, (f)(2)(B) & (f)(3)).

(8) While the 2008 proposed regulations were referred to as the "anti-*Kohler* regulations," the most significant impact of these proposed regulations may fall on efforts to bootstrap an estate into a valuation discount by distributing or otherwise disposing of a minority or other noncontrolling interest within the six-month period after death (valuing it as a minority interest under section 2032(a)(1)) and leaving another minority or noncontrolling interest to be valued six months after death (also valued as a minority interest under section 2032(a)(2)).

(a) Examples 7 and 8 of Proposed Reg. §20.2032-1(c)(5) specifically address the discount-bootstrap technique – Example 8 in the context of a limited liability company and Example 7 in the context of real estate – and leave no doubt that changes in value due to "market conditions" do not include the valuation discounts that might appear to be created by partial distributions.

(b) And perhaps most significantly, Example 1 reaches the same result with respect to the post-death formation of a limited partnership.

(9) The Office of Management and Budget's Spring 2020 Unified Agenda of Regulatory and Deregulatory Actions, released on June 30, 2020, offered the following concise summary of the scope of the proposed regulations:

> In cases where section 2032 election has been made, the regulations would provide guidance on: (1) The effect of certain post-death transactions on assets includible in the decedent's gross estate; (2) the treatment of assets the title to which is transferred at death by contract; (3) the determination of the portion of trusts in which the decedent retained an interest that are includible in the decedent's gross estate under section 2036; (4) the effect of the grant of a qualified conservation easement under section 2031(c) during the 6-month period after the date of death; and (5) the types of factors, the impact of which affect the fair market value of assets includible in the decedent's gross estate, that will be recognized under section 2032.

(10) The 2008 proposed regulations were to be effective April 25, 2008, the date the proposed regulations were published. The 2011 proposed regulations, more traditionally, state that they will be effective when published as final regulations.

e. **Item 5: Effect of Guarantees and Present Value Concepts on Estate Tax Deductions**

(1) Item 5 is described as "Regulations under §2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate."

(2) This project first appeared in the 2008-2009 Plan as an outgrowth of the project that led to the final amendments of the section 2053 regulations in October 2009. The significance of present value concepts is elaborated in this paragraph in the preamble to the 2009 regulations (T.D. 9468, 74 Fed. Reg. 53652 (Oct. 20, 2009)):

> Some commentators suggested that the disparate treatment afforded noncontingent obligations (deduction for present value of obligations) versus contingent obligations (dollar-for-dollar deduction as paid) is inequitable and produces an inconsistent result without meaningful justification. These commentators requested that the final regulations allow an estate to choose between deducting the present value of a noncontingent recurring payment on the estate tax return, or instead deducting the amounts paid in the same manner as provided for a contingent obligation (after filing an appropriate protective claim for refund). The Treasury Department and the IRS find the arguments against the disparate treatment of noncontingent and contingent obligations to be persuasive. The final regulations eliminate the disparate treatment by removing the present value limitation applicable only to noncontingent recurring payments. The Treasury Department and the IRS believe that the issue of the appropriate use of present value in determining the amount of the deduction allowable under section 2053 merits further consideration. The final regulations reserve § 20.2053-1(d)(6) to provide future guidance on this issue.

(3) But it is easy to see how the Treasury Department's and the IRS's "further consideration" of "the appropriate use of present value concepts" could turn their focus to the leveraged benefit in general that can be obtained when a claim or expense is paid long after the due date of the estate tax, but the additional estate tax reduction is credited as of, and earns interest from, that due date.

(a) *Graegin* loans (see *Estate of Graegin v. Commissioner*, T.C. Memo. 1988-477) could be an obvious target of such consideration.

(b) If this project results in a deduction of only the present value of the payment, as of the due date of the tax, *and* the discount rate used in the calculation of the present value is the same as the rate of interest on the tax refund, *and* the interest is not subject to income tax (or the discount rate is also reduced by the income tax rate), then the invocation of "present value

concepts" might make very little difference on paper. But it might require legislation to accomplish all these things.

(c) Since claims or expenses are rarely paid exactly on the due date of the tax, the *precise* application of such principles might be exceedingly complicated.

f. **Items 6 and 7: Allocation of GST Exemption**

(1) Item 6 is described as "Regulations under §2632 providing guidance governing the allocation of generation-skipping transfer (GST) exemption in the event the IRS grants relief under §2642(g), as well as addressing the definition of a GST trust under §2632(c), and providing ordering rules when GST exemption is allocated in excess of the transferor's remaining exemption."

(a) It is the only new item under the heading of "Gifts and Estates and Trusts" in the 2021-2022 Plan.

(b) It is evidently related to Item 7 and is intended to address not only the consequences of the relief described in Item 7 but also, as the description says, the definition of a "GST trust" and ordering rules when too much GST exemption is ostensibly allocated.

(2) Item 7 is described as "Final regulations under §2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption." This project first appeared in the 2007-2008 Plan.

(3) The background of this project is section 564(a) of the 2001 Tax Act, which added subsection (g)(1) to section 2642, directing Treasury to publish regulations providing for extensions of time to allocate GST exemption or to elect out of statutory allocations of GST exemption (when those actions are missed on the applicable return or a return is not filed).

(a) Before the 2001 Tax Act, similar extensions of time under Reg. §301.9100-3 (so-called "9100 relief") were not available, because the deadlines for taking such actions were prescribed by the Code, not by the regulations.

(b) The legislative history of the 2001 Tax Act stated that "[n]o inference is intended with respect to the availability of relief from late elections prior to the effective date of [section 2642(g)(1)]," and section 2642(g)(1)(A) itself directs that the regulations published thereunder "shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of [section 2642(g)(1)]." Section 2642(g)(1)(B) adds:

> In determining whether to grant relief under this paragraph, the Secretary shall 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. For purposes of determining whether to grant relief under this paragraph, the time for making the allocation (or election) shall be treated as if not expressly prescribed by statute.

(c) Shortly after the enactment of the 2001 Tax Act, Notice 2001-50, 2001-2 C.B. 189, acknowledged section 2642(g)(1) and stated that taxpayers may seek extensions of time to take those actions under Reg. §301.9100-3. The Service has received and granted many requests for such relief over the years since the publication of Notice 2001-50.

(4) In addition, Rev. Proc. 2004-46, 2004-2 C.B. 142, provides a simplified method of dealing with pre-2001 gifts that meet the requirements of the annual gift tax exclusion under section 2503(b) but not the special "tax-vesting" requirements applicable for GST tax purposes to gifts in trust under section 2642(c)(2).

(a) Gifts subject to Crummey powers are an example.

(b) In such cases, GST exemption may be allocated on a Form 709 labeled "FILED PURSUANT TO REV. PROC. 2004-46," whether or not a Form 709 had previously been filed for that year.

