BESSEMER TRUST

Washington Update: Pending and Potential Administrative and Legislative Changes

March 2024

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March 12, 2024

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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 percent to 28 percent and increasing individual income taxes for annual incomes over $400,000, including an increase in the top rate from 36 percent to 39.6 percent 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 April 18, 2023, Senator Bernie Sanders (I-Vermont) introduced S. 1178, 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 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). 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, as well as the current Biden Administration Greenbooks described in Part 3 below. On the same day, a companion bill (H.R. 2676) was introduced in the House of Representatives by Representative Jimmy Gomez (D-California).

(a) Senator Sanders' and Representative Gomez's proposals will be important to their 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 these 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' and Representative Gomez's bills are 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 5.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) 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) 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.

(e) These proposals would "apply to estates of decedents dying, and generation-skipping transfers and gifts made, after December 31, 2023." 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 rate changes. Presumably, pursuant to that preference, if this legislation were enacted, for example, in 2024, the reference to 2023 would be changed to 2024, making the effective date January 1, 2025.

(3) **Value of Farm, etc. Real Property.** Section 3 would, effective January 1, 2024, increase the cap on the reduction in value under the special use valuation rules of section 2032A from $750,000 ($1.39 million in 2024, after indexing since 1998) to $3 million, indexed for inflation going forward from 2024. As noted in Part 2.b(6), however, despite this proposal's family-business-friendly curb appeal, it 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.

(4) **Land Subject to Conservation Easements.** Section 4 would, effective January 1, 2024, 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 the initial funding of the trust, including perhaps transfers involving value-for-value sales or exchanges with an existing trust.

(b) The 2023 version of section 5 adds the following:

> No inference may be drawn from the amendments made by this section with respect to the application of section 1014 of the Internal Revenue Code of 1986 to property described in subsection (f) of such section (as added by subsection (a)) which was transferred on or before the date of enactment of this Act.

It is likely that this insertion is intended, in effect, to affirm the administrative action the IRS has taken in Rev. Rul. 2023-2, 2023-16 I.R.B. 658 (see Part 5.i(9) below), to deny a new basis in such cases, and to prevent or at least discourage the argument that the enactment of legislation to achieve this result is an admission that the IRS did not otherwise have that

authority. In that regard, in the title of section 5 in this version of the bill – "Clarification Regarding Disallowance of Step-Up in Basis for Property Held in Certain Grantor Trusts" – the words "Clarification Regarding" at the beginning have been added.

(6) **Limitation on Minority Discounts; Valuation of Nonbusiness Assets.** Section 6 is titled "Limitations on Discounts; Valuation Rules for Certain Transfers of Nonbusiness Assets." It is similar 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 Representative 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 similar to section 303 of H.R. 1264, introduced by Representative Rangel in March 2001 as an alternative to the Republican proposals that became the 2001 Tax Act, and to three bills subsequently introduced by Representative Earl Pomeroy (D-North Dakota): H.R. 5008 in June 2002, H.R. 1577 in April 2005, and H.R. 4242 in November 2007. Those bills are described in Part 3.h(1)(c) below.

(b) The bill would add a new section 2705 to the Code, applicable to transfers after the date of enactment. Section 2705(a) would read as follows:

> (a) Limitation on Discount by Reason of Family Control.—
>
> (1) In General.—For purposes of this subtitle, 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), if the transferor, the transferee, and members of the family of the transferor and transferee have control of such entity immediately before such transfer, no discount shall be allowed—
>
> (A) by reason of the fact that the transferor or transferee does not have control of such entity,
>
> (B) by reason of the lack of marketability of the interest, or
>
> (C) for any other reason.
>
> (2) Definitions.—In this subsection, the terms "control" and "member of the family" have the same meanings given such terms in section 2704(c).
>
> (3) Attribution.—For purposes of this section, the rule of section 2701(e)(3) shall apply for purposes of determining the interests held by any individual.

Simply stated, the objectives of the proposed new section 2705(a) 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. The inclusion of the phrases "by reason of the lack of marketability of the interest" and "for any other reason" in describing the discounts that would be disallowed are apparently broad enough to deny even discounts that would otherwise be applied to a transfer of 100 percent of the entity or of the assets (including a business) held by the entity.

(c) New section 2705(b)(1) would read as follows:

> (b) Valuation Rules for Certain Transfers of Nonbusiness Assets.—
>
> (1) In General.—For purposes of this subtitle, 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)—
>
> (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 goes on to provide detailed rules about "passive assets" that might be used in a business and a "look-thru rule" for entities that are at least 10 percent owned by another entity.

(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, as well as the current Biden Administration Greenbook proposal discussed in Part 3.f(1) below.

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

iii. prohibit any decrease in the annuity during the GRAT term (a proposal added in the 2010 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, although it is included in the current Greenbook.

(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, but not explicitly, 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 of property expected to appreciate).

(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" was omitted from his 2021 bill and again from his 2023 bill.)

(f) Section 2901 provides that any tax imposed under 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 Transfers to Certain Younger-Generation Persons.** Unlike Senator Sanders' previous proposals, which most recently would have prevented the allocation of GST exemption to a trust that could last longer than 50 years, section 9 of the current bill, effective upon the date of enactment, roughly follows the current Biden Administration Greenbook proposal (described in Part 3.e below).

(a) A trust's inclusion ratio would be treated as 1 – in other words, any allocation of GST exemption would not apply – with respect to distributions to a person other than an "exempt person" and with respect to terminations occurring when no living "exempt person" is a beneficiary of the trust. An "exempt person" is defined as a beneficiary who is no more than two generations below the transferor (such as the transferor's children and grandchildren, even if born after the creation of the trust), or a younger generation beneficiary (such as a great-grandchild) who was alive at the creation of the trust.

(b) In the case of a transfer of property from one trust to another trust, the date of creation of the transferee trust would be reset to the date of creation of the transferor trust if that date is earlier.

(c) The "reset" rule of section 2653(a) would not apply, apparently meaning that subsequent distributions to members of the then oldest generation would in effect be subject to GST tax twice in the same generation (which is surprising).

(d) Again surprisingly, the effective date exceptions in section 1433(b)(2) of the Tax Reform Act of 1986, including the exception for trusts that were irrevocable on September 25, 1985, would be repealed.

(10) **"Simplifying" Gift Tax Exclusion for Annual Gifts.** Section 10 would significantly limit the availability of the gift tax annual exclusion, effective on January 1 following the date of enactment. It would implement a similar proposal in the Obama Administration's 2014 Greenbook and the current Biden Administration Greenbook (discussed in Part 3.d(6) below), 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 Greenbook would be $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, $36,000 in 2024 (also indexed for inflation).

(c) Like the Greenbooks, the bill would impose this new limitation on transfers in trust (without an exception for "vested" 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 retain the per-donee annual exclusion ($18,000 in 2024). The new per-donor limit would supplement, not replace, the per-donee limit.

(e) Unlike the current Greenbook, the bill would repeal section 2503(c), which provides a special way that a "vested" trust for a minor can qualify as a present interest.

(f) As in the Greenbook proposals, the new $36,000 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 $18,000 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.

(11) **Gross-Up of Gift Tax.** Section 11 (new in this bill) would "gross up" the gift tax, in effect making it "tax-inclusive" like the estate tax, by treating any gift tax paid on a gift as an additional gift during the year of the gift. It would take effect on January 1 following the date of enactment.

The gross-up would not affect the annual gift tax exclusion or the applicable exclusion amount and unified credit. Where a gift tax is paid, the gross-up would have an effect similar to the inclusion of gift taxes paid on gifts within three years of death in the gross estate under section 2035(b), although – surprisingly and probably inadvertently – the proposal would not repeal or modify section 2035(b). Above the annual exclusion and the applicable exclusion amount, the gift tax rate on any gift would in effect become two-thirds, or 66-2/3 percent. For example, a taxable gift of $60 would result in a gift tax of $40 ($60 × 2/3), which, when added to the $60 gift, would create a tax base of $100, and the application of the 40 percent rate in section 2001(c) to $100 would confirm the tax of $40. Although at first blush a two-thirds rate seems high, it is, as

intended, the same as the current estate tax rate, when measured, not against the "gross" estate, but against the net amount the estate beneficiaries receive (.4/(1-.4) = .4/.6 = 2/3).

(12) **Expanded Definition of "Executor."** Section 12 (also new in this bill) would implement the proposal in the Greenbook (see Part 3.d(1) below) by moving the definition of "executor" from section 2203 of the Code to a new paragraph (51) of section 7701(a). The definition is unchanged, but it is not limited, as in section 2203, to use "in connection with the estate tax." Indeed, proposed section 7701(a)(51)(B) would explicitly provide that "an executor shall be authorized to act on behalf of the decedent, including with respect to any liability or obligation incurred under this title [the Internal Revenue Code] which preceded the death of the decedent." This would be a welcome change. Consistently with its helpful purpose, the proposal would take effect on the date of enactment, without regard to the date of the decedent's death.

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 would 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 Representative 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)(e) 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 Representative 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 percent 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 and $12.06 million for 2022), 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 Representative 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 realized 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)." That means that the 39.6 percent capital gains rate and 40 percent estate tax rate would produce a combined rate of 63.76 percent ($0.396 + 0.4 \times (1 - 0.396)$) on appreciation.

(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 seems 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 "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 legislative 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. 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 ended 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-South Dakota), 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, Representative Stephanie Murphy (D-Florida), joined all the Republicans in voting against it. The bill, with revisions as discussed below, was approved by the House. The Ways and Means Committee's bill included 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 have been 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 projected would be $6,020,000 for 2022 (it was actually $6,030,000). This was 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 have created 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 picked 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 have added 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 stated 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."

Section 1062 and section 2901 together were 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 have required 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 included 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 included 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)(b) 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, limited its description of the proposal to only "cash and readily marketable securities," without explanation.

This proposal was 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 have increased 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 and $1,230,000 in 2022). 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 happened to be the 2021 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 unevenly. Indeed, when section 2032A was added to the Code by the Tax Reform Act of 1976, the House Ways and Means Committee, while affirming a desire to favor small businesses, at the same time admitted that its proposal was limited to preventing a tax on "speculative value":

> Your committee believes that, when land is actually used for farming purposes or in other closely held businesses (both before and after the decedent's death), it is inappropriate to value the land on the basis of its potential "highest and best use" especially since **it is desirable to encourage the continued use of property for farming and other small business purposes**. Valuation on the basis of highest and best use, rather than actual use, may result in the imposition of substantially higher estate taxes. In some cases, the greater estate tax burden **makes continuation of farming, or the closely held business activities, not feasible** because the income potential from these activities is insufficient to service extended tax payments or loans obtained to pay the tax. Thus, the heirs may be forced to sell the land for development purposes. Also, **where the valuation of land reflects speculation to such a degree that the price of the land does not bear a reasonable relationship to its earning capacity, your committee believes it unreasonable to require that this "speculative value" be included in an estate with respect to land devoted to farming or closely held businesses**.

"Estate and Gift Tax Reform Act of 1976," H.R. REP. NO. 94-1380, 94TH CONG., 2D SESS. 21-22 (Aug. 2, 1976) (emphasis added). "Tax Reform Act of 1976," S. REP. NO. 94-938, PART 2, 94TH CONG., 2D SESS. 15 (July 20, 1976) was similar.

Thus, this Ways and Means Committee proposal in 2021 should not have been expected to be viewed by owners of family farms and businesses as much of a consolation. It was 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 have been reinstated for taxable incomes over $400,000 ($450,000 for joint returns and surviving spouses) and $12,500 indexed ($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 have been 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 [$13,450 in 2022] 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) **Expansion of Tax on Net Investment Income.** Beginning **January 1, 2022**, the 3.8 percent tax on net investment income would have been 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 ($13,450 in 2022).

(d) **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 have been 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 Passed by House**

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 (rather than 3 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. And, as noted above, the November 3 update helpfully added a provision allowing the deduction for charitable payments and set-asides under section 642(c) in calculating the threshold for the surcharge.

The Rules Committee version kept the limitation on the "trade or business" exception for the 3.8 percent tax on net investment income, but it omitted the limitation of the qualified business income deduction. The House passed the Rules Committee version on November 19, 2021. The vote was 220-213, with no Republicans voting for it and only one Democrat (Representative Jared Golden of Maine) voting against it. The bill became stalled in the closely divided Senate.

e. **Senate Amendment and the "Inflation Reduction Act of 2022"**

On Sunday, August 7, 2022, the Senate approved an amendment of H.R. 5376 that it referred to as the "Inflation Reduction Act of 2022." The vote was strictly by party lines, with 50 Democrats (and Independents who caucus with the Democrats) in favor and 50 Republicans opposed, before Vice President Harris cast the tie-breaking vote. The House of Representatives agreed to the Senate amendment in a party-line 220-207 vote on August 12, 2022. President Biden signed it into law as Public Law 117-169 on August 16, 2022.

(1) The Inflation Reduction Act ("IRA") focused on major energy, environment, and health care provisions. It did not include any of the tax provisions discussed above. The "revenue raisers" were a targeted 15 percent corporate alternative minimum tax and a 1 percent stock buyback tax.

(2) **Long-Term IRS Funding.** But the IRA did include a provision labelled **"Enhancement of Internal Revenue Service Resources."** In a significant break from the historical pattern of annual, sometimes dramatically eleventh-hour, appropriations, the Act included the following eight amounts directed **"to remain available until September 30, 2031"** – that is, **for nine years**, to help ensure partial continuity of IRS funding free from the uncertainty and drama of those year-by-year appropriations:

- $3,181,500,000 for taxpayer services;
- $45,637,400,000 for enforcement;
- $25,326,400,000 for operations support (basically overhead);
- $4,750,700,000 for business services modernization, including callback technology;
- $403,000,000 for the Treasury Inspector General for Tax Administration;
- $104,533,803 for the Treasury Office of Tax Policy;
- $153,000,000 for the United States Tax Court; and
- $50,000,000 for "oversight and implementation support" by the Treasury Department.
- Total: $79,606,533,803.

In addition, $15,000,000 was included, available through September 30, 2023, for a task force to design an IRS-run free direct efile tax return system and report to Congress within nine months – that is, by May 16, 2023.

(3) **The Treasury Secretary's Response.** A month after the Act became law, on September 15, 2022, Secretary of the Treasury Yellen laid out the following priorities for allocation of these amounts in a visit to an IRS facility (see **https://home.treasury.gov/news/press-releases/jy0952#_ftnref10**).

- First, Treasury will fully staff **IRS Tax Assistance Centers**, where individual taxpayers can get help at an in-person location. In the last filing season, 900,000 Americans were helped in these Centers. With increased funding, Treasury projects that at least 2.7 million Americans (triple last filing season's amount) can be served. (Secretary Yellen noted that one study suggests that the average American spends 13 hours preparing and filing a return, compared to Sweden where some taxpayers can file simply by responding to a text message.)
- Second, the IRS will hire 5,000 additional customer service representatives at **call centers**. In the most recent filing season, call centers averaged a 10-to-15 percent "level of service," indicating that less than three out of every 20 calls were answered. The additional funding will greatly improve this, and Treasury is committed to reach an 85 percent level of service.
- Third, with the funds allocated for business modernization, "**the IRS will firmly move into the digital age**." For example, in many cases IRS employees manually transcribe paper returns. For the next filing season, the IRS will scan paper returns, leading to faster processing and faster refunds. In addition, the IRS will increase the capability for taxpayers to engage with the IRS online, including receiving and responding to notices from the IRS.
- Fourth, Treasury will engage "industry-leading customer service experts from the private sector" to advise on modernization efforts.

In addition, the IRS will dedicate increased budget resources to enforcement. Secretary Yellen elaborated the need for that:

> The world has become more complex. Enforcing tax laws is not as simple as it was a few decades ago. Average tax returns for large corporations now reach 6,000 pages. And more complicated partnerships have skyrocketed from less than 5% of total income in 1990 to over a third today. As a result, the tax gap – the amount of unpaid taxes – has grown to enormous levels. It's estimated at $7 trillion over the next decade. And since the IRS has lacked the resources to effectively audit high earners – whose audits are more complex and take more time – these high earners are responsible for a disproportionate share of unpaid taxes. To illustrate: In 2019, the top one percent of Americans was estimated to owe over a fifth of unpaid taxes – totaling around $160 billion. Data shows that less than half of all taxes from more complex sources of income are paid. Yet nearly all taxes due from wages and salaries – which are earned by ordinary Americans – are paid.

To address this, she emphasized that the IRS would refocus its enforcement priorities:

> Importantly, I've directed that enforcement resources will not be used to raise audit rates for households making under $400,000 a year relative to historical levels.

She had included that direction in an August 10, 2022, letter to then IRS Commissioner Rettig.

In a follow-up memo to Commissioner Rettig on August 17, 2022, she noted that the IRA had once required the IRS to produce an operational plan within six months, detailing how these additional resources would be deployed, but that provision had been dropped from the final Act to meet Senate parliamentary requirements. Reviving that idea, she herself directed that such a plan be delivered to her within six months – that is, by February 17, 2023.

(4) **IRS Strategic Operating Plan.** The plan Secretary Yellen had requested was not completed by February 17 (probably in part because the nomination of the new IRS Commissioner, Danny Werfel, was not confirmed by the Senate until March 9). But on April 6, 2023, the IRS released a 150-page "Internal Revenue Service Inflation Reduction Act Strategic Operating Plan" (available at **https://www.irs.gov/pub/irs-pdf/p3744.pdf**). Longer and more detailed than might have been expected, it likely was not entirely conceived and designed in eight months, but draws

heavily from "wish lists" or even "To Do lists" that had been compiled within the IRS over the last 13 years or even much longer. It cites, for example (at page 138), the "historical lack of investment" epitomized by declining appropriations from 2010 through 2021.