(c) Post-2000 gifts are addressed by the expanded deemed allocation rules of section 2632(c), enacted by the 2001 Tax Act.

(5) Proposed Reg. §26.2642-7 (REG-147775-06) was released on April 16, 2008. When finalized, it will oust Reg. §301.9100-3 and become the exclusive basis for seeking the extensions of time Congress mandated in section 2642(g)(1) (except that the simplified procedure for dealing with pre-2001 annual exclusion gifts under Rev. Proc. 2004-46 will be retained).

(6) The proposed regulations resemble Reg. §301.9100-3, but with some important differences. Under Proposed Reg. §26.2642-7(d)(1), the general standard is still "that the transferor or the executor of the transferor's estate acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the Government."

(a) Proposed Reg. §26.2642-7(d)(2) sets forth a "nonexclusive list of factors" to determine whether the transferor or the executor of the transferor's estate acted reasonably and in good faith, including (i) the intent of the transferor to make a timely allocation or election, (ii) intervening events beyond the control of the transferor or the executor, (iii) lack of awareness of the need to allocate GST exemption to the transfer, despite the exercise of reasonable diligence, (iv) consistency by the transferor, and (v) reasonable reliance on the advice of a qualified tax professional.

(b) Proposed Reg. §26.2642-7(d)(3) sets forth a "nonexclusive list of factors" to determine whether the interests of the Government are prejudiced, including (i) the extent to which the request for relief is an effort to benefit from hindsight, (ii) the timing of the request for relief, and (iii) any intervening taxable termination or taxable distribution.

(c) Noticeably, the proposed regulations seem to invite more deliberate weighing of all those factors than the identification of one or two dispositive factors as under Reg. §301.9100-3.

(7) "Hindsight," which could be both a form of bad faith and a way the interests of the Government are prejudiced, seems to be a focus of the proposed regulations. This is probably explained by the obvious distinctive feature of the GST tax – its effects are felt for **generations**, in contrast to most "9100 relief" elections that affect only a current year or a few years. There simply is more opportunity for "hindsight" over such a long term. Thus, the greater rigor required by the proposed regulations seems to be justified by the nature of the GST tax and consistent with the mandate of section 2642(g)(1)(B) to "take into account all relevant circumstances."

(8) 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)."

(a) The references to "any aspect of the transfer" and "the trust" appear to go beyond the procedural requirement of Reg. §301.9100-3(e)(3) for "detailed affidavits from the individuals having knowledge or information about the events that led to the failure to make a valid regulatory election and to the discovery of the failure." Presumably, a professional who advised only with respect to "the transfer" or "the trust" would have nothing relevant to contribute other than a representation that they did not advise the transferor to make the election, a fact that the transferor's own affidavit could establish.

(b) Out of concern about returning to the supercharged "fall on your sword" days before the reformation of the 9100 rules reflected in Rev. Proc. 92-85, 1992-2 C.B. 490, the author of this outline recommended the relaxation of that requirement in a comment letter dated July 3, 2008.

(9) Section 2642(g)(1) itself, having been enacted by the 2001 Tax Act, was once scheduled to "sunset" on January 1, 2011, then on January 1, 2013, and is now permanent.

(10) These regulations ought to have been close to completion for a long time now.

(a) The current Item 7 last appeared in the 2015-2016 Plan. It was removed in the 2016-2017 Plan, perhaps so these regulations could be issued at the same time as the ETIP-related regulations envisioned by the project discussed in Part 4.i(5)(a) below. Or it might have been

thought that the consistent basis and section 2704 regulations alone may have kept Treasury and the IRS busy through June 2017, while most of the objectives of the section 2642(g) regulations were being served anyway by Reg. §301.9100-3.

(b) Then these regulations were revived in the 2017-2018 Plan as a "burden reduction" project. How can this be, when the proposed regulations would generally be more burdensome than Reg. §301.9100-3, which Notice 2001-50 now allows to be used? **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, especially with respect to the excessive requirements of affidavits.**

(c) Like the consistent basis regulations of Item 2 discussed in paragraph b above, there is no reason to assume that whatever "burden-reducing" changes Treasury and the IRS have had in mind would not continue to be their objective when finalizing these regulations, even though "burden reduction" has been dropped as a separate category of projects.

(11) In addition, Item 25 of the 2021-2022 Plan under the heading of "General Tax Issues" is described simply and broadly as "Guidance under §301.9100 regarding relief for late regulatory elections." Like the project aimed particularly at section 2642(g) elections, it appeared under the heading of "Burden Reduction" in the Priority Guidance Plans during the Trump Administration.

g. **Item 8: Taxation of Transfers from Certain Expatriates**

(1) Item 8 is described as "Final regulations under §2801 regarding the tax imposed on U.S. citizens and residents who receive gifts or bequests from certain expatriates. Proposed regulations were published on September 10, 2015." This project first appeared on the 2008-2009 Priority Guidance Plan, but was dropped from the Plans during the Trump Administration.

(2) The Heroes Earnings Assistance and Relief Tax Act of 2008 (the "HEART" Act) enacted a new income tax "mark to market" rule (section 877A) when someone expatriates on or after June 17, 2008, and a new succession tax on the receipt of certain gifts or bequests from someone who expatriated on or after June 17, 2008. The new succession tax is provided for in section 2801, comprising all of new chapter 15.

(3) Referring to the guidance contemplated by this project, Announcement 2009-57, 2009-29 I.R.B. 158 (released July 16, 2009), helpfully stated:

> The Internal Revenue Service intends to issue guidance under section 2801, as well as a new Form 708 on which to report the receipt of gifts and bequests subject to section 2801. The due date for reporting, and for paying any tax imposed on, the receipt of such gifts or bequests has not yet been determined. The due date will be contained in the guidance, and the guidance will provide a reasonable period of time between the date of issuance of the guidance and the date prescribed for the filing of the return and the payment of the tax.

Nevertheless, it seems likely that the longer it takes to finalize these regulations consistently with the June 17, 2008, effective date the harder it is going to be, and that the harder it is the longer it might take. A dilemma that has led some to think that this provision of the HEART Act will never take effect, and that Congress must intervene to provide a more workable approach.

(4) When this project first appeared on the 2008-2009 Plan, Treasury and IRS personnel referred to it as a top priority. Evidently the implementation of what amounts to a succession tax on transferees, not transferors or their estates, is quite complicated and challenging. Perhaps the current interest in broader deemed realization legislation (see Parts 1.c and 1.e above) has given this project new cause for optimism, or pessimism, as the case may be.

(5) The regulations proposed in 2015 (§§28.2801-1 through -7 and related procedural sections, REG-112997-10) are about 18,000 words long and were accompanied by a preamble of about 8,600 words. The preamble included the estimate that there would be 1,000 respondents annually.

(6) Proposed Reg. §28.6011-1(a) provides that "covered" gifts and bequests must be reported by the recipient on Form 708, "United States Return of Tax for Gifts and Bequests from Covered Expatriates."

(a) Under Proposed Reg. §28.6071-1(a)(1), Form 708 is generally due on the 15th day of the 18th month following the close of the calendar year in which the transfer was received. But, fulfilling the promise of Announcement 2009-57, Proposed Reg. §28.6071-1(d) states that no Form 708 will be due before the date specified in the final regulations.

(b) Under Proposed Reg. §28.2801-3(c)(1) and (2), if a gift or bequest is reported by the expatriate donor or executor of the expatriate decedent on a Form 709 or 706, and gift or estate tax is paid, it is not a covered gift or bequest and need not be reported on Form 708.

(7) Proposed Reg. §28.2801-3(b) confirms that covered bequests include the receipt of assets the value of which would be included in a U.S. citizen's gross estate under section 2036, 2037, 2038, 2040, 2042, or 2044.

(8) There are some oddities and surprises in the calculation of the tax.

(a) Under Proposed Reg. §28.2801-4(b)(2), the sum of both covered gifts and covered bequests is reduced by the annual exclusion amount provided for gift tax purposes under section 2503(b). But only one such reduction is allowed, regardless of the number of donors. In the case of a gift to a spouse who is not a U.S. citizen, that amount is determined under section 2523(i) (see Proposed Reg. §28.2801-3(c)(4) and -3(f), *Example 1*) and is 10 times the unrounded amount determined under section 2503(b).

(b) Under section 2801(b), the tax is an obligation of the recipient. Nevertheless, under the calculation rules in Proposed Reg. §28.2801-4(b), the gift tax the recipient pays is not deducted from the amount subject to tax, as it would be in the case of a typical "net gift." The section 2801 tax, whether on a gift or a bequest, is "tax-inclusive."

(c) Proposed Reg. §28.2801-4(a)(2)(iii) provides rules for computing the tax in the case of a covered transfer to a charitable remainder trust. The value of the transferred property is allocated between the noncharitable interest and the charitable remainder interest in the usual way and the tax is calculated on the noncharitable portion. Although the payment of the tax by the trust does not reduce the value of the gift for purposes of the calculation of the section 2801 tax (see paragraph (b) above), it does reduce the value of the charitable remainder and therefore might actually *increase* the value of the covered gift.

(d) Under Proposed Reg. §28.2801-6(a), the recipient's payment of the tax does not increase the basis of the transferred property.

(9) One of the most vexing issues regarding the section 2801 tax has been figuring out how the recipient will know when a gift or bequest is a "covered" gift or bequest from a "covered" expatriate. Gifts and bequests normally have no tax consequences to the recipient.

(a) Proposed Reg. §28.2801-7(a) provides this ominous and exasperating, but probably unavoidable, confirmation:

> (a) *Responsibility of recipients of gifts and bequests from expatriates*. It is the responsibility of the taxpayer (in this case, the U.S. citizen or resident receiving a gift or bequest from an expatriate or a distribution from a foreign trust funded at least in part by an expatriate) to ascertain the taxpayer's obligations under section 2801, which includes making the determination of whether the transferor is a covered expatriate and whether the transfer is a covered gift or covered bequest.

(b) Apparently doing the best it can to be helpful, Proposed Reg. §28.2801-7(b) adds:

> (b) *Disclosure of return and return information*—(1) *In general*. In certain circumstances, the Internal Revenue Service (IRS) may be permitted, upon request of a U.S. citizen or resident in receipt of a gift or bequest from an expatriate, to disclose to the U.S. citizen or resident return or return information of the donor or decedent expatriate that may assist the U.S. citizen or resident in determining whether the donor or decedent was a covered expatriate and whether the transfer was a covered gift or covered bequest. The U.S. citizen or resident may not rely upon this information, however, if the U.S. citizen or resident knows, or has reason to know, that the information received from the IRS is incorrect. The circumstances under which such information may be disclosed to a U.S. citizen or resident, and the procedures for requesting such information from the IRS, will be as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b)).

> (2) *Rebuttable presumption*. Unless a living donor expatriate authorizes the disclosure of his or her relevant return or return information to the U.S. citizen or resident receiving the gift, there is a rebuttable presumption that the donor is a covered expatriate and that the gift is a covered gift. A taxpayer who reasonably concludes that a gift or bequest is not subject to section 2801 may file a protective Form 708 in accordance with §28.6011-1(b) to start the period for the assessment of any section 2801 tax.

(c) The preamble further explains:

> Section 28.2801-7 provides guidance on the responsibility of a U.S. recipient, as defined in §28.2801-2(e), to determine if tax under section 2801 is due. The Treasury Department and the IRS realize that, because the tax imposed by this section is imposed on the U.S. citizen or resident receiving a covered gift or covered bequest, rather than on the donor or decedent covered expatriate making the gift or bequest, U.S. taxpayers may have difficulty determining whether they are liable for any tax under section 2801. Nevertheless, the same standard of due diligence that applies to any other taxpayer to determine whether the taxpayer has a tax liability or a filing requirement also applies to U.S. citizens and residents under this section. Accordingly, it is the responsibility of each U.S. citizen or resident receiving a gift or bequest, whether directly or indirectly, from an expatriate (as defined in section 877A(g)(2)) to determine its tax obligations under section 2801. Thus, the burden is on that U.S. citizen or resident to determine whether the expatriate was a covered expatriate (as defined in section 877A(g)(1)) and, if so, whether the gift or bequest was a covered gift or covered bequest.

(d) In other words, if a family member expatriates, life will be tougher for other family members (or any objects of the expatriate's bounty) who do not expatriate.

(e) Proposed Reg. §28.6011-1(b)(i) does provide that a recipient who reasonably concludes that a gift or bequest is not a "covered" gift or bequest may file a protective Form 708, and that such a filing will start the period for assessment of tax with respect to any transfer reported on that return.

(10) Section 2801(e)(1) provides that a "covered gift or bequest" includes any property acquired "directly or indirectly." Section 2801(e)(4)(A) provides that a covered transfer includes a transfer to a U.S. domestic trust. Section 2801(e)(4)(B)(i) provides that in the case of a covered gift or bequest to a foreign trust, the tax is imposed on distributions *from* the trust "attributable to such gift or bequest."

(a) Proposed Reg. §28.2801-5(c)(1)(i) provides that the amount of any distribution attributable to covered gifts and bequests is determined by applying a "section 2801 ratio" to the value of the distribution. Tracing of particular trust assets is not allowed.

(b) Under Proposed Reg. §28.2801-5(c)(1)(ii), the "section 2801 ratio," representing the portion of the trust and of each distribution that is deemed to be attributable to covered transfers, is redetermined after each contribution to the trust in a manner resembling the calculation of the inclusion ratio for GST tax purposes.