Even so, while the Plan offers a lot about what its objectives are ("Where we are heading" and "What success will look like"), it offers less about how to achieve those objectives. This is very understandable. It will obviously take significant investment, and analysis funded by that investment, to determine what works amid the complex challenges the IRS faces. For example, with respect to technology, as often noted, the Plan points to "more than 600 applications today, many of them over 20 years old" (page 80) and "foundational technology architecture … developed many years ago – some as far back as the 1960s" (page 86). That is a huge challenge.

The Plan presents 42 objectives, organized into five categories:

1. Dramatically improve services to help taxpayers meet their obligations and receive the tax incentives for which they are eligible.

2. Quickly resolve taxpayer issues when they arise.

3. Focus expanded enforcement on taxpayers with complex tax filings and high-dollar noncompliance to address the tax gap.

4. Deliver cutting-edge technology, data, and analytics to operate more effectively.

5. Attract, retain, and empower a highly skilled, diverse workforce and develop a culture that is better equipped to deliver results for taxpayers.

Those 42 objectives are each accompanied by phased annual "milestones," with only one limited to Fiscal Year 2023, seven extending through Fiscal Year 2024, most (26) extending through Fiscal Year 2025 or 2026, seven extending through Fiscal Year 2027, and only one (related to data processing and the ultimate retirement of the IRS legacy Individual Master File) extending through Fiscal Year 2028. The Inflation Reduction Act has made the extra funds available through Fiscal Year 2031. No "milestones" extend that far, although six (involving workforce hiring and onboarding) explicitly include an additional "ongoing" component after the last "milestone." Consistent with Secretary Yellen's directive, the Plan affirms that "small businesses and households earning $400,000 or less will not see audit rates increase relative to historical levels."

Implementation of the Plan will be coordinated by a new Transformation and Strategy Office, led by a Chief Transformation and Strategy Officer, who will report directly to the Commissioner. And the authors of the Plan warn (at page 129):

> Based on what we know today, we believe that we will need an ongoing investment on top of the allocated IRA funding to deliver all of the transformation objectives outlined in this Plan in taxpayer service improvements and information technology modernization.

In today's political climate, that may also be quite a challenge. In fact, the Fiscal Responsibility Act of 2023 (the debt-ceiling legislation that President Biden signed on June 3, 2023) rescinded $1.39 billion of the IRA's long-term funding, and reportedly one condition of its dramatic negotiation was a commitment to repurpose an additional $10 billion of that funding in each of Fiscal Years 2024 and 2025, raising serious concerns about the durability and trustworthiness of the funding.

(5) Meanwhile, the "omnibus" Consolidated Appropriations Act, 2023 that President Biden signed on December 29, 2022, included only $12.3 billion for the IRS for fiscal year 2023 (which ends September 30, 2023). This is lower than the $12.6 billion appropriated for fiscal year 2022 and lower than the $14.1 billion President Biden had requested for fiscal year 2023.

A Summary of the Financial Services and General Government provisions of the act (available at **https://www.appropriations.senate.gov/imo/media/doc/FSGG FY 23.pdf**) published by the Senate Appropriations Committee on December 19, 2022, commented on the reduction from the prior year by stating that "[f]unds have not been provided for business systems modernization

since funds are available for that activity from unobligated balances in the American Rescue Plan."

f. **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 it was not well received, including by some Democrats. Effective January 1, 2022, it 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 would tax the appreciation of "**covered assets**" held by "**applicable taxpayers**."

(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).

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

3. The Administration's Fiscal Year 2023, 2024, and 2025 Budget Proposals

The Treasury Department released its "General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals" (popularly called the "Greenbook") on March 28, 2022 (see **https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf**), its Fiscal Year 2024 Greenbook on March 9, 2023 (see **https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf**), and its Fiscal Year 2025 Greenbook on March 11, 2024 (see **https://home.treasury.gov/system/files/131/General-Explanations-FY2025.pdf**). Many of the proposals in these Greenbooks resemble legislative proposals made in 2021 (including in the Fiscal Year 2022 Greenbook) that were not included in the "Build Back Better Act" (H.R. 5376) passed by the House of Representatives on November 19, 2021.

With a sharply divided Congress, it is very possible that **none** of the Greenbook proposals will be acted on. Even so, whenever we see legislative proposals articulated like this, it is important to pay attention, because they are constantly evolving and could be pulled from the shelf and enacted, if not in this Congress then in the future when the political climate is different. Such proposals never completely go away. And each time they are refined and updated, we can learn more about what to watch for and how to react.

a. **Individual Income Tax Rates, Including Capital Gains**

Like the Fiscal Year 2022 Greenbook (discussed in Part 1.e above) and the Fiscal Year 2023 and 2024 Greenbooks, the Fiscal Year 2025 Greenbook proposes (at page 78) to accelerate the return of the top marginal individual income tax rate to 39.6 percent (as it was before 2018 and will be again in 2026 under the 2017 Tax Act), effective January 1, 2024. Unlike the Fiscal Year 2022 proposal, however, and like the Fiscal Year 2023 and 2024 proposals, the current proposal would lower the levels of taxable incomes at which that rate would apply to $450,000 for joint returns, $400,000 for unmarried individuals (other than surviving spouses), $425,000 for head of household filers, and $225,000 for married individuals filing separate returns. After 2024, the thresholds would be indexed for inflation using the "Chained CPI" ("C-CPI-U") that was introduced in the 2017 Tax Act. Over the next 10 fiscal years, this proposal is estimated to raise approximately $246 billion.

Also mirroring the Fiscal Year 2022, 2023, and 2024 Greenbooks, the current Greenbook proposes (at page 80) to tax long-term capital gains and qualified dividends at the same rate as ordinary income (that is, 37 percent under current law or 39.6 percent as proposed). This would apply to taxpayers with taxable income over $1 million ($500,000 for married individuals filing separately). It would be effective "for gains required to be recognized and for dividends received on or after the date of enactment" (an improvement over the puzzling "date of announcement" as in the Fiscal Year 2022 proposal).

b. **Deemed Realization of Capital Gains**

In terms almost identical to the Fiscal Year 2022, 2023, and 2024 budget proposals, the current Greenbook (at pages 80-82) again advocates the "deemed realization" of capital gains upon transfers by gift and at death.

(1) **Effective Date.** The proposal would take effect on January 1, 2025. But it would apply to previous appreciation; there would be no "fresh start" as, for example, in the 1976 carryover basis legislation.

(2) **Realization Events.** Gain would be explicitly realized 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. The Greenbooks do not mention holding periods or distinguish short-term and long-term gain. The Greenbooks also do not specifically incorporate the alternate valuation date for transfers at death, although they do state generally that a transfer "would be valued at the value used for gift or estate tax purposes."

(3) **Taxpayer, Return, and Deductibility.** The Greenbooks state that the gain would be reported "on the Federal gift or estate tax return or on a separate capital gains return." Reassuringly, however, the Greenbooks confirm 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)." That means that, after all exclusions are used, the proposed 39.6 percent capital gains rate and the current 40 percent estate tax rate would produce a combined tax rate on appreciation of 63.76 percent ($0.396 + 0.4 \times (1 - 0.396)$).

(4) **Exclusion for Tangible Personal Property.** The Greenbooks would exclude "gain on all tangible personal property such as household furnishings and personal effects (excluding collectibles)."

(5) **Exclusion for Transfers to Spouses.** The Greenbooks would exclude "[t]ransfers to a U.S. spouse." 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. Transfers to a spouse would carry over the transferor's basis. Thus, the effect of excluding transfers to spouses would 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 Greenbooks would exclude "[t]ransfers … to charity," adding that "[t]he transfer of appreciated assets to a split-interest trust would be subject to this capital gains tax, with an exclusion from that tax 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."

Thus, for many purposes, the exclusion would correspond to the allowable gift or estate tax charitable deduction. Like transfers to a spouse, transfers to charity would carry over the transferor's basis.

(7) **Other Exclusions.** The Greenbooks propose a unified exclusion of capital gains for transfers both by gift and at death of $5 million per person (up from $1 million in the Fiscal Year 2022 Greenbook), indexed for inflation and "portable to the decedent's surviving spouse under the same rules that apply to portability for estate and gift tax purposes." The Greenbooks add that this would "result … in a married couple having an aggregate $10 million exclusion," but they do not explain exactly how that would be accomplished for lifetime gifts when there has been no "decedent" or "surviving spouse." The Greenbooks do not address whether the use of the exclusion for lifetime gifts is mandatory or elective. But they add, quixotically and without further elaboration, that the $5 million exclusion "would apply only to unrealized appreciation on gifts to the extent that the donor's cumulative total of lifetime gifts exceeds the basic exclusion amount in effect at the time of the gift." Thus, in effect, a lifetime gift must actually generate a gift tax liability for the donor to use this $5 million exclusion of gain during life. So the first $12 million or so of gifts would trigger recognition of gain, and after that gifts with $5 million of appreciation would escape deemed realization, and after that gifts would trigger gain again. This could significantly influence the selection of assets to use for lifetime gifts.

But in an apparent reversal of the Fiscal Year 2022 Greenbook (see Part 1.e(7) above), the three recent Greenbooks state that "[t]he recipient's basis in property, whether received by gift or by reason of the decedent's death, would be the property's fair market value at the time of the gift or the decedent's death" (except, presumably, for excluded transfers to spouses and to charity discussed above). The Fiscal Year 2022 Greenbook, not surprisingly, included the caveat that "the donee's basis in property received by gift during the donor's life would be the donor's basis in that property at the time of the gift to the extent the unrealized gain on that property counted against the donor's $1 million exclusion from recognition." Thus, the recent Greenbooks would increase that proposed $1 million exclusion to $5 million and at the same time allow a stepped-up basis even if the gain is excluded. Although surprising, that would be a significant simplification.

In addition, the Greenbooks confirm 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 they add that that exclusion would be made "portable to the decedent's surviving spouse." In this case the application of the portability model 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 Greenbooks also confirm 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 for lifetime realization events in sections 1211 and 1212. There is no mention of relaxing the rules of section 267 prohibiting the deduction of losses from sales or exchanges between related persons, but it seems almost certain that those rules would be relaxed in any provision for taking losses into account at death, where transfers to related persons are the norm.

(9) **Valuation.** As noted above, the Greenbooks contemplate that a transfer generally "would be valued at the value used for gift or estate tax purposes." The Greenbooks add that "a transferred partial interest generally would be valued at its proportional share of the fair market value of the entire property." In other words, no entity-level discounts. But, elaborating the word "generally," which was new in the Fiscal Year 2023 Greenbook, they also helpfully add that "this rule would not apply to an interest in a trade or business to the extent its assets are actively used in the conduct of that trade or business."

(10) **Special Rules for Trusts and Entities.** The Greenbooks provide 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 Greenbooks call "the donor." Again there is no exclusion or exemption for pre-enactment gain, and indeed the current Greenbook explicitly states that the proposal would apply to "certain property owned by trusts … on January 1, 2025." In other words, this proposed recognition treatment would apply to distributions of appreciated assets to both current and successive or remainder beneficiaries of preexisting trusts, including, for example, a pre-2025 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.

The Fiscal Year 2022 Greenbook, surprisingly, provided that the rules about transfers into and distributions in kind from a trust would also apply to a "partnership" or "other non-corporate entity," without further explanation. The subsequent Greenbooks clarify that this extension to such entities applies "if the transfers have the effect of a gift to the transferee."

The Greenbooks also propose, in effect, a 90-year mark-to-market rule. The current Greenbook states (footnote omitted):

> Gain on unrealized appreciation also would be recognized by a trust, partnership, or other non-corporate entity that is the owner of property if that property has not been the subject of a recognition event within the prior 90 years. For this purpose, a tacking rule would apply to property received in a nonrecognition event from another such entity. This provision would apply to property held on or after January 1, 1944, that is not subject to a recognition event since December 31, 1943, so that the first recognition event would be deemed to occur on December 31, 2033.

Again assets of partnerships and other entities are included, in this case without a gift-equivalent requirement or other explanation. The current Greenbook adjusts an anomaly in the previous Greenbooks, in which the cited dates seemed to provide for a period of 91 years, not 90 years, and it adds the clarification of "a tacking rule." But, because the 90-year mark-to-market rule does not depend on any arguable recognition "event" like a gift, death, or other transfer, that rule is probably the feature of this proposal that would most likely attract a constitutional challenge.

(11) **Deferral of Tax.** The Greenbooks also provide that "[t]axpayers could elect not to recognize unrealized appreciation of certain family-owned and -operated businesses until the interest in the business is sold or the business ceases to be family-owned and -operated." This is a helpful clarification of the Fiscal Year 2022 Greenbook, which provided only that the "[p]ayment of tax … would not be due." Deferral 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, which might sometimes be a vexing consideration in the executor's decision to make this election.

If that election is made, would it still be true, as the Greenbooks state in the context of exclusions immediately before their discussions of deferral, that "[t]he recipient's basis in property, whether received by gift or by reason of the decedent's death, would be the property's fair market value at the time of the gift or the decedent's death"? Probably not, because mere deferral of deemed realization (regardless of the amount of gain deferred) is much different from the total escape from realization provided by the limited exclusion. Thus, the loss of a stepped-up basis at intervening deaths could make this ultimate income tax liability much more severe than under current law.

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

security at any time from any person and in any form acceptable to the IRS, which could be another complication for the family business, for example in raising capital, over a long-term deferral.

In addition, the Greenbooks 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 appears much broader and more robust than, for example, section 6166 with its multiple qualification tests.

(12) **Administrative Provisions.** The Greenbooks envision (but without details) a number of other legislative 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, would not necessarily 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 enacting such a proposal without a "fresh start" for basis as in 1976, the Greenbooks explicitly contemplate 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 taxable income over $1 million and the proposed "deemed realization" of capital gains together were estimated in the Fiscal Year 2023 and 2024 Greenbooks to raise approximately $174 billion and $214 billion, respectively, over the following 10 fiscal years. In the Fiscal Year 2025 Greenbook, this estimate is $289 billion.

c. **Minimum Tax on the Wealthiest Taxpayers**

This provision, new in the Fiscal Year 2023 Greenbook and repeated in the Fiscal Year 2024 Greenbook and now in the Fiscal Year 2025 Greenbook (at pages 83-85), is an adaptation of Senator Wyden's "Treat Wealth Like Wages" proposal, rolled out to a very lukewarm reception as his "Billionaires Income Tax" on October 27, 2021. See Part 2.f above. The Fiscal Year 2024 and 2025 Greenbooks propose (effective January 1, 2025, in the Fiscal Year 2025 Greenbook) a minimum tax of 25 percent of total income (up from 20 percent in the Fiscal Year 2023 Greenbook), generally including unrealized capital gains, for taxpayers with "wealth" (that is, assets minus liabilities) greater than $100 million. Taxpayers could choose to pay the minimum tax liability in equal annual installments over nine years for the first year of minimum tax liability and over five years for subsequent years (perhaps because it is assumed that after the first year a taxpayer will be more prepared for it). The minimum tax payments would be treated as a prepayment to be credited against subsequent taxes on realized gains to avoid taxing the same amount of gain more than once.

Taxpayers with tradable assets constituting less than 20 percent of their wealth would be treated as "illiquid" and could elect to include the unrealized gain only for tradable assets in determining the annual minimum tax, subject to a "deferral charge" (not to exceed 10 percent of unrealized gains, but otherwise unquantified) "upon, and to the extent of, the realization of gains on any non-tradable assets." No estimated payments would be required for the minimum tax. Taxpayers with wealth over the $100 million threshold would have to report annually the total basis and total estimated value of assets in each specified asset class, with alternatives to appraisals available for valuing non-tradable assets.

This proposal was estimated to raise approximately $361 billion over 10 fiscal years in the Fiscal Year 2023 Greenbook, and $437 billion in the Fiscal Year 2024 Greenbook. In the Fiscal Year 2025

Greenbook, the estimate is $503 billion. The constitutionality of either the wealth trigger, or the taxation of unrealized appreciation, or both, might be challenged in court.

Statutory language for this proposal, with some embellishments, appeared in the "Billionaire Minimum Income Tax Act" (H.R. 8558), introduced on July 28, 2022, by Representative Steve Cohen (D-Tennessee), with 32 cosponsors (all Democrats). Among the embellishments in H.R. 8558 is a provision requiring the "wealth" used to determine the applicability of the tax to any taxpayer to include (1) any asset of a trust treated as owned by the taxpayer under sections 671-679, (2) any asset of any other trust if the asset or the income (in whole or in part) therefrom is "distributable" to the taxpayer (not including distribution rights that are contingent upon the death of another trust beneficiary), and (3) any gratuitous transfers by the taxpayer within the last five years (other than charitable contributions, transfers to a spouse or former spouse incident to divorce under section 1041, and transfers to a spouse who is also subject to this tax). Under H.R. 8558, the requirement for annual reporting contemplated by the Greenbook would be spelled out in regulations.

d. **Improve Tax Administration for Trusts and Estates**

Like the Fiscal Year 2024 Greenbook, a section of the Fiscal Year 2025 Greenbook (at pages 120-124) titled "Improve Tax Administration for Trusts and Decedents' Estates" proposes a number of changes, none of which were included in the Fiscal Year 2022 Greenbook and only the first four of which were included in the Fiscal Year 2023 Greenbook.

(1) **Expanded Definition of Executor.** The Internal Revenue Code's definition of "executor" would be moved from section 2203 to section 7701, and the authorized party could act for all tax purposes (including with respect to pre-death tax liabilities). Elaborating on the helpfulness of this change, the Greenbook adds:

> Because reporting obligations (particularly regarding interests in foreign assets or accounts) have increased, problems associated with this absence of any representative authority are arising more frequently. Additionally, in the absence of an appointed executor, multiple persons may meet the definition of executor and, on occasion, multiple persons have filed separate estate tax returns for the decedent's estate or have made conflicting tax elections.