(c) Proposed Reg. §28.2801-5(c)(3) provides:

> If the trustee of the foreign trust does not have sufficient books and records to calculate the section 2801 ratio, or if the U.S. recipient is unable to obtain the necessary information with regard to the foreign trust, the U.S. recipient must proceed upon the assumption that the entire distribution for purposes of section 2801 is attributable to a covered gift or covered bequest.

This encourages the expatriate transferor to cooperate with transferees.

(d) Proposed Reg. §28.2801-5(d) permits a foreign trust to elect to be treated as a U.S. domestic trust.

i. Thereby the section 2801 tax is imposed on the value of the trust multiplied by the section 2801 ratio and on all current and future transfers to the trust from covered expatriates, but *not* on future distributions *from* the trust.

ii. The trustee of an electing foreign trust must designate and authorize a U.S. agent solely for purposes of section 2801. Proposed Reg. §28.2801-5(d)(3)(iv) states:

> By designating a U.S. agent, the trustee of the foreign trust agrees to provide the agent with all information necessary to comply with any information request or summons issued by the Secretary.

> Such information may include, without limitation, copies of the books and records of the trust, financial statements, and appraisals of trust property. … Acting as an agent for the trust for purposes of section 2801 includes serving as the electing foreign trust's agent for purposes of section 7602 ("Examination of books and witnesses"), section 7603 ("Service of summons"), and section 7604 ("Enforcement of summons") with respect to … [a]ny request by the Secretary to examine records or produce testimony related to the proper identification or treatment of covered gifts or covered bequests contributed to the electing foreign trust and distributions attributable to such contributions; and … [a]ny summons by the Secretary for records or testimony related to the proper identification or treatment of covered gifts or covered bequests contributed to the electing foreign trust and distributions attributable to such contributions.

Under such a rule, care would be advisable in agreeing to be a U.S. agent.

h. **Item 9: Actuarial Tables**

(1) Item 9 is described as "Regulations under §7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests." This item was new in the 2018-2019 Plan.

(2) The current mortality tables, based on 2000 census data, became effective May 1, 2009. Previous mortality tables had taken effect on May 1, 1989, and May 1, 1999. Section 7520(c)(2) mandates revision of the tables at least once every 10 years. This project is that routine revision, to reflect 2010 census data and to be effective as of May 1, 2019, even though it was not completed by that date.

(3) It is reasonable to assume that there will be transitional relief for taxpayers who, since May 1, 2019, have relied on the mortality tables that took effect May 1, 2009. Because the mortality tables have not been late before, there is no model for such transitional relief. But even the *timely* promulgation of the 2009 mortality tables provided two months of relief the preamble described as "certain transitional rules intended to alleviate any adverse consequences resulting from the proposed regulatory change." T.D. 9448, 74 Fed. Reg. 21438, 21439 (May 7, 2009). The preamble elaborated:

> For gift tax purposes, if the date of a transfer is on or after May 1, 2009, but before July 1, 2009, the donor may choose to determine the value of the gift (and/or any applicable charitable deduction) under tables based on either [the 1990 or 2000 census data]. Similarly, for estate tax purposes, if the decedent dies on or after May 1, 2009, but before July 1, 2009, the value of any interest (and/or any applicable charitable deduction) may be determined in the discretion of the decedent's executor under tables based on either [the 1990 or 2000 census data]. However, the section 7520 interest rate to be utilized is the appropriate rate for the month in which the valuation date occurs, subject to the … special rule [in section 7520(a)] for certain charitable transfers.

In other words, transitional relief may be provided with respect to the actuarial components of calculations based on mortality (life expectancy) tables, but not with respect to merely financial components such as applicable federal rates and the section 7520 rate, which have been published monthly as usual without interruption. For example, such transitional relief would apply to the calculations since May 1, 2019, of the values of an interest for life, an interest for joint lives, an interest for life or a term whichever is shorter or longer, or a remainder following such an interest. But no transitional relief would be necessary for calculations related to promissory notes or GRATs, for example, that involve only fixed terms without mortality components, which the new mortality tables would not affect.

i. **Notable Omissions from the Priority Guidance Plan**

(1) **Basis of Grantor Trust Assets Under Section 1014**

(a) A project described as "Guidance on basis of grantor trust assets at death under §1014" was new in 2015, but dropped in the 2021-2022 Plan

(b) In Letter Ruling 200434012 (April 23, 2004), involving a sale from one grantor trust to another, the Service included the caveat (emphasis added) that "when either Trust 1 or Trust 2 ceases to be treated as a trust owned by A under § 671 **by reason of A's death** or the waiver or release of any power under § 675, **no opinion is expressed or implied** concerning

whether the termination of such grantor trust treatment results in a sale or disposition of any property within the meaning of § 1001(a), **a change in the basis of any property** under § 1012 or § 1014, or any deductible administration expense under § 2053."

(c) An installment note received by the grantor from a grantor trust in connection with a sale to a grantor trust receives a new basis – presumably a stepped-up basis – under section 1014 when the grantor dies. The note is not an item of income in respect of a decedent ("IRD") under section 691, which would be excluded from the operation of section 1014 by section 1014(c), because the fact, amount, and character of IRD are all determined in the same manner as if "the decedent had lived and received such amount" (section 691(a)(3); *cf.* section 691(a)(1)), and the decedent would not have realized any income in that case, as confirmed by Rev. Rul. 85-13, 1985-1 C.B. 184). See the analysis in Manning & Hesch, "Deferred Payment Sales to Grantor Trusts, GRATs, and Net Gifts: Income and Transfer Tax Elements," 24 Tax Mgmt. Ests., Gifts & Tr. J. 3 (1999).

(d) Chief Counsel Advice 200923024 (Dec. 31, 2008) opined that "the Service should not take the position that the mere conversion of a nongrantor trust to a grantor trust [by reason of the replacement of an independent trustee with a related or subordinate party] results in taxable income to the grantor." After citing and discussing Reg. §1.1001-2(c), Example 5, *Madorin v. Commissioner*, 84 T.C. 667 (1985), and Rev. Rul. 77-402, 1977-2 C.B. 222 (which addressed the reverse conversion to nongrantor trust status), the Chief Counsel's office noted (emphasis added) that "the rule set forth in these authorities is narrow, insofar as it only affects inter vivos lapses of grantor trust status, not that caused by the death of the owner *which is generally not treated as an income tax event*." Because of the interrelationship with certain partnership transactions and section 754 basis elections, however, the Chief Counsel's office viewed the overall transaction as "abusive" and wanted to explore other ways to challenge it. But it nevertheless believed that "asserting that the conversion of a nongrantor trust to a grantor trust results in taxable income to the grantor would have an impact on non-abusive situations."