This would apply after enactment regardless of a decedent's date of death.

If enacted, this would be a welcome change because, as the quotation from the Greenbook illustrates, it would empower executors to take many actions in representing a decedent's interests before the IRS that currently might be complicated and difficult or even impossible.

For possible statutory language implementing this proposal, see section 12 of the "For the 99.5 Percent Act," discussed in Part 1.b(12) above.

(2) **Increased Benefit of Special Use Valuation.** Similar to the House Ways and Means Committee's version of the "Build Back Better Act" (discussed in Part 2.b(6) above), the current Greenbook proposes to increase the limit on the reduction in value of special use property from $750,000 (indexed, $1.39 million in 2024) to $14 million (up from $13 million in last year's proposal), applicable for decedents dying on or after the date of enactment. As noted in Part 2.b(6), however, despite this proposal's family-business-friendly curb appeal, it 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.

(3) **Extension of 10-Year Estate and Gift Tax Lien.** The automatic 10-year lien for estate and gift tax would be extended during any deferral or installment period for unpaid estate and gift tax. This provision would apply for existing 10-year liens and for the automatic lien that applies for gifts made or estates of decedents dying on or after the date of enactment. Like the expanded definition of "executor," this would also be a welcome change, to the extent it overcomes the IRS's reluctance to agree to some extensions of payment due dates.

(4) **Reporting of Estimated Value of Trust Assets.** Trusts would be required to file with the IRS annual reports including the name, address, and taxpayer identification number (TIN) of each

trustee and grantor of the trust and general information with regard to the nature and estimated total value of the trust's assets (which might be satisfied by identifying an applicable range of estimated total value on the trust's income tax return). The reporting requirement would apply to taxable years ending after the date of enactment for trusts valued over $300,000 or with gross income over $10,000 (with both amounts indexed for inflation after 2025). This change is described in a manner that might suggest it is intended to help the IRS develop a "comprehensive" "statistical data" base about trusts generally, not to target trusts for audit. Nevertheless, this proposed change could be very burdensome and, for many, quite ominous.

(5) **Limitation on Defined Value Formula Clauses**

(a) **Background**

i. 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 defined value clause with the excess remaining with the transferor).

ii. 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).

iii. 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.

iv. *Nelson v. Commissioner*, T.C. Memo. 2020-81 (June 10, 2020, Judge Pugh), *aff'd*, 17 F.4th 556 (5th Cir. 2021), 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.

v. 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)).

vi. The 2015-2016 Treasury-IRS Plan included a project described as "Guidance on the gift tax effect of defined value formula clauses under §§2512 and 2511," but that project was dropped in the 2017-2018 Plan. Maybe, in that guidance project, Treasury was proposing to accept that invitation of the Ninth Circuit.

vii. Meanwhile, the settlements described in paragraph ii above, the parties' stipulation in *Grieve* quoted in paragraph iii above, and the Tax Court's apparent respect for that stipulation in *Grieve* all might have suggested 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."

(b) **The Greenbook Proposal**

i. Now Treasury has signaled, although not very clearly, that it intends just the opposite. In a modest-looking 122-word "reasons for change" and 153-word explanation, the Fiscal Year 2024 and 2025 Greenbooks propose to dramatically crack down on the use of value formula clauses to define gifts and bequests. If a clause is "based on the result of involvement of the IRS" (such as a clause based on values "as finally determined" for gift or estate tax purposes), the Greenbooks complain (at page 122 in the current Greenbook) that it

> poses a significant challenge to the administration of the gift and income taxes by potentially (a) allowing a donor to escape the gift tax consequences of undervaluing transferred property, (b) making examination of the gift tax return and litigation by the IRS cost-ineffective, and (c) requiring the reallocation of transferred property among donees long after the date of the gift.

The Greenbooks also note that such determinations could "create a situation where the respective property rights of the various donees are being determined in a tax valuation process in which those donees have no ability to participate or intervene."

ii. But, in a most puzzling statement, the Fiscal Year 2024 Greenbook offered, and the current Greenbook (at page 124) repeats, this purported explanation (emphasis added):

> The proposal would provide that, if a gift or bequest uses a defined value formula clause that determines value based on the result of involvement of the IRS, then the value of such gift or bequest **will be deemed to be the value as reported on the corresponding gift or estate tax return**.

As much as taxpayers would welcome the assurance that the value reported on a return will be automatically accepted as the final value, it is obvious that Treasury does not intend that result. It probably is intended to say that the **quantity** of the transfer (number of shares, percentage interest, or the like) will be deemed to be the quantity estimated on the return. In other words, Treasury intends to overturn *Estate of Petter v. Commissioner*, T.C. Memo. 2009-280, *aff'd*, 653 F.3d 1012 (9th Cir. 2011), and *Hendrix v. Commissioner*, T.C. Memo. 2011-133 (in which gifts were divided by formula between noncharitable donees and charities), and *Wandry v. Commissioner*, T.C. Memo. 2012-88, *nonacq.*, AOD 2012-004, 2012-46 I.R.B. (in which the entire gift itself was effectively defined by formula).

iii. In any event, this proposed change would not apply if a defined value formula clause depends on action that does not include the involvement of the IRS. The Greenbook offers the example of "an appraisal that occurs within a reasonably short period of time after the date of the transfer (even if after the due date of the return)." That would include the outcome the IRS not only accepted, but argued for, in *Nelson v. Commissioner*, T.C. Memo. 2020-81 (June 10, 2020), *aff'd*, 17 F.4th 556 (5th Cir. 2021) ("as determined by a qualified appraiser within ninety (90) [or 180] days of the effective date of this Assignment").

iv. The rejection of defined value formula clauses also would not apply "for the purpose of defining a marital or exemption equivalent bequest at death based on the decedent's remaining transfer tax exclusion amount." This leaves open the possibility that, for example, a charitable lead annuity trust (CLAT) that defines the amount of the annuity to "zero-out" the bequest would be a target of this proposal. (It is also targeted by the proposal to require the value of a CLAT remainder to be at least 10 percent of the value of the property used to fund a CLAT, discussed in Part 3.f(6) below.)

v. The current proposal, once it is clarified, would apply to transfers by gift or on death occurring after December 31, 2024.

(6) **"Simplify" the Gift Tax Annual Exclusion.** Like proposals in the Clinton and Obama Administrations and in section 10 of Senator Sanders' "For the 99.5 Percent Act" (discussed in Part 1.b(10) above), the proposal would limit the annual gift tax exclusion to transfers Treasury seems to view as conveying a more genuine present interest. Following closely the explanation in the Obama Administration's Fiscal Year 2015 Greenbook, and like the Fiscal Year 2024 Greenbook, the Fiscal Year 2025 Greenbook (at page 124) states:

> The proposal would eliminate the present interest requirement for gifts that qualify for the gift tax annual exclusion. Instead, the proposal would define a new category of transfers (without regard to the existence of any withdrawal [*e.g., Crummey* power] or put rights) and would impose an annual limit of $50,000 per donor, indexed for inflation after 2025, on the donor's transfers of property within this new category that would qualify for the gift tax annual exclusion. This new $50,000 limit would not provide an exclusion in addition to the annual per-donee exclusion; rather, it would be a further limit on those amounts that otherwise would qualify for the annual per-donee exclusion. Thus, a donor's transfers in the new category in a single year in excess of a total amount of $50,000 would be taxable, even if the total gifts to each individual donee did not exceed $18,000. The new category would include transfers in trust (other than to a trust described in section 2642(c)(2) [a "vested" single-beneficiary trust]), transfers of interests in pass-through entities, transfers of interests subject to a prohibition on sale, partial interests in property, 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.

In other words, the proposal would **reverse** the IRS's lack of success in trying to limit the proliferation of *Crummey* powers in cases such as *Estate of Cristofani v. Commissioner*, 97 T.C. 74 (1991), and *Kohlsaat v. Commissioner*, T.C. Memo. 1997-212), and would **codify** the IRS's successes in limiting the treatment of interests in passthrough entities as present interests in cases such as *Hackl v. Commissioner*, 118 T.C. 279 (2002), *aff'd*, 335 F.3d 664 (7th Cir. 2003) (interests in an LLC engaged in tree farming), *Price v. Commissioner*, T.C. Memo. 2010-2 (interests in a limited partnership holding marketable stock and commercial real estate), and *Fisher v. United States*, 105 AFTR 2d 2010-1347 (D. Ind. 2010) (interests in an LLC owning undeveloped land on Lake Michigan).

Like the Obama Administration Greenbooks, the proposal apparently would not change the unlimited exclusion in section 2503(e) for tuition and medical expenses paid directly to the provider, the gift-splitting rules in section 2513, or (unlike Senator Sanders' bill) the special way in section 2503(c) a trust for a minor can qualify as a present interest.

The proposal would apply to gifts made after December 31, 2024.

(7) **Revenue Estimate.** These six proposals together are estimated to increase revenue by $1.3 billion over the next 10 fiscal years. (The estimated revenue increase in the Fiscal Year 2024 Greenbook was only $17 million, assumed at the time to be because any increased revenue from

the defined value formula clause and annual gift tax exclusion changes would be largely offset by the relaxation of the limit on the availability of special use valuation. In the Fiscal Year 2023 Greenbook, the first four provisions were estimated to decrease revenue by $326 million.)

e. **Limited Duration of GST Exemption**

Like the Fiscal Year 2023 and 2024 Greenbooks, the Fiscal Year 2025 Greenbook (at page 125) muses that "[a]t the time of the enactment of the GST provisions, the laws of most States included a common-law Rule Against Perpetuities (RAP) or some statutory version of it requiring that every trust terminate no later than 21 years after the death of a person who was alive at the time the trust was created" It's easy to see where that is headed.

Like its predecessors, the current Greenbook (at pages 125-126) proposes to

> make the GST exemption applicable only to: (a) direct skips and taxable distributions to beneficiaries no more than two generations below the transferor [in other words, to the transferor's children and grandchildren, even if born after the creation of the trust], and to younger generation beneficiaries who were alive at the creation of the trust; and (b) taxable terminations occurring while any person described in (a) is a beneficiary of the trust.

Therefore, trusts would not continue to be exempt, for example, throughout the entire applicable rule against perpetuities period, or for the full life of the trust if shorter (or if there is no rule against perpetuities in the applicable jurisdiction). Trusts would be exempt only for the life of any first- or second-generation beneficiary or any younger generation beneficiary who was alive at the creation of the trust. Unlike the typical rule against perpetuities, all grandchildren would be included as measuring lives, even if they were not "lives in being" at the creation of the trust, but, on the other hand, no 21-year period would be added. The Greenbook also provides that the "reset" rule of section 2653(a) would not apply, apparently meaning that subsequent distributions to members of the then oldest generation would in effect be subject to GST tax twice in the same generation (which is surprising). But it states that the special rule in section 2653(b)(2) for "pour-over trusts" created from a trust (whether under the trust instrument or under a decanting authority) would continue to apply, with such pour-over trusts deemed to have the same date of creation as the initial trust for purposes of determining the duration of the GST exemption.

This provision limiting the duration of the allocation of GST exemption would apply retroactively to existing trusts, but for purposes of determining the duration of the GST exemption "a pre-enactment trust would be deemed to have been created on the date of enactment and … the grantor is deemed to be the transferor and in the generation immediately above the oldest generation of trust beneficiaries in existence on the date of enactment." For example, if a trust had been created 30 years ago and the grantor and all the grantor's children had died before the date of enactment, then

- the grantor's grandchildren would be the oldest generation in existence,
- the grantor/transferor would therefore be deemed to be one generation above those grandchildren (in other words, in the generation of the deceased children of the grantor), and
- the measuring lives for purposes of the new rule would apparently be
    - the grandchildren and great-grandchildren of the grantor (whether or not alive on the date of enactment) and
    - all younger-generation descendants (such as great-great-grandchildren) alive on the date of enactment.

Not surprisingly, this proposal, focused on trust distributions to generations younger than grandchildren, is not projected to affect revenue over the next 10 fiscal years.

One approach to drafting statutory language to implement this proposal can be found in section 9 of the "For the 99.5 Percent Act," discussed in Part 1.b(9) above.

Additional limitations on GST exemptions are included in paragraphs f(4), (5), and (7) below.

f. **Modify Income, Estate, Gift, and GST Tax Rules for Certain Grantor Trusts**

The Fiscal Year 2023 Greenbook (at page 40) lamented that "[i]ndividuals who own assets expected to appreciate in value use two common techniques for reducing estate taxes that exploit the gift and income tax features of grantor trusts to remove value from their gross estates." Those two exploitative techniques turned out to be GRATs (which many would point out were created by Congress in section 2702(b)(1)) and sales of appreciating assets to grantor trusts (which, likewise, many would point out are facilitated by Congress's use of the phrase "treated as the owner" in sections 673 through 677 and its treatment of income tax as a liability of that owner under section 671). Be that as it may, the Greenbook invited Congress to blaze a new trail with the first three of the following proposals. The Fiscal Year 2024 Greenbook and the Fiscal Year 2025 Greenbook (at pages 127-133) follow suit, and go even farther in proposals (4) through (7).

(1) **GRATs.** Like the Obama Administration Greenbooks, the Greenbook would impose on GRATs

- a minimum term of 10 years,
- a maximum term of the life expectancy of the annuitant plus 10 years,
- a prohibition on any decrease in the annuity during the GRAT term (which otherwise might be used to reduce the amount includable in the grantor's gross estate if the grantor dies before the end of the GRAT term),
- a minimum remainder value equal to the greater of 25 percent of the assets contributed to the GRAT or $500,000 (but not more than the value of assets contributed to the GRAT), which would put an end to the very common and effective technique of nearly-zeroed-out GRATs, and
- a prohibition on the grantor's acquisition of any asset from the GRAT in an exchange without recognizing gain or loss on the exchange.

This proposal would apply to GRATs created on or after the date of enactment. If this proposal gained traction and was given a reasonable chance of being enacted, that might encourage the creation and funding of GRATs before enactment, which would avoid the first four limitations, particularly the huge fourth limitation of a minimum 25 percent remainder value. But merely creating a GRAT before enactment would not necessarily avoid the fifth limitation, because the proposals discussed in Part 3.b(10) above and paragraph (2) below would apparently also require a GRAT to recognize gain if the annuity payments were made with appreciated assets. (The gain recognition risk might be minimized, if feasible, by using a longer term GRAT in which the annuity amounts were low enough that they could be satisfied out of income, not with in-kind distributions.)

Statutory language for the first four of the five proposed requirements for GRATs can be found in section 7 of the "For the 99.5 Percent Act," discussed in Part 1.b(7) above.

(2) **Recognition of Gain on Sales Transactions with Grantor Trusts.** Mirroring the "Build Back Better" bill the House Ways and Means Committee approved in September 2021 (see Part 2.b(4) above), the Greenbook (at page 131) proposes that, "[f]or trusts that are not fully revocable by the deemed owner," "the transfer of an asset for consideration between a grantor trust and its deemed owner" would result in the recognition of gain (thus overruling Rev. Rul. 85-13, 1985-1 C.B. 184), and the basis of the asset would become the amount paid. The proposal uses, without elaboration, the term "deemed owner" (which sometimes implies that it includes a person other than the grantor under section 678) and also the term "grantor trust" (which sometimes implies that a trust treated as owned by a person other than the grantor is not included). The proposal would apply to transactions on or after the date of enactment. It would require the recognition of gain both on sales and on transfers in satisfaction of an obligation (such as an annuity or unitrust payment) with appreciated property. But, in a refinement of the Fiscal Year 2023 Greenbook proposal, the Fiscal Year 2024 and 2025 Greenbooks propose an addition to section 267(b) that would disallow recognition of losses in such transactions. The recognition proposal significantly overlaps with the deemed realization proposals for trusts discussed in Part 3.b(10) above.

(3) **Payment of Income Tax by Deemed Owner as Gift.** The payment of income tax on the income of a "grantor trust" (other than a trust that is fully revocable by the grantor, as the Fiscal Year 2024 Greenbook clarified) would be a gift "unless the deemed owner is reimbursed by the trust during that same year" in which the tax is paid. Again, the proposal uses the potentially clashing terms "deemed owner" and "grantor trust."

The Greenbooks state that the gift would generally occur "on December 31 of the year in which the income tax is paid." Acknowledging the need for some exceptions to that rule, the Greenbooks add "if earlier, immediately before the owner's death, or on the owner's renunciation of any reimbursement right for that year." But even with that addition the Greenbooks do not specifically provide for cases where the reimbursement is made only in the trustee's discretion and not as the deemed owner's "right," or where the "reimbursement right" terminates other than by the owner's renunciation, or when grantor trust (or "deemed owned") status itself terminates other than by the owner's death. Likewise, the Greenbooks do not address how to determine the year in which the deemed owner pays the income tax on the trust's income when some of the deemed owner's income tax liability is paid by quarterly estimated payments, three of which have been made in the year before the income tax return is filed, or by overpayments applied from the previous year's return. It is almost certain, however, that all such payments would be treated as made in the year the return is filed and the tax is due, because otherwise the notion of being "reimbursed by the trust during that same year" would make no sense.

And of course the annual reimbursement of such taxes pursuant to either a requirement or an exercise of discretion pursuant to an understanding or pre-existing arrangement would create a risk of including the value of the trust assets in the grantor's gross estate under section 2036 as applied in Rev. Rul. 2004-64, 2004-2 C.B. 7.

The Fiscal Year 2024 Greenbook added that "the amount of the gift cannot be reduced by a marital or charitable deduction or by the exclusion for present interest gifts or gifts made for the donee's tuition or medical care," presumably meaning that the deemed owner's payment of income tax on a trust's income would be a gift even if the trust's assets or income are used or could be used to make distributions that would not be taxable gifts if made directly by the deemed owner. But the Fiscal Year 2024 Greenbook clarified that the gift would be an adjusted taxable gift for estate tax purposes. The Fiscal Year 2025 Greenbook retains those refinements.

This proposal would apply to all trusts created on or after the date of enactment (which, if the proposal gains any traction, could provide an incentive to create and fund grantor trusts before the date of enactment).

(4) **Adjustment of a Trust's GST Inclusion Ratio on Transactions with Other Trusts.** Like the Fiscal Year 2024 Greenbook, the Fiscal Year 2025 Greenbook notes (at page 129) that a purchase by a GST tax-exempt trust of assets from, or a remainder interest in, another trust (particularly citing a purchase from a GRAT) is "[a] popular technique for leveraging the benefit of the GST exemption." (A sale of assets by one grantor trust to another grantor trust is generally thought to be exempt from recognition of gain under Rev. Rul. 85-13, 1985-1 C.B. 184, as applied, for example, in Letter Ruling 202022002 (issued Feb. 25, 2020; released May 29, 2020).) The Greenbooks would limit that leveraging opportunity by requiring a readjustment of the purchasing trust's inclusion ratio for all such transactions occurring after the date of enactment. Specifically, the value of the purchased assets would be included in the total value of the trust in the denominator of the applicable fraction, and the value of only the portion of those assets excluded from GST tax immediately before the purchase would be added to the numerator of the fraction. A similar readjustment would be required following a decanting.

(5) **Changing the GST Tax Characterization of Certain Tax-Exempt Organizations.** The Fiscal Year 2024 and 2025 Greenbooks would provide that interests held by "additional tax-exempt organizations" would be ignored for purposes of the GST tax. (Technically, according to a footnote, an organization described in section 501(c)(4) through (9) or 501(c)(11) through (29) would be treated for GST tax purposes like an organization described in section 2055(a).) For

example, a "health and education exclusion trust" ("HEET") builds on the rule of section 2611(b)(1) that distributions from a trust directly for a beneficiary's school tuition or medical care or insurance are not generation-skipping transfers, no matter what generation the beneficiary is in. Sometimes, by including charities or section 501(c)(4) social welfare organizations as permissible beneficiaries with interests that are vague enough to avoid being treated as separate shares, the designers of such trusts hope that a non-skip person (the charity or other organization) will always have an interest in the trust within the meaning of section 2612(a)(1)(A), and thereby the trust will avoid a GST tax on the taxable termination that would otherwise occur as interests in the HEET pass from one generation to another. This proposal would presumably prevent the inclusion of a section 501(c)(4) social welfare organization, for example, from producing that result.

(6) **Modifying the Definition of a Guaranteed Annuity Payment from a CLAT.** The Fiscal Year 2024 and 2025 Greenbooks note the benefits of a charitable lead annuity trust (CLAT), in which appreciation in excess of the annuity payments over the term of the CLAT accrues for the benefit of the noncharitable remainder beneficiaries, especially if the annuity payments begin lower and increase over the term of the CLAT (sometimes, in its most extreme form, referred to as a "shark-fin CLAT"). To address that, the Greenbooks propose (at page 132 of the current Greenbook) that, for all CLATs created after the date of enactment:

> The proposal would require that the annuity payments made to charitable beneficiaries of a CLAT at least annually must be a level, fixed amount over the term of the CLAT, and that the value of the remainder interest at the creation of the CLAT must be at least 10 percent of the value of the property used to fund the CLAT, thereby ensuring a taxable gift on creation of the CLAT.

The proposal refers only to "donors" and "gift tax," but it could conceivably apply for estate tax purposes too. (CLATs would also be affected by the proposal to prevent the use of a value formula clause to define the amount of the CLAT annuity, discussed in Part 3.d(5)(b)iv above.)

(7) **Modifying the Tax Treatment of Loans from a Trust.** The Fiscal Year 2024 and 2025 Greenbooks note that "[l]oans to trust beneficiaries are being used to avoid the income and GST tax consequences of trust distributions." In support of that assumption, they state the obvious fact that "the borrower … is receiving property from the trust," and then offer the possibly debatable and in any event situational views that "the borrower is unlikely to have been able to otherwise obtain" such a loan and "these loans often are forgiven or otherwise remain unpaid." Thus, for loans made, renegotiated, or renewed after the year of enactment:

(a) **Loans to Beneficiaries.** Loans to trust beneficiaries would be treated as distributions, carrying out distributable net income for income tax purposes and constituting, as appropriate, either a direct skip or a taxable distribution for GST tax purposes.

(b) **Repayment of Loans Made to Beneficiaries.** If a trust beneficiary repays a loan, the payor of any GST tax on the making of the loan could request a refund from the IRS within one year after the final payment on the loan.

(c) **Repayment of Loans Made to Deemed Owners.** The repayment of a loan made by a trust to a person who is not a trust beneficiary but is a deemed owner of the trust under the grantor trust rules would be treated as a new contribution to the trust, which, like any other contribution, would utilize GST exemption of the borrower, generate a GST tax liability in the case of a direct skip on the borrower or the borrower's estate, or increase the trust's inclusion ratio, depending on the borrower's elections and the generation assignments of the trust's beneficiaries at the time of the repayment. This is proposed, as the Greenbooks put it, "[t]o discourage borrowing from a trust by [such] a person." The Greenbooks add:

> Any GST tax payable on such a deemed direct skip that could not be collected from a deemed owner or a deceased deemed owner's estate (such as, if the time for collecting such a debt from a decedent has expired), would be payable by the trust itself.
>
> The proposal includes a grant of regulatory authority to identify certain types of loans that would be excepted from the application of the proposal. This authority could be used to exempt short-term loans, which do not raise the same concerns. Similarly, other exceptions might be the use of real or tangible property for a minimal number of days.

(8) **Revenue Estimate.** These seven proposals together are estimated to raise approximately $83.75 billion over the next 10 fiscal years. In the Fiscal Year 2024 Greenbook the estimate was approximately $65.1 billion, and in the Fiscal Year 2023 Greenbook the first three proposals were estimated to raise approximately $41.5 billion over 10 years.

g. **Valuation of Promissory Notes**

(1) **Background.** Loans with an interest rate equal to the applicable federal rate (AFR) incorporated into section 7872 are not treated as gifts, but the lender may take the position that the note should be discounted for gift tax purposes on a later re-transfer or for estate tax purposes at death because the interest rate is lower than a commercial rate at the time. Section 7872, added to the Code by the Deficit Reduction Act of 1984 (Public Law 98-369, July 18, 1984), authorized the issuance of regulations to address the estate tax valuation of notes, and proposed regulations were promptly promulgated but have never been finalized. Meanwhile, although the note is included in the decedent's gross estate, it is possible that it could be valued **for estate tax purposes** at less than its face amount, under general valuation principles, because section 7872 is not an **estate tax** valuation rule. That would be especially true if interest rates rise between the date of the sale and the date of death.

Section 7872(i)(2) states:

> Under regulations prescribed by the Secretary, 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) [which provides for the income and gift tax treatment of below-market loans].

Proposed Reg. §20.7872-1 (published on August 20, 1985, barely a year after the enactment of section 7872) states:

> For purposes of chapter 11 of the Internal Revenue Code, relating to estate tax, a gift term loan … that is made after June 6, 1984, shall be valued at the lesser of:
>
> (a) the unpaid stated principal, plus accrued interest; or
>
> (b) the sum of the present value of all payments due under the note (including accrual interest), using the applicable Federal rate for loans of a term equal to the remaining term of the loan in effect at the date of death.
>
> No discount is allowed based on evidence that the loan is uncollectible unless the facts concerning collectibility of the loan have changed significantly since the time the loan was made. This section applies with respect to any term loan made with donative intent after June 6, 1984 [the effective date of section 7872], regardless of the interest rate under the loan agreement, and regardless of whether that interest rate exceeds the applicable Federal rate in effect on the day on which the loan was made.

The estate planner's answers to the proposed regulation would include the arguments that

- the proposed regulation is not effective unless and until it is finalized,
- 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
- with respect to both this proposed regulation and section 7872(i)(2) itself, the loan is not made "with donative intent" because the transaction is a sale, not a gift.

With respect to the first point, it is arguable that section 7872(i)(2) itself requires consistency even in the absence of regulations (although it still might be unclear what "consistency" means in that context). Tax Court Judge Tannenwald distinguished between "how" regulations and "whether" regulations in *Estate of Neumann v. Commissioner*, 106 T.C. 216 (1996). Section 2663(2) provides that "[t]he Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this chapter, including … regulations (consistent with the principles of chapters 11 and 12) providing for the application of this chapter [the GST tax] in the case of transferors who are nonresidents not citizens of the United States." This, Judge Tannenwald held, refers to a "how" regulation that is not a necessary condition to the imposition of the GST tax on transfers by nonresident noncitizens. Similar results with reference to the

phrase "under regulations" (which is the phrase also used in section 7872(i)(2)) were reached in *Francisco v. Commissioner*, 119 T.C. 317 (2002), and *Flahertys Arden Bowl, Inc. v. Commissioner*, 115 T.C. 269 (2000). Compare section 465(c)(3)(D), which provides that a special rule "shall apply only to the extent provided in regulations prescribed by the Secretary." *Alexander v. Commissioner*, 95 T.C. 467 (1990). Also compare *Frazee v. Commissioner*, 98 T.C. 554 (1992), and *Estate of True v. Commissioner*, T.C. Memo. 2001-167, *aff'd*, 390 F.3d 1210 (10th Cir. 2004), discussing other proposed regulations under section 7872.

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. 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, as elaborated in Reg. §20.2031-4:

> 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.

The 2015-2016 Treasury-IRS Priority Guidance Plan for the 12 months beginning July 1, 2015, released on July 31, 2015, included a project, new that year, titled "Guidance on the valuation of promissory notes for transfer tax purposes under §§2031, 2033, 2512, and 7872." It was retained in the 2016-2017 Priority Guidance Plan but dropped from the slimmed-down 2017-2018 Plan published October 20, 2017, by the Trump Administration. It is not clear that this guidance project was related to Proposed Reg. §20.7872-1, which it does not cite. 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. See Part 5.k(1) below.

(2) **The Greenbook Proposal.** Rather than following through on the existing statutory authority to adopt regulations addressing the issue, however, Treasury proposed, in the Fiscal Year 2023 and 2024 Greenbooks, and now continues to advocate in the Fiscal Year 2025 Greenbook (at page 135), a legislative solution that would limit the discount rate used to value the note for estate tax purposes to "the greater of the actual rate of interest of the note, or the applicable minimum interest rate for the remaining term of the note on the date of death." The Greenbooks add (as stated in the current Greenbook):

> The Secretary would be granted regulatory authority to establish exceptions to account for any difference between the applicable minimum interest rate at the issuance of the note and actual interest rate of the note. In addition, the term of any note (regardless of its rate of interest) would be shortened for purposes of valuing that note if there is a reasonable likelihood that the note will be satisfied sooner than the specified payment date and in other situations as determined by the Secretary.

Exceptions "to account for any difference between the applicable minimum interest rate at the issuance of the note and actual interest rate of the note" would certainly be appropriate. Otherwise, for example, a note with a commercially reasonable interest rate, such as a note a seller of a home might take back from an unrelated buyer, might be artificially overvalued for estate tax purposes if its true value was depressed because market interest rates had risen.

Subject to what such regulations might provide, it appears that valuing a note by discounting future payments of principal and interest at a discount rate equal to that interest rate would be tantamount to simply valuing the note at its face amount of unpaid stated principal plus accrued

interest, the same as in Proposed Reg. §20.7872-1(a) or, for that matter, the general rule in Reg. §20.2031-4 (both quoted above).

The Fiscal Year 2023 Greenbook stated that "[t]he proposal would apply to valuations as of a valuation date on or after the date of introduction." Presumably that meant the introduction of legislation specifically drafted to implement proposals in that Greenbook, but it was left to the legislation itself to clarify that. In any event, the date of introduction is a rather bold effective date approach, usually reserved for cases where Congress perceives a particular abuse or other need for urgency. An argument for urgency, of course, could be somewhat awkward in a context that includes proposed regulations that have been pending since 1985. On the other hand, the argument described above that section 7872(i)(2) itself already requires consistency could make it awkward to object to that effective date as a surprise or as unfair.

In any event, the Fiscal Year 2024 and 2025 Greenbooks have changed the description of the effective date to "valuations as of a valuation date on or after the date of enactment," which is more normal.

This proposal was estimated in the Fiscal Year 2023 Greenbook to raise approximately $6.4 billion over the next 10 fiscal years. In the Fiscal Year 2024 Greenbook, this proposal and the following proposal regarding fractional interests were together estimated to raise approximately $12.3 billion over 10 years. In the Fiscal Year 2025 Greenbook, that estimate is $12.2 billion.

h. **Valuation of Partial and Fractional Interests in Intrafamily Transfers**

The Fiscal Year 2024 and 2025 Greenbooks propose to replace section 2704(b) of the Code with a rule requiring partial interests transferred to family members of the donor or decedent to be valued at "the interest's **pro-rata share of the collective FMV** [fair market value] of all interests in that property held by the transferor and the transferor's family members, with that collective FMV being determined as if held by a sole individual" (emphasis added). This is often referred to as a "look-through" approach to valuing interests, for example, in an entity that holds assets.

(1) **Background.** Pro-rata look-through valuation is not a new idea.

(a) **The Reagan Administration.** "Tax Reform for Fairness, Simplicity, and Economic Growth" (popularly called "Treasury I") (see **https://home.treasury.gov/system/files/131/Report-Tax-Reform-v1-1984.pdf** and **https://home.treasury.gov/system/files/131/Report-Tax-Reform-v2-1984.pdf**) was published by the Treasury on November 27, 1984, just three weeks after President Reagan's landslide reelection. Treasury I included the following (at volume 2, pages 386-387) (emphasis added):

> In most instances, the value of property transferred by gift will be the same regardless of whether such value is determined by reference to the separate value of the property, the diminution in value of the transferor's estate, or the enhancement in value of the transferee's estate. In other instances, however, these measures of value can vary greatly. This is particularly true in the case of transfers of minority interests in closely held businesses and undivided interests in assets such as real estate. These interests are often valued, for transfer tax purposes, at significant discounts from their **pro rata share of the value** of the underlying business or asset.
>
> …
>
> Minority or fractional-share discounts enable taxpayers to structure transfers so as to reduce the aggregate value of property brought within the transfer tax base. This is inconsistent with the underlying purpose of the gift tax, which is to serve as a backstop for the estate tax. Moreover, the overall reduced value of the property as it is reported for transfer tax purposes is inconsistent with economic reality.

Accordingly, Treasury I proposed (*id.* at page 387) (emphasis added):

> The value for transfer tax purposes of a fractional interest in any asset owned, in whole or in part, by a donor or decedent would be a **pro rata share of the fair market value** of that portion of the asset owned by the donor or decedent. Prior gifts of fractional interests in the asset, as well as any fractional interests in the asset held by the transferor's spouse, would be attributed to the donor or decedent for purposes of determining the value of the fractional interest transferred.

Notice that the purpose of the proposal was to tax all of the interests held (or previously transferred) **by the donor** as if they were transferred at one time. The only family attribution that Treasury I proposed was attribution between spouses.

In general, the transfer tax suggestions in Treasury I have not been enacted. Instead, in the consideration of the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203), the House of Representatives added a repeal of the state death tax credit, a rule valuing interests in family-owned entities at their pro rata share of the total value of all interests in the entity of the same class, and rules regarding "disproportionate" transfers of appreciation in estate freeze transactions. H.R. REP. NO. 100-391, 100TH CONG., 1ST SESS. 1041-44. The House-Senate conference retained only the estate freeze rules, as section 2036(c).

(b) **The George H. W. Bush Administration.** Section 2036(c) was never popular or viewed as very workable, and efforts to replace it began almost immediately. The House Ways and Means Committee and Senate Finance Committee received significant input from estate planning professionals and the family business community, including input into and comment on a "discussion draft" of a new chapter 14, which was the subject of an extensive Ways and Means Committee hearing on April 24, 1990. That chapter 14, and the revised chapter 14 that was added to the Omnibus Budget Reconciliation Act of 1990 (Public Law 101-508) by the Senate Finance Committee, included only three sections (2701, 2702, and 2703). The House-Senate Conference added section 2704 "to prevent results similar to that of *Estate of Harrison v. Commissioner*" (T.C. Memo. 1987-8), in which the IRS had failed to persuade the Tax Court that under sections 2033, 2035, 2036, 2037, 2038, and/or 2041 the value of a decedent's limited partnership interest that passed to his estate included the right to dissolve the partnership. The conference report added that "[t]hese rules do not affect minority discounts or other discounts available under present law." H.R. REPORT 101-964, 101ST CONG., 2D SESS. (Oct. 27, 1990), at 1137.

(c) **The Clinton Administration.** The Clinton Administration's budget proposals for fiscal year 1999 included a proposal to "eliminate non-business valuation discounts," described as follows (emphasis added):

> The proposal would eliminate valuation discounts except as they apply to active businesses. Interests in entities would be required to be valued for transfer tax purposes at **a proportional share of the net asset value** of the entity to the extent that the entity holds readily marketable assets (including cash, cash equivalents, foreign currency, publicly traded securities, real property, annuities, royalty-producing assets, non-income producing property such as art or collectibles, commodities, options and swaps) at the time of the gift or death. To the extent the entity conducts an active business, the reasonable working capital needs of the business would be treated as part of the active business (i.e., not subject to the limits on valuation discounts). No inference is intended as to the propriety of these discounts under present law.

"General Explanations of the Administration's Revenue Proposals" (Feb. 1998) at page 129.