(e) This guidance project may somehow be related to the analytical gymnastics found in those authorities.

(f) On the other hand, this proposal may simply be aimed at a clarification of the rules for foreign trusts.

   i. Rev. Proc. 2015-37, 2015-26 I.R.B. 1196, added "[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 under chapter 11 of subtitle B of the Internal Revenue Code" to the list of "areas under study in which rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, a revenue procedure, regulations, or otherwise." That designation was continued in section 5.01(12) of Rev. Proc. 2016-3, 2016-1 I.R.B. 126, section 5.01(10) of Rev. Proc. 2017-3, 2017-1 I.R.B. 130, section 5.01(8) of Rev. Proc. 2018-3, 2018-1 I.R.B. 130, section 5.01(8) of Rev. Proc. 2019-3, 2019-1 I.R.B. 130, section 5.01(9) of Rev. Proc. 2020-3, 2020-1 I.R.B. 131, and section 5.01(11) of Rev. Proc. 2021-3, 2021-1 I.R.B. 140.

   ii. Meanwhile, Letter Ruling 201544002 (June 30, 2015), similar to Letter Ruling 201245006 (July 19, 2012), held that assets in a revocable trust created by foreign grantors for their U.S. citizen children would receive a stepped-up basis under section 1014(b)(2) at the grantors' deaths. The ruling acknowledged the no-rule policy of Rev. Proc. 2015-37, but avoided it on the ground that the ruling request had been submitted before the no-rule policy was announced.

   iii. It is hard to believe that it is a coincidence that Rev. Proc. 2015-37 was published in the Internal Revenue Bulletin on June 29, 2015, the *day before* Letter Ruling 201544002 was issued. If those two contemporaneous events are related, then the no-rule position of Rev. Procs. 2015-37, 2016-3, 2017-3, 2018-3, 2019-3, 2020-3, and 2021-3 might have

been aimed only at foreign trusts, and so might this proposal first announced in the 2015-2016 Priority Guidance Plan a month later on July 31, 2015.

(g) It is also possible that, even if the project originally had such a narrow focus, it was expanded in the Trump Administration. But this item apparently was not mentioned in the Office of Management and Budget's Spring 2020 Unified Agenda of Regulatory and Deregulatory Actions, which was released on June 30, 2020. In any event, it is now dropped, and there does not seem to be any reason to expect its revival.

(2) **Valuation of Promissory Notes**

(a) A project described as "Guidance on the valuation of promissory notes for transfer tax purposes under §§2031, 2033, 2512, and 7872" first appeared in the 2015-2016 Plan, but was dropped in the 2017-2018 Plan (the first Plan in the Trump Administration).

(b) This project was joined in the 2016-2017 Plan by an item under the subject of "Financial Institutions and Products" described as "Regulations under §7872. Proposed regulations were published on August 20, 1985." When the promissory notes project was dropped from the subject of "Gifts and Estates and Trusts" in the 2017-2018 Plan, that item under "Financial Institutions and Products" remained. It was carried over to the 2018-2019 Plan, but dropped from the 2019-2020 Plan.

(c) It is well known that the Tax Court has held that section 7872 is the applicable provision for valuing an intra-family promissory note – specifically for determining that a note carrying the section 7872 rate may be valued at its face amount. *See Frazee v. Commissioner*, 98 T.C. 554 (1992). *See also Estate of True v. Commissioner*, T.C. Memo. 2001-167, *aff'd on other grounds*, 390 F.3d 1210 (10th Cir. 2004).

(d) But Judge Hamblen concluded his opinion in *Frazee* by stating:

> We find it anomalous that respondent urges as her primary position the application of section 7872, which is more favorable to the taxpayer than the traditional fair market value approach, but we heartily welcome the concept.

98 T.C. at 590. Perhaps this project was intended to resolve that anomaly, probably by regulations.

(e) Section 7872(i)(2) states:

> Under regulations prescribed by the Secretary [of the Treasury], any loan which is made with donative intent and which is a term loan shall be taken into account for purposes of chapter 11 [the estate tax chapter] in a manner consistent with the provisions of subsection (b) [providing for the income and gift tax treatment of below-market loans].

i. Proposed Reg. §20.7872-1 (proposed in 1985) provides that a "gift term loan" shall be valued for estate tax purposes at no less than (a) its unpaid stated principal plus accrued interest or (b) the present value of all the future payments under the note using the applicable federal rate in effect at the time of death.

ii. Answers to the proposed regulation might include the arguments that (1) the proposed regulation is not effective unless and until it is finalized, (2) the loan represented by the installment note is not a "gift term loan" because it uses an interest rate calculated to avoid below-market treatment under section 7872(e), and (3) with respect to section 7872(i)(2) itself, the loan is not made "with donative intent" because the transaction is a sale.

iii. Under section 7805, the proposed regulations could probably be expanded even beyond the strict mandate of section 7872(i)(2), and under section 7805(b)(1)(B) such expanded final regulations might even be made effective retroactively to the publication date of the proposed regulations in 1985 (although that would be an aggressive choice that undoubtedly would be roundly criticized). But, unless and until that happens, most estate planners have seen no reason why the estate tax value should not be fair market value, which, after all, is the general rule, subject to Reg. §20.2031-4, which states:

> The fair market value of notes, secured or unsecured, is presumed to be the amount of unpaid principal, plus interest accrued to the date of death, unless the executor establishes that the value is lower or that the notes are worthless. However, items of interest shall be separately stated on the estate tax return. If not returned at face value, plus accrued interest, satisfactory evidence must be submitted that the note is worth less than the unpaid amount (because of the interest rate, date of maturity, or other cause), or that the note is uncollectible, either in whole or in part (by reason of the insolvency of the party or parties liable, or for other cause), and that any property pledged or mortgaged as security is insufficient to satisfy the obligation.

(f) It is not clear that this guidance project was related to these developments, and in any event it did not cite Proposed Reg. §20.7872-1.

i. It *is* clear that the IRS has long been interested in the valuation of promissory notes, and at times has seemed to embrace a market interest rate standard. *See* Letter Ruling 200147028 (issued Aug. 9, 2001; released Nov. 23, 2001).

ii. The interest of the IRS was especially apparent after the docketing of *Estate of Davidson v. Commissioner*, T.C. Docket No. 13748-13, in which the IRS asserted $2.8 billion in estate, gift, and generation-skipping taxes owed. On July 6, 2015, the case was settled for just over $550 million. Addressing Mr. Davidson's sales both in Chief Counsel Advice 201330033 (Feb. 24, 2012) and in its answer in the Tax Court, the IRS argued that the notes should be valued, not under section 7520, but under a willing buyer-willing seller standard that took account of Mr. Davidson's health. *See also Estate of Kite v. Commissioner*, T.C. Memo. 2013-43.