The Clinton Administration's budget proposals for fiscal year 2000 and fiscal year 2001 repeated this proposal, except that "readily marketable assets" was changed to "non-business assets" and "the propriety of these discounts under present law" was changed to "whether these discounts are allowable under current law."

This proposal was reduced to legislative language in section 276 of H.R. 3874, 106TH CONG., 2D SESS., introduced on March 9, 2000, by the Ranking Democrat on the House Ways and Means Committee, Representative Charles Rangel of New York. This bill would have added a new section 2031(d) to the Code, the general rule of which read as follows (emphasis added):

> (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)]), the value of such interest shall be determined by taking into account

(A) the **value of such interest's proportionate share of the nonbusiness assets** of such entity (and no valuation discount shall be allowed with respect to such nonbusiness assets), plus

(B) the value of such entity determined without regard to the value taken into account under subparagraph (A).

A slightly different articulation of this rule appeared in section 303 of H.R. 1264, 107TH CONG., 1ST SESS., introduced by Representative Rangel on March 26, 2001, partly as an alternative to the Republican proposals that became the 2001 Tax Act. Representative Rangel's bill would have added a new section 2031(d) to the Code, to 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)—

(A) the value of any nonbusiness assets held by the entity 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) the nonbusiness assets shall not be taken into account in determining the value of the interest in the entity.

Representative Rangel's 2001 bill would also have added a new section 2031(e) to the Code, to read as follows:

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 if the transferee and members of the family (as defined in section 2032A(e)(2)) of the transferee have control of such entity.

Identical statutory language for new sections 2031(d) and (e) appeared in H.R. 5008, 107TH CONG., 2D SESS. §3 (introduced June 24, 2002, by Representative Earl Pomeroy (D-North Dakota)), H.R. 1577, 109TH CONG., 1ST SESS. §4 (introduced April 12, 2005, by Representative Pomeroy), and H.R. 4242, 110TH CONG., 1ST SESS. §4 (introduced November 15, 2007, by Representative Pomeroy).

Clinton Administration proposals inevitably experienced a bit of a revival after Democrats took control of the Congress and White House. Democratic staff members publicly referred to them as a possible model for legislative drafting. This is perhaps reflected in H.R. 436, the 2009 version of Representative Pomeroy's bill, discussed in Part 3.h(1)(e)i below.

(d) **The George W. Bush Administration.** On January 27, 2005, the Staff of the Joint Committee on Taxation published a 430-page Report titled "Options to Improve Tax Compliance and Reform Tax Expenditures" (JCS-02-05), as requested in February 2004 by Chair Grassley and Ranking Member Baucus of the Senate Finance Committee. Under the heading of Estate and Gift Taxation, it presented five proposals estimated to raise revenue by $4.2-4.7 billion over 10 years. The second proposal is labeled "Determine Certain Valuation Discounts More Accurately for Federal Estate and Gift Tax Purposes (secs. 2031, 2512, and 2624)." The purpose of this proposal was described as follows:

The proposal responds to the frequent use of family limited partnerships ("FLPs") and LLCs to create minority and marketability discounts. … The proposal seeks to curb the use of this strategy frequently employed to manufacture discounts that do not reflect the economics of the transfers during life and after death.

The proposal would determine valuation discounts for transfers of interests in entities by applying aggregation rules and a look-through rule. Somewhat reflecting the 1984 proposal in Treasury I, the aggregation rules are what the Report calls a "basic aggregation rule" and a "transferee aggregation rule."

i. The basic aggregation rule would value a transferred interest at its **pro rata share of the value of the entire interest** owned by the transferor before the transfer. For example, a transferred 20 percent interest would be valued at one-fourth the value of an 80 percent interest if the transferor owned an 80 percent interest and at one-half the value of a 40 percent interest if the transferor owned a 40 percent interest.

ii. The transferee aggregation rule would take into account the interest already owned by the transferee before the transfer if the transferor does not own a controlling interest. For example, if a person who owns an 80 percent interest transfers a 40 percent interest by gift and the other 40 percent interest at death to the same transferee, the gifted 40 percent interest would be valued at one-half the value of the 80 percent interest originally owned by the donor and the bequeathed 40 percent interest would be valued at one-half of the value of the 80 percent interest ultimately owned by the donee/legatee.

iii. Interests of spouses would be aggregated with the interests of transferors and transferees. The proposal explicitly rejected any broader family attribution rule "because **it is not correct to assume that individuals always will cooperate with one another merely because they are related**" (emphasis added).

iv. The look-through rule would require the portion of an interest in an entity represented by marketable assets to be valued at its **pro rata share of the value of the marketable assets** if those marketable assets represent at least one-third of the value of the assets of the entity.

(e) **The Obama Administration**

i. **Congressional Proposals.** On January 9, 2009, Representative Earl Pomeroy (D-North Dakota) introduced H.R. 436, called the "Certain Estate Tax Relief Act of 2009." It would freeze 2009 estate tax law – a $3.5 million exemption equivalent (with no indexing) and a 45 percent rate – and would also revive, effective January 1, 2010, the "phaseout of graduated rates and unified credit" of pre-2002 law, expressed as a 5 percent surtax.

H.R. 436 would also add a new section 2031(d), generally valuing transfers of nontradable interests in entities holding nonbusiness assets as if the transferor had transferred **a proportionate share of the assets themselves**. If the entity holds both business and nonbusiness assets, the nonbusiness assets would be valued under this special rule and would not be taken into account in valuing the transferred interest in the entity. Meanwhile, new section 2031(e) would deny a minority discount (or discount for lack of control) in the case of any nontradable entity controlled by the transferor and the transferor's ancestors, spouse, descendants, descendants of a spouse or parent, and spouses of any such descendants. The statutory language is identical to the bills introduced by Representative Rangel in 2001 and Representative Pomeroy in 2002, 2005, and 2007, discussed in Parts 3.h(1)(c) and 3.h(1)(e)i above. These rules would have applied for both gift and estate tax purposes and would have been effective on the date of enactment.

ii. **Proposed Regulations.** Famously, on August 2, 2016, the IRS released proposed regulations under section 2704(b). REG-163113-02, 81 FED. REG. 51413-51425 (Aug. 4, 2016). They were proposed under the statutory authority of section 2704(b)(4), which states, in the context of corporate or partnership restrictions that are disregarded:

> The Secretary may by regulations provide that other restrictions shall be disregarded in determining the value of the transfer of any interest in a corporation or partnership to a member of the transferor's family if such restriction has the effect of reducing the value of the transferred interest for purposes of this subtitle but does not ultimately reduce the value of such interest to the transferee.

Although complicated and not always clear, the thrust of the proposed regulations was to provide that an interest in an entity would be valued for gift and estate tax purposes by disregarding certain restrictions on that interest that would limit the ability of the holder of

the interest to be redeemed or bought out for the interest's **pro rata share of the net fair market value of the assets held by the entity** (which the proposed regulations awkwardly referred to as "minimum value"). The proposed regulations created an almost immediate firestorm of criticism, particularly from the appraisal profession and from representatives of family-owned businesses.

This hostility was aggravated by political skepticism. From May 2009 until April 2013, the Obama Administration's "Greenbooks" had included a **legislative** proposal to "create an additional category of restrictions ('disregarded restrictions') that would be ignored in valuing an interest in a family-controlled entity transferred to a member of the family … [and] the transferred interest would be valued **by substituting for the disregarded restrictions certain assumptions to be specified in regulations**." "General Explanations of the Administration Fiscal Year 2013 Revenue Proposals" (Feb. 2012) (emphasis added). That legislative proposal was dropped from subsequent Greenbooks, and meanwhile, in President Obama's State of the Union Address to Congress on February 12, 2013, in the context of environmental regulation (to which some family-owned businesses are also very sensitive), he stated that "if Congress won't act soon to protect future generations, I will." The impression this left seemed to feed the suspicion of both family businesses and appraisers that the **substituted** (presumably artificial) valuation assumptions for which the IRS had sought congressional approval were being imposed without congressional authority, even though, echoing the 1990 conference committee report (see Part 3.h(1)(b) above), the preamble to the proposed regulations stated that, subject to the disregarding of certain restrictions (authorized by section 2704(b)(4)), "[f]air market value is determined under **generally accepted valuation principles, including any appropriate discounts or premiums**." 81 FED. REG. at 51418 (emphasis added). (Ironically, although this skepticism was directed toward the Obama Administration, the section 2704 regulation project had been first announced by the Administration of President George W. Bush, pursuant to the statute that had been signed into law by President George H. W. Bush.)

A contentious public hearing was held on the proposed regulations on December 1, 2016, and the proposed regulations were withdrawn on October 20, 2017, after a life of 14½ months. 82 FED. REG. 48779-80 (Oct. 20, 2017).

(f) **The Biden Administration.** Section 6 of Senator Bernie Sanders' (I-Vermont) "For the 99.5 Percent Act" (S. 994, introduced on March 25, 2021, in the last Congress, and S. 1178, introduced on April 18, 2023, in the current Congress and discussed in Part 1.b(6) above), would value "nonbusiness assets" held by a non-actively-traded entity as if they were transferred directly to the transferee, without any valuation discount. This is similar to what Senator Sanders had been introducing in every Congress since 2010. The same statutory language was included in the version of the "Build Back Better Act" approved by the Ways and Means Committee on September 15, 2021 (see Part 2.b(5) above), but not included in the version passed by the House or the "Inflation Reduction Act" that ultimately became law on August 16, 2022. In addition, for purposes of the deemed realization of gain proposal (see Part 3.b(9) above), the Greenbook provides that "a transferred partial interest generally would be valued at its proportional share of the fair market value of the entire property."

(2) **The Greenbook Proposal**

(a) **Reasons for Change.** Under the heading of "Reasons for Change," the Greenbooks (at page 135 of the Fiscal Year 2025 Greenbook) offer the following (emphasis added):

> The valuation of partial interests in closely held entities, real estate and other personal property offers **opportunities for tax avoidance when those interests are transferred intrafamily**. Taxpayers regularly transfer **portfolios of marketable securities and other liquid assets** into partnerships or other entities, make intrafamily transfers of interests in those entities (instead of transferring the liquid assets themselves), and then claim entity-level discounts in valuing the gift. Similarly, taxpayers often make intrafamily transfers of partial interests in **other hard-to-value assets such as real estate, art, or intangibles**, allowing all family co-owners to claim fractional interest discounts.

> While valuation discounts for lack of marketability and lack of control are factors properly considered in determining the FMV of such interests in general, they are **not appropriate when families are acting in concert to maximize their economic benefits**. In these cases, because **the family often ignores the restrictions** that justified the discounts, the claimed FMV of the transferred interest is below its real economic value, artificially reducing the amount of transfer tax due.

Unlike the proposals during the Reagan and George W. Bush Administrations (see Parts 3.h(1)(a) and 3.h(1)(d)iii above), the current Greenbooks are focused on the potential tax-reduction motivation of the entire family, not just spouses. The guiding principle of the staff of the Joint Committee on Taxation in 2005 that "it is not correct to assume that individuals always will cooperate with one another merely because they are related" has been superseded by the assumption that "the family often ignores the restrictions that justified the discounts."

On the other hand, **unlike** the concern of the Reagan Administration's "Treasury I" with variations in value that were "particularly true in the case of transfers of minority interests in closely held businesses" (see Part 3.h(1)(a) above), the current Greenbook is apparently intended to follow the example of the Clinton Administration's focus, Representative Pomeroy's subsequent focus, and the Ways and Means Committee's focus in September 2021 on "non-business assets" (see Parts 3.h(1)(c), 3.h(1)(e)i, and 3.h(1)(f) above). That could be crucial.

(b) **Proposal.** The Fiscal Year 2025 Greenbook proposal (at page 136), applicable "only to intrafamily transfers of partial interests in property in which the family collectively has an interest of at least 25 percent," is expressed this way (emphasis added):

> The proposal would **replace section 2704(b)** of the Code, which disregards the effect of liquidation restrictions on FMV, and instead provide that the value of a partial interest in nonpublicly traded property (real or personal, tangible or intangible) transferred to or for the benefit of a family member of the transferor would be **the interest's pro-rata share of the collective FMV of all interests in that property held by the transferor and the transferor's family members**, with that collective FMV being determined **as if held by a sole individual**. Family members for this purpose would include the transferor, the transferor's ancestors and descendants, and the spouse of each described individual.

It is interesting that the proposal leads with the replacement of section 2704(b), in light of both its unique 1990 provenance (see Part 3.h(1)(b) above) and its 2016 controversy (see Part 3.h(1)(e)ii above). In what apparently is an effort to protect operating family businesses from the effects of the proposal, the Greenbook adds (emphasis added):

> In applying this rule to **an interest in a trade or business**, passive assets would be **segregated and valued as separate from the trade or business**. Thus, the FMV of the family's collective interest would be the sum of the FMV of the interest allocable to a trade or business (not including its passive assets), and the FMV of the passive assets allocable to the family's collective interest determined as if the passive assets were held directly by a sole individual. Passive assets are assets not actively used in the conduct of the trade or business, and thus would not be discounted as part of the interest in the trade or business.

It is not at all clear what the second sentence is intended to say. This is often true of narrative proposals like this, for which it takes actual legislative language to provide clarity. The problem may actually be just a matter of grammar that centers on something as simple as the meaning of the word "the." Here again are the two sentences involved, with emphasis added to highlight the ambiguity:

> In applying this rule to **an interest in a trade or business**, passive assets would be segregated and valued as separate from the trade or business. Thus, the FMV of **the family's collective interest** would be the sum of the FMV of **the interest** allocable to a trade or business (not including its passive assets), and the FMV of the passive assets allocable to the family's collective interest determined as if the passive assets were held directly by a sole individual.

Assume that one family member owns and transfers a 30 percent interest in a business entity that is entirely owned by that family. What is "the interest" that the second sentence contemplates as the first item to be added? Put in grammatical terms, what is the antecedent of "the interest"? Or what is the meaning of "the"?

First Possibility: In what the second sentence is apparently intended to say, the antecedent is the "interest in a trade or business" in the first sentence – in other words, the 30 percent interest being valued. In that case, in valuing that 30 percent interest for transfer tax purposes,

1. that 30 percent interest is first valued by ignoring the passive assets (or non-business assets) owned by the business or by the entity in determining the underlying value of the entity's assets, but still by applying all lack of marketability and lack of control discounts appropriate to a 30 percent interest;
2. the passive assets excluded in the first step are valued as a whole as if owned by one person, and that value is multiplied by 30 percent; and
3. those two values are added together to determine the gift or estate tax value of the 30 percent interest.

Second Possibility: But the antecedent could be viewed as "the family's collective interest" (which is the previous use of the word "transfer" that is closest to "the interest" and therefore perhaps the first choice of antecedent as a matter of pure grammatical construction). In that case, in valuing that 30 percent interest for transfer tax purposes,

1. the entire family business (that is, "the family's collective interest") is valued by ignoring the passive assets owned by the business or by the entity but as if the business were owned by one person (because the entire business is owned by one family in this example), and that value is multiplied by 30 percent;
2. the passive assets excluded in the first step are valued as a whole as if owned by one person, and that value is multiplied by 30 percent; and
3. those two values are added together to determine the gift or estate tax value of the 30 percent interest.

That possibility could be quite different. There are often restrictions associated with even majority interests, designed, for example, to "keep the business in the family," or to "keep the family in the business," or simply to permit the vetting and filtering of prospective equity-investors, that would not necessarily apply to a business owned by just one person. The first possibility would respect such restrictions, which seems to be the very point of exempting businesses from the proposal. In the second possibility, it is hard to see how the objective of providing for passive assets to be "segregated and valued as separate from the trade or business" would be achieved, or would make any difference. Again, it is likely that actual statutory language would remove this ambiguity. But in the meantime, this multiple use of the word "interest" to describe the replacement of section 2704(b) might have the same unsettling effect that, for example, the use of the term "minimum value" had in the 2016 proposed regulations under section 2704(b).

In either interpretation, however, it is possible that the proposal may still leave a significant marketability discount, as it should, because even the entire ("collective") trade or business would present a lack of marketability if it were to be sold (in contrast to marketable assets like stock of a publicly traded business corporation that could be sold at any time). The marketability discount interest may be higher for a small interest in a business (like the 30 percent interest in the example), but a marketability discount is usually appropriate for even a majority (or "collective") interest in a business. Although the Greenbook offers as a reason for the proposal the point that "discounts for lack of marketability and lack of control … are not appropriate when families are acting in concert to maximize their economic benefits," there is no reason to interpret that to include the decision of the current or predecessor family members to own and operate a business. And the operation of the business is hardly something the authors of the Greenbook proposal could have assumed "the family often ignores." Indeed, returning to technicalities of grammar, the Greenbook's reference to "valuation discounts …" is itself limited to "**such** interests," which in that case clearly refers

to entities holding "marketable securities and other liquid assets" and "other hard-to-value assets such as real estate, art, or intangibles" (with no mention of businesses).

Finally, any interpretation and implementation of the Greenbook proposal that provides a different valuation method for "passive assets" must deal with the appropriate definition and identification of such "passive assets." For example, "working capital" is explicitly treated as a business asset in the Clinton Administration proposal (see Part 3.h(1)(c) above). But what about capital reserves held for possible expansion, modernization, or other extraordinary expenses incurred by the business?

These are important questions, and the answers could have a big impact on determining whether such legislation, if it gained any traction in Congress, would meet opposition of the kind and degree met by the proposed section 2704 regulations in 2016.

(c) **Effective Date.** The Greenbook proposes that this change apply to valuations for which the valuation date is on or after the date of enactment.

(d) **Revenue Estimate.** This proposal and the preceding proposal regarding the valuation of promissory notes are together estimated to raise approximately $12.2 billion over 10 years.

i. Refinement of Distribution Rules for Private Nonoperating Foundations

Private nonoperating foundations are required to make qualifying distributions of at least 5 percent of the total fair market value of their non-charitable-use assets each year, or be subject to a 30 percent excise tax on the undistributed amount. Qualifying distributions include amounts paid for religious, charitable, scientific, or educational purposes, as well as reasonable and necessary administrative expenses paid by the foundation to further its charitable purposes.

(1) Limiting the Use of Donor Advised Funds

Like the Fiscal Year 2023 and 2024 Greenbooks, the Fiscal Year 2025 Greenbook (at page 144-145) would clarify that a distribution by a private foundation to a donor advised fund (DAF) is not a qualifying distribution unless the DAF's assets are expended as a qualifying distribution by the end of the following taxable year and the private foundation maintains adequate records or other evidence to show that the DAF in fact made that qualifying distribution within that time. The proposal would be effective after the date of enactment. Its revenue estimate, over the next 10 fiscal years, is $64 million in the Fiscal Year 2023 Greenbook, $83 million in the Fiscal Year 2024 Greenbook, and $270 million in the Fiscal Year 2025 Greenbook.

This is not the "Accelerating Charitable Efforts Act" ("ACE Act"), like, for example, S. 1981 (117th Cong.), introduced on June 9, 2021, by Senators Angus King (I-Maine) and Chuck Grassley (R-Iowa) to encourage philanthropic funds to be made available to working charities within a reasonable time by tightening restrictions on donor advised funds (DAFs) and private foundations generally.

(2) Excluding Certain Payments to Family Members

Like the Fiscal Year 2024 Greenbook, the Fiscal Year 2025 Greenbook (at page 146) notes that "[s]ome private foundations meet their entire payout requirement by hiring family members," taking advantage of the exception from the self-dealing rules for paying for personal services that are reasonable and necessary to carry out the foundation's exempt purposes. To curb that practice, the Greenbook proposes that a private foundation's payment of compensation or expense reimbursement to a disqualified person (other than a foundation manager of the private foundation who is not a member of the family of any substantial contributor) would not count toward the 5 percent payout requirement (although, to the extent reasonable and necessary to carry out the foundation's exempt purposes, it would still qualify for the exception from self-dealing). The proposal would apply to payments after the date of enactment and is estimated to raise $7 million over the next 10 fiscal years.

4. Requirements of the Regulatory Process

a. Effects of Executive Orders

(1) 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."

(2) Executive Order 12866, which was signed by President Clinton on September 30, 1993, requires generally that Treasury

(a) 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),

(b) 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

(c) 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*.

(3) Under section 3(f) of Executive Order 12866, a "significant regulatory action" to which the requirements described in paragraphs (b) and (c) 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.

(4) 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).

(5) Obviously, the information listed above 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.

(6) A Memorandum of Agreement signed by the Administrator of OIRA and the General Counsel of the Treasury Department on April 11, 2018, superseded the 1983 Memorandum of Agreement and generally affirmed the application of Executive Order 12866 to "tax regulatory actions."

(a) Under paragraph 3 of the new Memorandum of Agreement, the frequency of providing the list of planned "tax regulatory actions" referred to in paragraph (2)(a) above was quarterly.

(b) Under paragraph 8, the new Memorandum of Agreement was effective immediately, except that the regulatory impact assessment described in paragraph (2)(c) 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."

(c) Under paragraph 4, the time allowed for OIRA review was 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."

(7) This did not work too badly in the tax context. For example, there did not appear to have been excessive delays. And there has been some bipartisan support for this type of oversight. Nevertheless, a new Treasury-OMB Memorandum of Understanding of June 9, 2023, superseded the 2018 Memorandum with regard to "tax regulatory actions," returning processes generally to where they had been since 1983 and before 2017.

b. **Cases Construing the Administrative Procedure Act**

In *Hewitt v. Commissioner*, 128 AFTR 2d 2021-7033 (11th Cir. Dec. 29, 2021), *rev'g and rem'g* T.C. Memo. 2020-89, the Court of Appeals for the Eleventh Circuit held that the proceeds formula in Reg. §1.170A-14(g)(6)(ii), applicable upon judicial extinguishment of a conservation easement, was invalid because the IRS had failed to comply with the Administrative Procedure Act ("APA") by failing in the preamble to the final regulations to address a comment on the proposed regulations that the appellate court considered significant. The Tax Court and a three-judge panel of the Sixth Circuit have rejected that argument and have held that the formula is valid. *Oakbrook Land Holdings, LLC v. Commissioner*, 154 T.C. 180 (reviewed by the Court) (2020), *aff'd*, 129 AFTR 2d 2022-1031 (6th Cir. March 14, 2022), *rehearing en banc denied*, 130 AFTR 2d 2022-5017 (6th Cir. July 6, 2022). See Nancy A. McLaughlin, *Conservation Easements and The Proceeds Regulation*, 56 REAL PROP., TRUST & EST. LAW J. (Summer 2021), and The Top Ten Estate Planning and Estate Tax Developments of 2020 (January 2021) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights)**. If this difference of opinion is ultimately resolved as the Eleventh Circuit sees it, the burden of preparing final regulations and the preambles thereto might significantly increase. The effect on the regulatory process, especially in light of the additional burdens already imposed under the executive orders discussed above, is hard to predict.

5. 2023-2024 Priority Guidance Plan

On September 29, 2023, the Treasury Department and the IRS released the third Priority Guidance Plan in the Biden Administration (**https://www.irs.gov/pub/irs-utl/2023-2024-priority-guidance-plan-initial-version.pdf**) for the plan year from July 1, 2023, through June 30, 2024. The introduction to the 2023-2024 Plan states:

> We are pleased to announce the release of the 2023-2024 Priority Guidance Plan.
>
> In Notice 2023-36, 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 2023-2024 Priority Guidance Plan contains 237 guidance projects that are priorities for allocating Treasury Department and Service resources during the 12-month period from July 1, 2023 through June 30, 2024 (the plan year). Of these projects, 9 have been released or published as of August 31, 2023. 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 2022-2023 Priority Guidance Plan are not included on the 2023-2024 plan because they are no longer considered priorities for purposes of allocating resources during the 2023-2024 plan year. Some of those projects may be considered for inclusion on a future priority guidance plan. …
>
> We intend to update the 2023-2024 plan during the plan year to reflect additional items that have become priorities, guidance that is 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 published guidance process can be fully successful only if we have the benefit of the insight and experience of taxpayers and practitioners who must apply the rules. Therefore, we invite the public to continue to provide us with their comments and suggestions throughout the plan year.

The 2023-2024 Plan includes the following nine items under the subject heading of "Gifts and Estates and Trusts." (A tenth item proposes to identify certain transactions involving charitable remainder annuity trusts as "listed transactions," an action that historically would probably have been handled in a Notice or similar publication, before some courts held that approach to violate the Administrative Procedure Act.)

a. **Item 1: Duration of Section 645 Election**

Item 1 is described as "Regulations under §645 pertaining to the duration of an election to treat certain revocable trusts as part of an estate." No further explanation is offered. Section 645 was added to the Code (then as section 646) in 1997, and regulations were proposed in 2000 and finalized in 2002. The current regulations identify Reg. §1.645-1(i) as "Reserved." But there is no explanation in the 2002 preamble of what might have been intended by that.

On the other hand, under Reg. §1.645-1(f)(2)(ii)(A), one of the measurements of the termination of an election under section 645 is the day before the date that is 12 months after the IRS issues an estate tax closing letter (unless a claim for refund has been filed within that 12 months). Because the IRS no longer routinely issues estate tax closing letters, this measurement may no longer be appropriate, and removing or replacing it may be one of the objectives of this regulation project.

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," and in the 2021-2022 and 2022-2023 Plans it was under the heading of "Gifts and Estates and Trusts."

(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 **https://home.treasury.gov/system/files/131/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-Vermont)) and H.R. 5764 (introduced on July 15, 2010, by Representative Linda Sanchez (D-California)), 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 Representative Jim McDermott (D-Washington), 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 Chair 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 Representative 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 Chair 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 (September 2016) 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 5.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 also suggests that Treasury is either indifferent to that problem or considers itself unable to address 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 Information and Regulatory Affairs' 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, 2022-2023, and 2023-2024 Priority Guidance Plans have not had 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. In fact, the Fall 2021 Unified Agenda of Regulatory and Deregulatory Actions released by the Office of Information and Regulatory Affairs on December 10, 2021, 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." **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" Addition 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). Proposed regulations were published on April 27, 2022." This was also Item 3 under the heading of "Gifts and Estates and Trusts" in the 2021-2022 Plan.

Regulations to prevent "clawback" were proposed in November 2018 (REG-106706-18, 83 FED. REG. 59343 (Nov. 23, 2018)) and finalized in November 2019. The proposed "anti-abuse" addition to the regulations contemplated by this Priority Guidance Plan project was published in the Federal Register on April 27, 2022 (REG-118913-21, 87 FED. REG. 24918). 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 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 basic exclusion amount ("BEA")**. 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 that the 2026 $5 million exclusion amount (indexed) is $6.8 million. (These numbers – $9 million, $11.4 million, and $6.8 million – are the same numbers that are used in the examples in the 2019 regulations and the 2022 proposed addition to the regulations.) 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, within the meaning of section 2001(b)(2), to the extent such credits are based solely on the basic exclusion amount as defined and adjusted in section 2010(c)(3), **exceeds** the credit allowable within the meaning of section 2010(a) in computing the estate tax, again only to the extent such credit is based solely on such basic exclusion amount, in each case by applying the tax rates in effect at the decedent's death, then the portion of the credit allowable in computing the estate tax on the decedent's taxable estate that is attributable to the basic exclusion amount is **the sum of the amounts attributable to the basic exclusion amount allowable as a credit in computing the gift tax payable** on the decedent's post-1976 gifts.

In other words, in the example above, 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 $6.8 million to calculate the credit for estate tax purposes. 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 (death in 2026)	20,000,000	20,000,000
4	Adjusted taxable gifts ($9,000,000 gift made in 2019)	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 (subtract line 7 from line 6)	11,545,800	11,545,800
9a	**Basic exclusion amount [BEA]**	**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 (line 9e minus line 10)	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
* The greater of the 2026 BEA or the BEA used to calculate the credit in 2019	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 … required to be applied against the net tentative estate tax" to a credit "based on the larger amount of BEA … that was used to compute gift tax payable" – in other words, by adjusting the basic exclusion amount ("BEA") entered on line 9a of the estate tax return.

(c) By increasing the amount on line 9a, rather than the amount on line 7, the regulations achieve the same result, because both line 7 and line 9a are subtractions in the estate tax calculation. But line 7 already required over two pages of instructions (pages 7-9 in the September 2021 version), 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." And in a way

it mirrors section 2001(g)(2) itself, which expresses Congress's clawback concern in 2017 in terms of the basic exclusion amount.

(d) That approach should work fine if the law is not changed and sunset occurs January 1, 2026. 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 2019 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) The preamble to the 2019 final regulations added:

> 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), **while the gift itself is excluded from "adjusted taxable gifts" (line 4 of the estate tax return) under the last phrase of section 2001(b)**. 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 looking at that $8,880,000 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) = $8,880,000, or

ii. 40 percent times (the taxable estate of $29,000,000 minus the applicable exclusion amount of $6,800,000) = 0.4 × $22,200,000 = $8,880,000.

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 anti-clawback bonus, as the following table indicates.

Same Comparison, Except that the 2019 $9,000,000 Gift is a "String Gift" 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 (in 2026, including $9,000,000 string gift)	29,000,000	29,000,000
4	Adjusted taxable gifts (string gift omitted under §2001(b))	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 (subtract line 7 from line 6)	11,545,800	11,545,800
9a	**Basic exclusion amount [BEA]**	**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 (line 9e minus line 10)	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
* The greater of 2026 BEA or BEA used in 2019	Intuitively correct tax	8,880,000	8,880,000
	Unintended anti-clawback bonus	0	880,000

That "bonus" is undoubtedly what prompted the IRS and Treasury to consider an "anti-abuse provision."

(8) **The Proposed "Anti-Abuse" Addition.** The April 2022 proposal would do what the 2019 preamble foretold and would address the "anti-clawback bonus" the preceding table illustrates. The proposal would add a new subparagraph (3) to the anti-clawback paragraph (c) that was added to Reg. §20.2010-1 in 2019. The new subparagraph (3) provides exceptions from the anti-clawback rules of paragraph (c) for "transfers includible in the gross estate, or treated as includible in the gross estate for purposes of section 2001(b)." It elaborates such transfers as "**including without limitation**" four specific types of transfers:

(a) "Transfers includible in the gross estate pursuant to section 2035 [gifts completed by a transfer or by a relinquishment of a power within three years of death], 2036 [transfers with a retained life estate], 2037 [transfers taking effect at death], 2038 [revocable transfers], or 2042 [life insurance proceeds], regardless of whether all or any part of the transfer was deductible pursuant to section 2522 [charitable gifts] or 2523 [gifts to the donor's spouse]." This is as forecast in the 2019 preamble. It would simply preserve the "clawback," in effect, that provisions like section 2036 (and their predecessors) have been designed to achieve since at least the 1930s.

(b) "Transfers made by enforceable promise to the extent they remain unsatisfied as of the date of death." Such transfers were not explicitly targeted in the 2019 preamble. But, because the donor/promisor keeps the enjoyment of the property until the promise is satisfied, there certainly is a resemblance to section 2036. As the preamble observes, such transfers have been excluded from adjusted taxable gifts under Rev. Rul. 84-25, 1984-1 C.B. 191.

(c) "Transfers described in §25.2701-5(a)(4) or §25.2702-6(a)(1)" of the regulations. This fulfills the explicit attention of the 2019 preamble to "certain transfers within the purview of chapter 14 of subtitle B of the Code." In two helpful paragraphs, the current preamble explains why Treasury and the IRS did not consider it necessary to also amend Reg. §25.2701-5 (as the comments of the Tax Section of the New York State Bar Association had recommended) or, similarly, Reg. §25.2702-6(b).

(d) Transfers that would have fit one of those three categories "but for the transfer, relinquishment, or elimination of an interest, power, or property, effectuated within 18 months of the date of the decedent's death by the decedent alone, by the decedent in conjunction with any other person, or **by any other person**" (emphasis added), unless "effectuated by the termination of the durational period described in the original instrument of transfer by either the mere passage of time or the death of any person" (Proposed Reg. §20.2010-1(c)(3)(ii)(B)). While similar to the existing three-year rule of section 2035, this provision is conspicuously extended to affirmative actions not by the decedent but "by any other person." The exception for "the termination of the durational period described in the original instrument of transfer" may encourage more attention to the provision of such durational periods in original transfer documents.

Of course, the phrase "including without limitation" leaves open the possibility that scenarios other that the four scenarios spelled out would also be excepted from the anti-clawback rules. But the description "includible in the gross estate, or treated as includible in the gross estate for purposes of section 2001(b)" ought to be quite objective and easy to apply in most cases.

This exception from the anti-clawback rules would not apply to "[t]ransfers includible in the gross estate in which the value of the taxable portion of the transfer, determined as of the date of the transfer, was 5 percent or less of the total value of the transfer." The preamble explains this limitation by comparison to similar rules applicable to reversionary interests in sections 2037(a)(2) (estate tax consequences of the retention of a reversionary interest), 2042(2) (estate tax consequences of the possession of an "incident of ownership" in a life insurance policy) , and 673(a) (consequences of a reversionary interest on the determination of grantor trust treatment). That makes sense because the types of transfers targeted by the exception do resemble reversionary interests. A 5 percent de minimis rule might also make sense because such transfers by definition would use a small amount of the doubled basic exclusion amount ("BEA") compared to the total amount transferred. The preamble adds that "[t]his bright-line exception … is proposed in lieu of a facts and circumstances determination of whether a particular transfer was intended to take advantage of the increased BEA without depriving the donor of the use and enjoyment of the property."

The proposed addition to the regulations includes seven reasonably helpful, but not particularly surprising, examples, illustrating the treatment of various combinations and amounts of gifts of cash and promissory notes, gifts to GRATs and GRITs, and use of DSUE amounts. Among other things, the examples confirm the results of the examples in the 2019 regulations (see paragraph (5) above) that in the case of a portability election the DSUE amount is applied before the surviving spouse's basic exclusion amount.

(9) **Effective Date.** The contemplated addition to the regulations would apply only prospectively – that is, only to the estates of decedents dying on or after April 27, 2022, the date the proposed addition was published in the Federal Register. But it should also be noted that it would apply to the calculation of the future **estate tax**, even if the **gift** includible, or treated as includible, in the gross estate was made before April 27, 2022. Thus, it should be expected to first apply to the estate of someone who dies after December 31, 2025, when the "sunset" enacted in 2017

occurs, which the preamble to the proposed addition acknowledges. In that way, 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, even if those lifetime actions were taken before April 27, 2022 – indeed, as early as January 1, 2018.

The Ways and Means Committee's proposal (see Part 2.b(2) above) to accelerate the "sunset" to January 1, 2022, could have meant that, unless the "anti-abuse" addition was made before the end of 2021, some persons who had made post-2017 gifts with potential for inclusion in the gross estate might die before the regulations were effective. Those persons' estates might have benefited from the unintended anti-clawback bonus. Or the regulations might have provided for retroactive application to those estates, which is sometimes done in true "abuse" cases. Such planning after December 31, 2017, by persons who die on or after April 27, 2022, would have been 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 Information and Regulatory Affairs' 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 "Final regulations under §2053 regarding the deductibility of certain interest expenses and amounts paid under a personal guarantee, certain substantiation requirements, and the applicability of present value concepts in determining the amount deductible. Proposed regulations were published on June 28, 2022." Previously, as in Item 5 in the 2021-2022 Plan, this project has been described simply 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." Proposed regulations were released on June 24, 2022, and published as REG-130975-08, 87 FED. REG. 38331 (June 28, 2022).