(g) Promissory notes are frequently used in estate planning, and guidance could provide welcome clarity.

(3) **Defined Value Clauses**

(a) A project described as **"Guidance on the gift tax effect of defined value formula clauses under §§2512 and 2511"** was also new in 2015 but dropped in the 2017-2018 Plan.

(b) Defined value clauses have an interesting history. See, for example, Technical Advice Memorandum 8611004 (Nov. 15, 1985) (approving a transfer of "such interest in X Partnership … as has a fair market value of $13,000"); *Knight v. Commissioner*, 115 T.C. 506 (2000) (disregarding the use of such a technique to transfer "that number of limited partnership units in [the partnership] which is equal in value, on the effective date of this transfer, to $600,000"); *Succession of McCord v. Commissioner*, 461 F.3d 614 (5th Cir. 2006), *rev'g* 120 T.C. 358 (2003) (reviewed by the Court) (approving a defined value clause, with the excess going to charity); *Estate of Christiansen v. Commissioner*, 130 T.C. 1 (2008) (reviewed by the Court), *aff'd*, 586 F.3d 1061 (8th Cir. 2009) (approving a formula disclaimer in favor of charity); *Estate of Petter v. Commissioner*, T.C. Memo. 2009-280, *aff'd*, 653 F.3d 1012 (9th Cir. 2011) (approving a defined value clause, with the excess going to charity); *Hendrix v. Commissioner*, T.C. Memo. 2011-133 (approving a defined value clause, with the excess going to charity); *Wandry v. Commissioner*, T.C. Memo. 2012-88, *nonacq.*, AOD 2012-004, 2012-46 I.R.B. (approving a type of defined value clause, with the excess remaining with the transferor).

(c) The taxpayers' actual implementation of defined value clauses (that is, returning property to the donors where it might be taxed as part of their estates) was likely an element of the settlements in *Estate of Donald Woelbing v. Commissioner* (Tax Court Docket No. 30261-13, stipulated decision entered March 25, 2016) and *Estate of Marion Woelbing v. Commissioner* (Tax Court Docket No. 30260-13, stipulated decision entered March 28, 2016); and possibly in *Karen S. True v. Commissioner* (Tax Court Docket No. 21896-16, stipulated decision entered July 9, 2018) and *H.A. True III v. Commissioner* (Tax Court Docket No. 21897-16, stipulated decision entered July 6, 2018).

(d) Another example of the IRS and the taxpayer agreeing to give effect to a formula – in this case a formula for determining the annuity payments from a GRAT – is the stipulation in *Grieve v. Commissioner*, T.C. Memo. 2020-28 (Judge Kerrigan). In that case, in addition to other transfers, there was a two-year GRAT with annuity payments determined as stated

percentages of what the opinion describes only as "the fair market value of assets transferred to the trust for Federal gift tax purposes." As the court noted in a footnote:

> The parties stipulated that petitioner will not owe additional gift tax if we determine that he understated the initial fair market value of assets transferred to the GRAT if, within a reasonable time, the GRAT pays to petitioner, or to his personal representative in the event of his passing, an amount equal to the difference of the properly payable annuity and the annuity actually paid.

They never had the opportunity to make such a payment, however, because the taxpayer won the case on the underlying valuation issue.

(e) *Nelson v. Commissioner*, T.C. Memo. 2020-81 (June 10, 2020, Judge Pugh), involved a gift to a trust of a limited partner interest "having a fair market value" of a specified dollar amount, "as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment," followed two days later by a sale to the same trust described in the same way, except that the time for obtaining the appraisal was 180 days instead of 90 days. The taxpayer argued unsuccessfully that this permitted an adjustment to the transfer based on the values finally determined for gift tax purposes, as in *Wandry*. Significantly, the IRS not only accepted the formulas based on appraisals within a specified time but actually advocated for them, obviously not offended by such formula transfers as it is by *Wandry* clauses. This is understandable, because by the time the IRS looks at the return the transferred quantity will already have been determined, and the IRS can contest the valuation of that quantity.

(f) For an important analysis of limitations on the effectiveness of *Wandry* clauses, see Bramwell & Dillon, "Not Another *Wandry* Article: Real Issue With *Wandry* Formulas," 41 Est. Plan. 3 (May 2014).

(g) In affirming the Tax Court in *Petter*, albeit in the context of a rather narrow subpoint of a condition precedent within the meaning of Reg. §25.2522(c)-3(b)(1), the Court of Appeals for the Ninth Circuit concluded its opinion by quoting:

> "[W]e expressly invite[ ] the Treasury Department to "amend its regulations" if troubled by the consequences of our resolution of th[is] case." *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 713 (2011) (quoting *United Dominion Indus., Inc. v. United States*, 532 U.S. 822, 838 (2001)).

Maybe, in this guidance project, Treasury was proposing to accept that invitation. Meanwhile, the settlements described in paragraph (c) above, the parties' stipulation in *Grieve* quoted in paragraph (d) above, and the Tax Court's apparent respect for that stipulation in *Grieve* all might suggest that actually giving effect to defined value clauses in audit, settlement, or litigation to cut down the tax benefits of an estate planning technique might have become a "new normal."

(4) **"Material Participation" by Trusts and Estates**

(a) Also in the 2017-2018 Priority Guidance Plan, a project described as "Guidance regarding material participation by trusts and estates for purposes of §469," which had been in previous Plans under the heading of "General Tax Issues," was omitted. This guidance could have shed light on the application to trusts and estates of the 3.8 percent tax on net investment income under section 1411.

(b) Final regulations addressing many issues under section 1411 were issued on November 26, 2013, but did not address the issue of material participation in the context of trusts. The preamble (T.D. 9644) candidly acknowledged Treasury's sympathy with the problems of material participation and the difficulty of dealing with those problems, which it described as "very complex." The preamble to proposed regulations published on December 2, 2013, cited the preamble to the 2013 final regulations and deferred the issue of material participation by estates and trusts, including QSSTs, which it said "is more appropriately addressed under section 469." Even so, the guidance project under section 469 was omitted from the 2017-2018 Plan.

(c) Meanwhile, *Frank Aragona Trust v. Commissioner*, 142 T.C. 165 (2014), provides an encouraging precedent.

(d) And this issue might become moot if the proposed expansion of the tax on net investment income described in Part 2.b(7)(d) above is enacted.

(5) **Allocation of GST Exemption at the End of an ETIP**

(a) A project described as "Regulations under §2642 regarding available GST exemption and the allocation of GST exemption to a pour-over trust at the end of an ETIP" first appeared in the 2012-2013 Plan and then was dropped from the 2016-2017 Plan.