(2) This project first appeared in the 2008-2009 Plan as an outgrowth of the project that led to the amendments of the section 2053 regulations that had been proposed in April 2007 and finalized 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)) (emphasis added):

> 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) Specifically addressing that issue, a new Proposed Reg. §20.2053-1(d)(6) would require, except for unpaid principal of mortgages and other indebtedness deductible under Reg. §20.2053-7, a present-value discounting of claims and expenses not paid or expected to be paid within a "grace period" ending three years after the decedent's death. Under Proposed Reg. §20.2053-1(d)(6)(i)(B), the discount rate to be used would be the applicable federal rate determined under section 1274(d) for the month in which the decedent died, compounded annually. Whether that is the mid-term rate (3-9 years) or long-term rate (over 9 years) would be determined by the length of time from the date of the decedent's death to the date of payment or expected date of

payment. Proposed Reg. §20.2053-1(d)(6)(vi) provides that any such discounted deduction is "subject to adjustment" to reflect any change in the amount or timing of the payment while the statute of limitations on assessment of estate tax has not run or a claim for refund is pending – basically an application of the existing rule in Reg. §20.2053-1(d)(2).

(4) A new Proposed Reg. §20.2053-3(d) (with the current paragraphs (d) and (e) redesignated paragraphs (e) and (f)) addresses the deduction of interest as an estate administration expense.

(a) Proposed Reg. §20.2053-3(d)(1)(i) affirms the nondeductibility of interest on federal estate tax deferred under section 6166, in accordance with section 2053(d)(1)(D), which was added to the Code in 1997.

(b) Proposed Reg. §20.2053-3(d)(1)(ii) and (iii) affirm and amplify the requirement of Reg. §20.2053-3(a) that to be deductible the payment of interest must be "actually and necessarily incurred in the administration of the decedent's estate."

i. Proposed Reg. §20.2053-3(d)(1)(ii) states that interest on federal estate tax deferred under section 6161 or 6163 meets that requirement because of "a demonstrated need to defer payment," while other interest on unpaid federal tax or interest payable under state or local law "generally" meets that requirement.

ii. But Proposed Reg. §20.2053-3(d)(1)(iii) provides that interest does not meet that requirement "to the extent the interest expense is attributable to an executor's negligence, disregard of applicable rules or regulations (including careless, reckless, or intentional disregard of rules or regulations) as defined in [Reg. §1.6662-3(b)(2)], or fraud with intent to evade tax." Because the proposed regulation confirms that interest on federal tax is "generally" deductible, it should be presumed (hoped?) that this exception would be applied with moderation and balance.

(c) Proposed Reg. §20.2053-3(d)(2) addresses "[i]nterest on a loan entered into by the estate to facilitate the payment of the estate's tax and other liabilities or the administration of the estate." It proposes that such interest "may be deductible depending on all the facts and circumstances." In general, citing Reg. §20.2053-1(b)(2), the proposed regulation would require that the loan and the interest expense be "bona fide," and, again echoing Reg. §20.2053-3(a), would require that "both the loan to which the interest expense relates and the loan terms must be actually and necessarily incurred in the administration of the decedent's estate and must be essential to the proper settlement of the decedent's estate." The proposed regulation then goes on to provide a non-exclusive list of 11 factors it describes as "factors that collectively may support a finding that the interest expense also satisfies the additional requirements under §20.2053-1(b)(2) and paragraph (a)." For example:

i. Proposed Reg. §20.2053-3(d)(2)(viii) (emphasis added) cites favorably the factor that "[t]he estate's illiquidity does not occur after the decedent's death as a result of the decedent's **testamentary estate plan to create illiquidity**." The preamble (emphasis added) distinguishes the case where "illiquidity has been created **intentionally** (whether **in the estate planning**, or by the estate …") and later adds a reference to a "need for the loan … **contrived** to generate, or increase the amount of, a deduction for the interest expense." A lot of entirely legitimate "estate planning," especially in the context of family-owned and -operated businesses, includes the creation of safeguards to preserve family ownership, which necessarily prevent or seriously limit transfers outside the family. The side effect could of course be viewed as "illiquidity." Estate planners would welcome some assurance in the final regulations that such legitimate business planning is not the target of these regulations, possibly with both positive and negative examples involving family businesses.

ii. Proposed Reg. §20.2053-3(d)(2)(ix) and (x) view negatively the fact that the lender is a beneficiary of the estate. Specifically, as "factors that collectively may support a finding that the interest expense also satisfies the additional requirements" of the regulations, these subdivisions state (emphasis added):

(ix) The lender is **not a beneficiary** of a substantial portion of the value of the estate, and is not an entity over which such a beneficiary has control (within the meaning of section 2701(b)(2)) or the right to compel or direct the making of the loan.

(x) The lender or lenders are **not beneficiaries** of the estate whose individual share of liability under the loan is substantially similar to his or her share of the estate.

It is understandable that the IRS and Treasury would be concerned about structures that might try to convert distributions to beneficiaries in their capacities as beneficiaries into interest payments that are deductible in computing the estate tax. Or concerned about borrowing from a family-owned entity that might own enough liquid assets to have accommodated the funding of the estate's tax and other obligations with a simple distribution, as analyzed in *Estate of Koons v. Commissioner*, 686 Fed. Appx. 779, 119 AFTR 2d 2017-1609 (11th Cir. 2017), *aff'g* T.C. Memo. 2013-94, and cases cited therein. But it is also the experience of many estate planners that the option of borrowing from a family-owned entity, including an operating business, may be not only the most convenient but also the most protective of the viability of that entity or business whose owners are faced with tax liabilities that shareholders of public corporations, for example, could satisfy simply by sales of stock that do not affect the company. The proposed regulations would not prohibit the deduction of interest in such cases; they simply offer "factors" to be weighed. Again, estate planners would welcome some assurance in the final regulations that such weighing would be appropriately balanced.

(5) In any event, *Graegin* loans (see *Estate of Graegin v. Commissioner*, T.C. Memo. 1988-477), which prohibit prepayment of either principal or interest and therefore have been held to allow a full undiscounted estate tax deduction for the payment of interest that might be deferred for, say, 15 years, would lose that element of their effectiveness. Even if such loans satisfy the "bona fide" and "actually and necessarily incurred" tests (which is not assured), the interest would be expected to be paid more than three years after the decedent's death and thus would be discounted under Proposed Reg. §20.2053-1(d)(6).

(6) Reg. §20.2053-4(b) and (c), part of the 2009 amendments of the regulations, incorporate the "qualified appraisal" and "qualified appraiser" concepts from the context of valuing charitable gifts for income tax purposes into the context of valuing claims against the estate for estate tax purposes. The preamble to the current proposed regulations acknowledges that those concepts are an awkward fit, and proposed amendments to those regulations would replace it with a list of requirements for an appraisal that is more focused on the section 2053 context. One of those requirements, in Proposed Reg. §20.2053-4(b)(1)(iv)(F) and (c)(i)(iv)(F), is that the appraisal be signed by the appraiser "under penalties of perjury." That is apparently an unprecedented requirement, and it is especially surprising in a context that requires the appraiser to be unrelated and therefore less likely to have first-hand knowledge of the underlying facts.

(7) New Proposed Reg. §20.2053-4(d)(5)(ii) addresses the "personal guarantees" component of the guidance project. Currently, Reg. §20.2053-4(d)(5) affirms that under section 2053(c)(1)(A), except for pledges or subscriptions addressed in Reg. §20.2053-5, deducting a claim based on a promise or agreement requires that the promise or agreement was bona fide (that is, was bargained for at arm's length and, in the case of a claim involving a family member, meets the requirements of Reg. §20.2053-1(b)(2)(ii)) and was in exchange for adequate and full consideration in money or money's worth. The new subdivision (ii) would provide that those tests are met by a decedent's agreement to guarantee a debt of an entity if, at the time the guarantee is given, either the decedent had an interest in the entity and had control of the entity within the meaning of section 2701(b)(2) or the maximum liability of the decedent under the guarantee did not exceed the fair market value of the decedent's interest in the entity. The amount deductible is reduced to the extent the guaranteed debt is taken into account in computing the value of the gross estate or the estate has a right of contribution or reimbursement.

(8) As proposed, the changes would apply to the estates of decedents dying on or after the date the final regulations are published in the Federal Register.

f. **Item 6: Qualified Domestic Trust Elections**

Item 6, which was new in the 2022-2023 Plan, is described as "Regulations under §20.2056A-2 for qualified domestic trust elections on estate tax returns, updating obsolete references." Reg. §20.2056A-2 is among the qualified domestic trust (QDOT) regulations added in 1995. There is no reason to think that this project is intended to make any substantive changes, in contrast to merely "updating obsolete references."

g. **Items 7 and 8: Allocation of GST Exemption**

(1) Item 7 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." It is identical to Item 6 in the 2021-2022 Plan, which is the first time it appeared, and to Item 8 in the 2022-2023 Plan. It is evidently related to Item 8 and is intended to address not only the consequences of the relief described in Item 8 but also, as the description says, the definition of a "GST trust" for purposes of the deemed allocation rules of section 2632(c) and ordering rules when too much GST exemption is ostensibly allocated.

(2) Item 8 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. Proposed regulations were published on April 17, 2008." This project first appeared in the 2007-2008 Plan. In the 2021-2022 Plan it was Item 7 under "Gifts and Estates and Trusts," and in the 2020-2021 Plan it was Item 18 of Part 3, which was titled "Burden Reduction."

(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). In addition to an "extension of time … to allocate GST exemption," as the Priority Guidance Plan cites, the proposed regulations would also apply to elections out of deemed allocations under section 2632(b)(3) for direct skips and section 2632(c)(5)(A)(i) for indirect skips and transfers made to a GST trust, and elections under section 2632(c)(5)(A)(ii) to treat any trust as a GST trust for purposes of section 2632(c)).

(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 8 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 5.k(4) 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 Part 5.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 37 under the heading of "General Tax Issues" in the 2023-2024 Plan 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.

h. **Item 9: Taxation of Transfers from Certain Expatriates**

(1) Item 9 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 in the 2008-2009 Priority Guidance Plan, but was dropped from the Plans during the Trump Administration, and then reappeared as Item 8 under the heading of "Gifts and Estates and Trusts" in the 2021-2022 Plan.

(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 in 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

interest in broader deemed realization legislation (see Parts 1.c, 1.e, and 3.b 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, 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. 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.

i. **Removed, Apparently Because Purportedly Completed: Basis of Grantor Trust Assets**

(1) Item 2 of the 2022-2023 Plan was described as "Guidance regarding availability of §1014 basis adjustment at the death of the owner of a grantor trust described in §671 when the trust assets are not included in the owner's gross estate for estate tax purposes."

(2) 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.

(3) In Letter Ruling 200434012 (April 23, 2004), involving a sale from one grantor trust to another, the Service included the caveat 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" (emphasis added).

(4) 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).

(5) 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 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**" (emphasis added). 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."

(6) This guidance project, at least at first, may somehow have been related to the analytical gymnastics found in those authorities.

(7) On the other hand, there was reason to assume that this proposal was simply aimed at a clarification of the rules for foreign trusts.

   (a) 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, section 5.01(11) of Rev. Proc. 2021-3, 2021-1 I.R.B. 140, section 5.01(11) of Rev. Proc. 2022-3, 2022-1 I.R.B. 144, and section 5.01(11) of Rev. Proc. 2023-3, 2023-1 I.R.B. 144.

   (b) Meanwhile, Letter Ruling 201544002 (June 30, 2015) 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. Letter Ruling 201544002 was similar to Letter Ruling 201245006 (July 19, 2012), which in addition had cited Rev. Rul. 84-139, 1984-2 C.B. 168 (holding that foreign real property that is inherited by a U.S. citizen from a nonresident noncitizen will receive a step-up in basis under section 1014(a)(1) and (b)(1)).

   (c) 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, 2021-3, 2022-3, and 2023-3 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.

(8) Then again, the revival of this project might have stemmed from something much more recent and dramatic than a 2015 private letter ruling.

   (a) On March 8, 2022, Representative Bill Pascrell (D-New Jersey), Chair of the House Ways and Means Committee's Oversight Subcommittee, wrote to Secretary of the Treasury Yellen, urging her "to expand efforts to crackdown on tax abuse by wealthy families," (See his press release at **https://pascrell.house.gov/news/documentsingle.aspx?DocumentID=5043**.) This is an excerpt from his letter:

> One of those strategies is to claim stepped-up basis for assets in an irrevocable grantor trust upon the grantor's death. A common estate planning technique used by wealthy individuals is to transfer assets to an irrevocable grantor trust while the individual is still alive. The trust's property will generally not be included in the individual's gross estate at death, thereby avoiding the estate tax. Internal Revenue Code section 1014 generally provides that the basis of property acquired from a decedent is the fair market value at the decedent's death ("stepped-up basis"). Property is eligible for this treatment if it is acquired by bequest, devise, or inheritance or by the decedent's estate from the decedent. Also eligible for the stepped-up basis treatment is property included in the decedent's estate for federal estate tax purposes. Thus, assets outside the estate in an irrevocable trust do not qualify for Code section 1014's stepped-up basis treatment under long-established interpretations of the language of Code section 1014.

> … Complicating matters is a 2012 private letter ruling (PLR 201245006) that seemed to imply that a transfer from an irrevocable grantor trust to another taxpayer at the grantor's death would qualify as a "bequest, devise, or inheritance," thus potentially qualifying for stepped-up basis treatment.
>
> While the IRS announced it would no longer issue private letter rulings on this issue in 2015, it has not followed up with regulations, despite Treasury including this issue in its Priority Guidance Plan in 2015-2016. However, the 2021-2022 Priority Guidance Plan does not include it.
>
> I would like to request that you promulgate regulations clarifying that the phrase "bequest, devise, or inheritance" in Code section 1014(b)(1) does not apply to the termination of grantor trust status upon the grantor's death or to the transfer of an irrevocable grantor trust's property upon a grantor's death. Further, the regulations should be promulgated through notice-and-comment rulemaking to ensure they withstand Administrative Procedure Act scrutiny.

(b) The letter overlooks the relevance of the fact that the trusts in Letter Ruling PLR 201245006 (which the letter cites) and in Letter Ruling 201544002 (which apparently triggered the no-ruling position the letter cites) were created by non-U.S. persons and otherwise would not have "avoid[ed] the estate tax" But Representative Pascrell is perhaps just as concerned about a basis step-up without realization of gain for trusts that are subject to estate tax. The principal deemed realization provision in his bill, H.R. 2286 (which his letter also cites) expressly cites "includible in the gross estate" as one of the tests for the trusts to which it would apply. See the description of H.R. 2286 in Part 1.c above.

(c) This issue might have come to a head in a Ways and Means Committee hearing on June 8, 2022, where Representative Pascrell initiated the following exchange with Secretary Yellen:

> Rep. Pascrell: "In March I wrote to you suggesting that the Department issue regulations on irrevocable grantor trusts to limit rampant abuse of the infamous stepped-up basis loophole. And we talked a good game about tax reform and we didn't do anything, really. We tried. I appreciate your response and your willingness to work on the issue. This loophole is used by some of the wealthiest Americans as a way to avoid paying their fair share. And we're defining it. I think both sides are zeroing in on that really. We speak more of it than they do. Can you tell me specifically how and when the Treasury Department and the Internal Revenue Service will implement the guidance?"
>
> Secretary Yellen: "We are working very hard on that and …"
>
> Rep. Pascrell: "Yeah, I've heard that before, but when?"
>
> Secretary Yellen: "Very soon. Very soon."
>
> Rep. Pascrell: "Thank you."

About five months later, this project appeared (or reappeared) in the 2022-2023 Priority Guidance Plan.

(9) On March 29, 2023, the IRS released Rev. Rul. 2023-2, 2023-16 I.R.B. 658, apparently the intended product of this Priority Guidance Plan project (at least in its most recent iteration).

(a) The revenue ruling simply goes through the list in section 1014(b) of circumstances that cause property to be "considered to have been acquired from or to have passed from the decedent" for purposes of the adjusted basis at death rule of section 1014(a) and finds that a decedent's power over a trust that causes the decedent to be treated as the owner of the trust under the grantor trust rules but does not cause the value of the trust assets to be included in the decedent's gross estate is not on that list. Therefore, the basis of that trust's asset is not adjusted to fair market value at the decedent's death.

(b) Rev. Rul. 2023-2 cites Rev. Rul. 84-139 and adds in a footnote:

> This revenue ruling does not alter the result in Rev. Rul. 84-139. Property acquired from a non-resident non-citizen decedent that is not included in his or her gross estate may receive a basis adjustment under § 1014 if the property is acquired by bequest, devise, or inheritance within the meaning of § 1014(b)(1) or is otherwise specifically described in § 1014(b).

It appears that the outcomes in Letter Rulings 201245006 and 201544002 (which applied the principle of Rev. Rul. 84-139) would not be affected either, because revocable trusts are

explicitly included in section 1014(b)(2) and therefore "otherwise specifically described in § 1014(b)."

(c) The facts in the revenue ruling include the curious details that (1) the asset it addresses was transferred to the trust in a transaction that was "a completed gift for gift tax purposes" and that at the grantor's death (2) the trust's liabilities did not exceed the basis of its assets and (3) neither the trust nor the grantor "held a note on which the other was the obligor." The first stipulation in particular would exclude the familiar case of an installment sale to a grantor trust, especially (under the third stipulation) if the note is not paid off before the grantor's death. Despite those significant limitations of the revenue ruling's reach, on the same day the IRS released the revenue ruling Representative Pascrell, in a press release (**https://pascrell.house.gov/news/documentsingle.aspx?DocumentID=5310**), "praised fresh action by the U.S. Treasury Department and Internal Revenue Service to curb abuse of arguably the worst loophole in the entire federal tax code, so-called stepped-up basis." The press release added that "[t]his action follows prodding by Pascrell to issue this guidance." So, even if the guidance project once had a more technical purpose, as discussed above, the political purpose illustrated in paragraph (8) above has apparently been accomplished.