(b) Some context might be derived from a request for guidance from the AICPA, first made in a letter to the IRS dated June 26, 2007, which stated:

> The issues presented here are best illustrated by considering the following fact pattern:
>
> > Taxpayer creates an irrevocable trust, Trust Z, in which a qualified annuity interest (as defined in section 2702(b)) is payable to the taxpayer or his estate for 10 years. Upon the termination of the annuity interest, Trust Z is to be separated into two trusts, Trust A and Trust B. Trust A is for the exclusive benefit of Taxpayer's children and grandchildren. Trust B is for the exclusive benefit of Taxpayer's children. Trust A is to receive from Trust Z so much of the Trust Z's assets as is equal to Taxpayer's remaining GST exemption, if any. Trust B is to receive from Trust Z the balance of Trust Z's assets, if any, after funding Trust A. The taxpayer is alive at the end of the 10 years.
>
> Presumably, the transfer to Trust Z is an indirect skip to which GST exemption will be automatically allocated at the end of the ETIP. Will the automatic allocation rules apply to all the assets remaining in Trust Z at that time? If so and if the taxpayer wants to allocate GST exemption only to the assets going to Trust A, the taxpayer should timely elect out of the automatic allocation rules of section 2632(c), and then affirmatively allocate GST exemption only to the assets going into Trust A at the end of the ETIP. Is that possible?
>
> In the alternative, the automatic allocation rules may apply only to the transfer going into Trust A because Trust B is not by definition a GST trust. Because of the application of the ETIP rules, the transfer from the taxpayer for GST purposes would occur only at the time that the assets are funded into Trust A. If that is the case, then the taxpayer does not need to do anything affirmatively to ensure that GST exemption is allocated to Trust A and not Trust B as he or she desires.
>
> It has been our experience that many trusts are structured in a manner similar to the above referenced fact pattern. By letter dated November 10, 2004, the AICPA submitted comments on the proposed regulations on electing out of deemed allocations of GST exemption under section 2632(c). In that letter, guidance was requested on these issues. The preamble to the final regulations (T.D. 9208) acknowledged this request for the inclusion in the regulations of an example addressing the application of the automatic allocation rules for indirect skips in a situation in which a trust subject to an ETIP terminates upon the expiration of the ETIP, at which time the trust assets are distributed to other trusts that may be GST trusts. According to the preamble, the Treasury Department and the Internal Revenue Service believed that this issue was outside the scope of the regulation project and would consider whether to address these issues in separate guidance.

(6) **Private Trust Companies as Fiduciaries**

(a) Privately owned and operated trust companies are becoming an option that families with large trusts are turning to in increasing numbers, and state law authority for such private trust companies is being continually refined. Until 2014, every Priority Guidance Plan since 2004 had included an item referring to private trust companies.

i. When this project first appeared, in the 2004-2005 Plan, it was described as "Guidance regarding family trust companies."

ii. In the 2005-2006, 2006-2007, and 2007-2008 Plans, it was described as "Guidance regarding the consequences under various *estate, gift, and generation-skipping transfer tax* provisions of using a family-owned company as the trustee of a trust." The omission of *income tax* issues from that formulation was a source of concern, because income tax issues have frequently been addressed in the relevant letter rulings. Indeed, in the first such letter rulings, Letter Rulings 9841014 and 9842007 (July 2, 1998), the only issue was whether a family-owned trust company was a "related or subordinate party" with respect to the living grantors of various trusts, within the meaning of section 672(c), an income tax rule.

iii. In the 2008-2009 and 2009-2010 Plans (published after Notice 2008-63, which is discussed below), the description was a more comprehensive "Revenue ruling regarding the consequences under various income, estate, gift, and generation-skipping transfer tax provisions of using a family owned company as a trustee of a trust."

iv. That reassurance of comprehensive treatment was maintained in the 2010-2011 Plan by describing the project as "Guidance concerning private trust companies under §§671, 2036, 2038, 2041, 2042, 2511, and 2601."

v. By dropping the reference to a revenue ruling, the 2010-2011 Plan suggested that Treasury and the IRS might be reviewing the basic approach of the proposed revenue ruling, which had attracted many diverse public comments after the publication of Notice 2008-63 (discussed below). But a revenue ruling as the vehicle for the guidance would be much easier to finalize than would, for example, amendment of the many regulations that would have to be amended.

vi. Following the first appearance of this project on the 2004-2005 Plan, the IRS identified the treatment of private trust companies for estate tax purposes under sections 2036, 2038, and 2041 as "areas under study in which rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, a revenue procedure, regulations, or otherwise." Rev. Proc. 2005-3, 2005-1 C.B. 118, §§5.07, 5.08 & 5.09. This designation has continued to the present. Rev. Proc. 2021-3, 2021-1 I.R.B. 140, §§5.01(12), (13) & (14).

(b) The proposed revenue ruling in question was released with Notice 2008-63 on July 11, 2008, and published at 2008-31 I.R.B. 261 on August 4, 2008. The Notice solicited comments on the proposed revenue ruling, which affirmed favorable conclusions with respect to five tax issues faced by trusts of which a private trust company serves as trustee:

i. Inclusion of the value of trust assets in a grantor's gross estate by reason of a retained power or interest under section 2036 or 2038.

ii. Inclusion of the value of trust assets in a beneficiary's gross estate by reason of a general power of appointment under section 2041.

iii. Treatment of transfers to a trust as completed gifts.

iv. Effect on a trust's status under the GST tax either as a trust created before the effective date or as a trust to which GST exemption has been allocated.

v. Treatment of a grantor or beneficiary as the owner of a trust for income tax purposes.

While these are not the only issues that the use of private trust companies can present, these are the most common issues. It was especially encouraging to see grantor trust treatment addressed, in view of the omission of income tax from the formulation of this project on the then most recent 2007-2008 Plan.

(c) The proposed revenue ruling posited several trusts, illustrating both the introduction of a private trust company as the trustee of a preexisting trust and the creation of new trusts with a private trust company as the trustee. The trusts had the following features:

i. The trustee has broad discretionary authority over distributions of both income and principal.

ii. Each successive primary beneficiary has a broad testamentary power of appointment (although not as broad as a power to appoint to anyone other than the beneficiary's estate, creditors, and creditors of the estate).

iii. The grantor or primary beneficiary may unilaterally appoint (but not remove) trustees, with no restrictions other than on the ability to appoint oneself.

(d) The proposed revenue ruling presented two situations – Situation 1, in which the private trust company is formed under a state statute with certain limitations, and Situation 2, in which the private trust company is formed in a state without such a statute but comparable limitations are included in the governing documents of the private trust company itself.

(e) The basic premise of the proposed revenue ruling, as stated in the second paragraph of Notice 2008-63, was:

> The IRS and the Treasury Department intend that the revenue ruling, once issued, will confirm certain tax consequences of the use of a private trust company that are not more restrictive than the consequences that could have been achieved by a taxpayer directly, but without permitting a taxpayer to achieve tax consequences through the use of a private trust company that could not have been achieved had the taxpayer acted directly. Comments are specifically requested as to whether or not the draft revenue ruling will achieve that intended result.

(f) Consistently with this basic premise, the proposed revenue ruling provided that the hypothetical private trust companies it addressed would generally avoid tax problems by the use of certain "firewall" techniques. For example:

i. A "Discretionary Distribution Committee" ("DDC") with exclusive authority to make all decisions regarding discretionary distributions "from each trust [meaning "all trusts"?] for which it serves as trustee." Anyone may serve on the DDC, but no member of the DDC may participate in the activities of the DDC with respect to a trust of which that DDC member or his or her spouse is a grantor or beneficiary, or of which the beneficiary is a person to whom that DDC member or his or her spouse owes an obligation of support.

ii. In Situation 2, an "Amendment Committee" with exclusive authority to amend the relevant sensitive limitations in the private trust company's governing documents (which are imposed by statute in Situation 1). A majority of the members of the Amendment Committee must be individuals who are neither members of the relevant family nor persons related or subordinate (within the meaning of section 672(c)) to any shareholder of the company.

(g) A paragraph near the end of the proposed revenue ruling identified three factual details that were not material to the favorable tax conclusions, explicitly confirming that the conclusions would not change if those details changed. No doubt the list of immaterial factual details could be expanded. Some likely examples (not exhaustive):

i. The designation of a "primary beneficiary" of each preexisting trust, possibly excluding so-called "pot" or "sprinkle" trusts.

ii. The possible requirement of a single independent "Discretionary Distribution Committee" for all trusts administered by the private trust company, possibly excluding a differently conceived body with a similar effect, a different committee for different trusts, and any exception for trusts for customers other than family members administered by family-owned trust companies that offer fiduciary services to the public.

iii. The explicit prohibition of certain express or implied reciprocal agreements regarding distributions, possibly excluding such prohibitions derived from general fiduciary law.

(h) The project relating to private trust companies was omitted from the 2014-2015 Priority Guidance Plan. But unlike decanting (which is discussed next), it cannot be said that private trust companies are a priority, or that the contemplated guidance may be issued soon. But meanwhile, the principles reflected in the proposed revenue ruling, including the reliance on "firewalls," will be relied on by those contemplating and organizing private trust companies and employing them as trustees of family trusts. If and when the IRS does issue guidance in this area, it is likely that such guidance will not be harsher in any material way than the guidance in the proposed revenue ruling.

(7) **Decanting**

(a) The 2011-2012 Priority Guidance Plan included "Notice on decanting of trusts under §§2501 and 2601." This project was new in 2011-2012, but it had been anticipated for some time, especially since the publication at the beginning of 2011 of Rev. Proc. 2011-3, 2011-1 I.R.B.

111, in which new sections 5.09, 5.16, and 5.17 included decanting among the "areas under study in which rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, regulations or otherwise." Rev. Proc. 2021-3, 2021-1 I.R.B. 140, §§5.01(8), (16) & (18) continues this designation.

(b) On December 20, 2011, the IRS published Notice 2011-101, 2011-52 I.R.B. 932. Notice 2011-101 asked for comments from the public by April 25, 2012, on the tax consequences of decanting transactions – the transfer by a trustee of trust principal from an irrevocable "Distributing Trust" to another "Receiving Trust." Notice 2011-101 asked for comments on the relevance and effect of the following 13 facts and circumstances (as well as the identification of any other factors that might affect the tax consequences):

i. A beneficiary's right to or interest in trust principal or income is changed (including the right or interest of a charitable beneficiary);

ii. Trust principal and/or income may be used to benefit new (additional) beneficiaries;

iii. A beneficial interest (including any power to appoint income or corpus, whether general or limited, or other power) is added, deleted, or changed;

iv. The transfer takes place from a trust treated as partially or wholly owned by a person under §§671 through 678 of the Internal Revenue Code (a "grantor trust") to one which is not a grantor trust, or vice versa;

v. The situs or governing law of the Receiving Trust differs from that of the Distributing Trust, resulting in a termination date of the Receiving Trust that is subsequent to the termination date of the Distributing Trust;

vi. A court order and/or approval of the state Attorney General is required for the transfer by the terms of the Distributing Trust and/or applicable law;

vii. The beneficiaries are required to consent to the transfer by the terms of the Distributing Trust and/or applicable local law;

viii. The beneficiaries are not required to consent to the transfer by the terms of the Distributing Trust and/or applicable local law;

ix. Consent of the beneficiaries and/or a court order (or approval of the state Attorney General) is not required but is obtained;

x. The effect of state law or the silence of state law on any of the above scenarios;

xi. A change in the identity of a donor or transferor for gift and/or GST tax purposes;

xii. The Distributing Trust is exempt from GST tax under §26.2601-1, has an inclusion ratio of zero under §2632, or is exempt from GST tax under §2663; and

xiii. None of the changes described above are made, but a future power to make any such changes is created.

(c) Notice 2011-101 also "encourage[d] the public to suggest a definition for the type of transfer ('decanting') this guidance is intended to address" and encouraged responses to consider the contexts of domestic trusts, the domestication of foreign trusts, and transfers to foreign trusts.

(d) Meanwhile, Notice 2011-101 said that the IRS "generally will continue to issue PLRs with respect to such transfers that do not result in a change to any beneficial interests and do not result in a change in the applicable rule against perpetuities period."

(e) There were extensive public comments, and there is little doubt that Treasury and the IRS have continued to study decanting. But decanting was omitted from the 2012-2013 Plan and from subsequent Plans.

(f) A new Uniform Trust Decanting Act (UTDA) was approved by the Uniform Law Commission at its annual conference in July 2015. The Act generally allows decanting whenever the

trustee has discretion to make principal distributions, or even if the trustee does not have such discretion if it is appropriate to decant into a special-needs trust.

i. Generally decanting under UTDA may not add beneficiaries, and Section 19 of UTDA includes extensive explicit safeguards, called “tax-related limitations,” to prevent decanting from jeopardizing any intended beneficial tax characteristics of the trust. The beneficial tax characteristics explicitly addressed are the marital deduction, the charitable deduction, the annual gift tax exclusion, the eligibility of the trust to hold S corporation stock, an inclusion ratio of zero for GST tax purposes, preservation of the use of the trust beneficiary’s life expectancy in determining minimum required distributions from a retirement plan or IRA, and the preservation, creation, avoidance, or termination of grantor trust status as the circumstances might warrant.

   UTDA in effect now provides the “definition” Notice 2011-101 asked for, and its publication should now pave the way for the long-awaited tax guidance for decantings done under UTDA or substantially identical statutes. And because of the care to avoid tax problems that UTDA exhibits, that guidance should not be as hard to complete or as harsh in its application as many might have feared.