(10) Ironically, despite the publication of Rev. Rul. 2023-2 and the omission of this item from the 2023-2024 Priority Guidance Plan, the issue of "[w]hether the assets in a grantor trust receive a § 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" remains on 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." Rev. Proc. 2024-3, 2024-1 I.R.B. 143, section 5.01(10). Perhaps that means that the IRS still plans to address the issue in the context of foreign trusts, or perhaps to address the application of Rev. Rul. 2023-2 without its limitations regarding a completed gift for gift tax purposes and liabilities in excess of basis and promissory notes between the trust and the grantor at the grantor's death.

j. **Removed Because Completed: Actuarial Tables**

(1) Item 11 of the 2022-2023 Plan was 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. Proposed regulations were published on May 5, 2022." This item was new in the 2018-2019 Plan.

(2) The previous mortality tables, based on 2000 census data, became effective May 1, 2009. Before that, mortality tables had taken effect on May 1, 1989, May 1, 1999, and May 1, 2009. Section 7520(c)(2) mandates revision of the tables "not less frequently than once each 10 years to take into account the most recent mortality experience available as of the time of the revision." Thus, the tables provided by this guidance project were due by May 1, 2019. They were delayed in part because the decennial life table data that form the basis for those tables was reportedly not compiled and made available by the National Center for Health Statistics of the Centers for Disease Control and Prevention until August 2020.

(3) New tables, based on 2010 census data, are applied in lengthy regulations, released as proposed regulations on May 4, 2022 (REG-122770-18, 87 FED. REG. 26806, May 5, 2022), and, with revisions, as final regulations on June 1, 2023 (T.D. 9974, 88 FED. REG. 37424, June 7, 2023). The new tables are available on the IRS website at **https://www.irs.gov/retirement-plans/actuarial-tables**. The 2010 census data on which these new tables are based show significantly increased longevity, especially for older persons, compared to the 2000 census data. Accordingly, these new tables produce significantly higher values for life interests and significantly lower values for remainder interests following life interests. For any given section 7520 interest rate, this results, for example, in larger charitable deductions for charitable lead annuity trusts (CLATs) for the life of an individual, but smaller charitable deductions (and more difficulty satisfying the 10 percent remainder test and 5 percent exhaustion test) for charitable remainder annuity trusts (CRATs). Valuations based on a fixed term and not life expectancies (as

in term loans and GRATs) are affected only by the monthly section 7520 rate and are not affected by these new tables.

(4) The new tables generally took effect on June 1, 2023, the day they were released by the IRS and filed with the Federal Register. But, in view of the tardiness of these tables, the regulations include special effective date and transitional rules.

(a) Under Reg. §§20.2031-7(d)(3) and 25.2512-5(d)(3) (other specific regulations have similar provisions), for gifts or dates of death after April 30, 2019, and on or before June 1, 2023, the mortality component of any applicable value, including a charitable deduction, may be determined under either the 2000 tables or these new 2010 tables "at the option of the donor or the decedent's executor."

i. That choice must be the same choice with respect to all valuation elements of the same transfer and, for estate tax purposes, all transfers occurring at death. Specifically, those regulations state:

> The decedent's executor [or "With respect to each individual transaction, the donor"] must consistently use the same mortality basis with respect to each interest (income, remainder, partial, etc.) in the same property, and with respect to all transfers occurring on the same valuation date. For example, gift and income tax charitable deductions with respect to the same transfer must be determined based on factors with the same mortality basis, and all assets includible in the gross estate and/or estate tax deductions claimed must be valued based on factors with the same mortality basis.

ii. The **interest rate** will be the applicable rate under section 7520 (which rates have continued to be published monthly without interruption) in effect for the month of the transfer or death.

iii. Applying the rules already contained in Reg. §§1.7520-2(a)(2), 20.7520-2(a)(2), and 25.7520-2(a)(2), the preamble to the proposed regulations noted that, in the case of a charitable deduction, if the taxpayer elects under section 7520(a) to use the interest rate for one of the two preceding months, and that elected month is prior to the elective transitional period (in other words, under the final regulations, it is March or April 2019), then **only the 2000 mortality tables** may be used to compute **the mortality component**.

(b) The proposed regulations would have provided for such an election only back to January 1, 2021, not May 1, 2019, despite the statutory mandate to update the tables "not less frequently than once each 10 years."

i. That is not entirely inexplicable, in view of the fact (noted above) that the IRS did not receive the necessary decennial life table data until August 2020. Even by August 2020, it was possible that some gift or estate tax returns reporting gifts made or deaths occurring on or after May 1, 2019, had already been filed. That possibility would have become a near certainty by the time the IRS had finished processing the data and had drafted and published proposed regulations. Choosing an election-back date of January 1, 2021, could have increased the likelihood that such returns would not have been filed before the publication of proposed regulations. Such gift tax returns and estate tax returns (on extension) would not have been due until April 2022.

ii. But then, the proposed regulations were not published in late 2020, or even in 2021, but not until May 2022, possibly because of Covid shutdowns, or competing regulatory priorities resulting from new legislation, or the unanticipated enforcement of old-fashioned administrative requirements that tables be reproduced in writing in the Federal Register and not just made available on the IRS website with appropriate references or links in the Federal Register version. Thus, when the proposed regulations were published in May 2022, January 1, 2021, arguably made no more sense than May 1, 2019, for avoiding amended returns and related burdens and inconveniences. In any event, section 7520(c)(2) seemed to mandate the option to elect back to May 1, 2019,

which was a recurring theme in the public comments that the IRS received about the proposed regulations.

iii. To illustrate, consider the case of a charitable lead annuity trust (CLAT) created for the lifetime of the creator's spouse by gift or at death on or after May 1, 2019, but before January 1, 2021. As noted above, the significantly increased longevity reflected in the 2010 census data would result in a significantly larger charitable deduction than the proposed regulations would allow. It seemed that the donor or the decedent's estate would be entitled to that larger deduction by statute. Even conceding that the delay in completing the tables was due to circumstances beyond anyone's control and thus was not anyone's "fault," it certainly wasn't the fault of that donor or decedent, and it would not have been fair to deny the donor or the estate what the statute mandates.

iv. In acknowledging the public comments and explaining the change of the election-back date to May 1, 2019, the preamble to the final regulations states:

> After careful thought and consideration of these comments as well as the administrative concerns of the IRS, the Treasury Department and the IRS have concluded that the issue of fairness to taxpayers in this circumstance outweighs the foreseeable administrative burdens on the IRS. As a result, the final regulations extend the proposed transition period to apply to transactions that occurred on or after May 1, 2019, and before June 2, 2023.

v. In addition, suppose the annuity payment from the CLAT was defined as a percentage of the value of the property transferred to the CLAT (as allowed by Reg. §20.2055-2(e)(2)(vi)(a)), and that percentage was determined by a formula intended to achieve a certain estate or gift tax result – "zeroing out" the CLAT, for example, and the gift or estate tax return had already been filed (which is likely for a transition period that goes back to May 1, 2019). The IRS has been wary of attempts to change those kinds of calculations in a manner that looks retroactive, as seen as early as *Commissioner v. Procter*, 142 F.2d 824 (4th Cir. 1944), *rev'g and rem'g* 2 T.C.M. 429 (1943), *cert. denied*, 323 U.S. 756 (1944), and as recently as *Estate of Moore v. Commissioner*, T.C. Memo. 2020-40. Thus, it is very helpful that the preamble to the final regulations dispels such alarm in such cases by adding:

> The availability of the option to use the revised actuarial tables based on Table 2010CM for valuation dates during the transition period, whether or not exercised, is not a condition subsequent and does not limit or otherwise affect the validity of any formula or other condition in a document (even if created before the transition period) that is intended to determine the amount, value, character, or tax treatment of a transfer.

vi. Picking up the point that a return might have already have been filed, the preamble also adds:

> Extending the transition period back to May 1, 2019, means that an applicable limitations period before which an amended or supplemental return may need to be filed may expire soon after the publication of this Treasury decision. Therefore, in the interests of efficient tax administration, and in order to allow the IRS to identify such an amended or supplemental return more easily, the final regulations require that the top of that return include the caption "AMENDED PURSUANT TO TD 9974" or "SUPPLEMENTED PURSUANT TO TD 9974", respectively.
>
> …
>
> … [N]o other affirmative statement is required to make the election.

The regulations that specifically refer to that option are Reg. §§1.642(c)-6(e)(2) (value for income tax purposes of a remainder interest in property transferred to a pooled income fund), 1.664-4(d) (value for income tax purposes of a remainder interest in a charitable remainder unitrust), 20.2031-7(d)(3) (value for estate tax purposes of annuities, interests for life or a term of years, and remainder or reversionary interests in general), and 25.2512-5(d)(3) (value for gift tax purposes of annuities, interests for life or a term of years, and remainder or reversionary interests in general).

k. **Other Notable Omissions from the Priority Guidance Plan**

(1) **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 (issued Feb. 24, 2012; released July 26, 2013) 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.

(h) On the other hand, Treasury and the IRS might have given up on regulatory guidance in favor of seeking new legislation. See the discussion of the Fiscal Year 2023, 2024, and 2025 Greenbook proposals in Part 3.g(2) above.

(2) **Defined Value Clauses**

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. The background of defined value clauses and their current status as a target of legislative proposals in the Fiscal Year 2024 and 2025 Greenbooks are described in Part 3.d(5) above.

(3) **"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.

(b) This guidance could have shed light on the application to trusts and estates of the "trade or business" exception in section 1411(c)(1)(A)(i) to the 3.8 percent tax on net investment income under section 1411 (enacted in 2010). Congress applied that requirement in 2010 to the "trade or business" exception by including in section 1411(c)(1)(A)(i) the qualifier "not described in paragraph (2)" and by including in subparagraph (A) of paragraph (2) "a passive activity (within the meaning of section 469)," thus incorporating into section 1411 the definition of section 469(c)(1) that "[t]he term 'passive activity' means any activity (A) which involves the conduct of any trade or business, and (B) in which **the taxpayer does not materially participate**."

(c) Chief Counsel Advice 201244017 (issued Aug. 3, 2012; released Nov. 2, 2012) took the position that

> a trust cannot meet the qualifying tests of 469(c)(7)(B) because those tests are intended to apply only to individuals. Only individuals are capable of performing "personal services" …, and the statute specifically states that the personal services must be performed by the taxpayer.

(d) 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 November 26, 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."

(e) Then, in the section 469 case of *Frank Aragona Trust v. Commissioner*, 142 T.C. 165 (March 27, 2014), the Tax Court (Judge Morrison) held that the material participation by the trust in real estate operations may be determined by considering the activities of the trustees, including the activities of some of the trustees in their roles as employees of an LLC wholly owned by the trust, and that by that standard the court was "convinced that the trust materially participated in the trust's real-estate operations."

(f) There has been no acquiescence or nonacquiescence or any other formal indication of the IRS's view of this subject in light of *Aragona*. But five months after the *Aragona* decision, on August 26, 2014, the 2014-2015 Treasury-IRS Guidance Plan, under the heading of "General Tax Issues," included for the first time a project described as "Guidance regarding material participation by trusts and estates for purposes of §469." That project was repeated in two more annual Plans but was dropped from the 2017-2018 Plan, thus essentially leaving the regular published Tax Court decision in *Aragona* as the last word on the subject.

(g) And this issue might become moot if an expansion of the tax on net investment income such as the proposal described in Part 2.b(7)(c) above is enacted.

(4) **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.

(5) **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 in 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. 2024-3, 2024-1 I.R.B. 143, §§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. 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.

(6) **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. 2024-3, 2024-1 I.R.B. 143, §§5.01(7), (16) & (19) 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.

ii. 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.

6. Gift by Adding Reimbursement of Income Tax to a Grantor Trust: CCA 202352018

a. Summary

(1) Reversing the position taken in a 2016 letter ruling, the IRS rules that trust beneficiaries have made a taxable gift, in an undetermined amount, by consenting to add to the terms of an irrevocable grantor trust a discretionary power in the independent trustee to reimburse the grantor for income tax the grantor pays on the trust's income. Chief Counsel Advice 202352018 (issued Nov. 28, 2023; released Dec. 29, 2023).

(2) Although this is not a pending or potential "administrative" or "legislative" change in the law, it is included because it seems to have a similar motivation, in effect to change the law, albeit in the context of actual cases that might be litigated. Unlike the other measures discussed in this paper – legislation, regulations, even a Revenue Ruling – a "written determination" like a letter ruling, determination letter, technical advice memorandum, or Chief Counsel Advice (section 6110(b)(1)(A)) "may not be used or cited as precedent" (section 6110(k)(3)). Nevertheless, CCA 202352018, while not **precedential**, is so **unprecedented** that it warrants attention.

b. **Facts**

(1) CCA 202352018 deals with an irrevocable trust that authorizes the independent (not "related or subordinate" to the grantor within the meaning of section 672(c)) trustee to distribute trust principal or income to the grantor's child "in the trustee's absolute discretion" and directs that at the child's death the trust remainder is to be distributed to the child's issue, per stirpes.

(2) The grantor retained a power with respect to the trust that causes the grantor to be taxed on all the trust income under section 671 but would not cause the value of the trust assets to be subject to estate tax at the grantor's death – in other words, making the trust a "grantor trust," often referred to as a "defective grantor trust." The CCA does not reveal what power the grantor held, but an example would be a power to reacquire trust assets by substituting property of equivalent value, under section 675(4)(C). Neither the governing state law nor the trust instrument required or authorized the trustee to reimburse the grantor for income tax the grantor pays on the trust's income.

(3) At a time when the grantor's child had living children but no grandchildren or more remote descendants, the trustee petitioned a state court to modify the terms of the trust to give the trustee the discretionary power to reimburse the grantor for the income tax the grantor pays on the trust's income. Pursuant to a state statute, the grantor's child and that child's children consented to the modification. The court granted the petition and issued an order modifying the trust to allow such reimbursements in the trustee's discretion.

c. **Conclusion**

The Chief Counsel's Office concluded that, as a result of the modification to which they had consented, the beneficiaries "each have made a gift of a portion of their respective interest in income and/or principal" of the trust. Ominously, it added without elaboration that "[t]he result would be the same if the modification was pursuant to a state statute that provides beneficiaries with a right to notice and a right to object to the modification and a beneficiary fails to exercise their right to object."

d. **Application of Rev. Rul. 2004-64**

(1) Rev. Rul. 2004-64, 2004-2 C.B. 7, has been the guide regarding the payment of income tax on the income of a grantor trust for almost 20 years. The Revenue Ruling confirmed that the grantor's payment of income tax is not a gift by the grantor to the trust's beneficiaries because it is paid in discharge of the grantor's own liability, imposed by section 671. It also clarified that if the terms of the trust require the trust to reimburse the grantor for those income tax payments, the grantor has "retained the right to have trust property expended in discharge of [the grantor's] legal obligation" that would cause the full value of the trust assets to be included in the grantor's gross estate under section 2036(a)(1). In contrast, it held (emphasis added) that if that reimbursement is only discretionary with the trustee under the terms of the trust or applicable state law and the trustee is not "related or subordinate" to the grantor, that discretion, whether or not exercised,

> would not **alone** cause the inclusion of the trust in [the grantor's] gross estate for federal estate tax purposes. … However, such discretion **combined with other facts** (including but not limited to: an understanding or pre-existing arrangement between [the grantor] and the trustee regarding the trustee's exercise of this discretion; a power retained by [the grantor] to remove the trustee and name [the grantor] as successor trustee; or applicable local law subjecting the trust assets to the claims of [the grantor's] creditors) may cause inclusion of [the trust's] assets in [the grantor's] gross estate for federal estate tax purposes.

(2) Rev. Rul. 2004-64 also held that reimbursement of the grantor for payment of income tax on the trust's income pursuant to a discretionary reimbursement authority held by an independent trustee "is not a gift by the trust beneficiaries," apparently even if there is an understanding or pre-arrangement or similar bad facts that are relevant under the Revenue Ruling to the grantor's own estate tax consequences.

With regard to the reimbursement discretion, CCA 202352018 distinguishes Rev. Rul. 2004-64 on the ground that the discretionary authority in the Revenue Ruling was granted under the

terms of the original governing instrument, not under a modification consented to by the beneficiaries as in the CCA.

e. **Reversal of a Previous Letter Ruling**

(1) The CCA acknowledges in a footnote that Letter Ruling 201647001 (issued Aug. 8, 2016; released Nov. 18, 2016) "concludes that the modification of a trust to add a discretionary trustee power to reimburse the grantor for the income tax paid attributable to the trust income is administrative in nature and does not result in a change of beneficial interests in the trust." But the CCA adds that "[t]hese conclusions no longer reflect the position of this office." Like the CCA, the 2016 ruling does not offer much insight into the actual context, other than the statement (not mirrored by the CCA) that "[d]ue to unforeseen and unanticipated circumstances, payment by the Grantors of the income taxes on Trust's income has become unduly burdensome."

(2) A similar IRS reversal of position, allowing neither a charitable deduction nor a marital deduction for a charitable remainder unitrust interest that the trustee may "sprinkle" between the grantor's spouse and charity, was seen in Chief Counsel Advice 202233014 (issued July 12, 2022; released Aug. 19, 2022). CCA 202233014 acknowledged in a footnote that four previous PLRs had allowed an estate tax or gift tax marital deduction for a unitrust interest that could be distributed between charity and the decedent's or grantor's spouse in the trustee's discretion, but (like CCA 202352018) stated in a footnote that "[t]he position in these earlier rulings no longer reflects the position of this office."

(3) Significantly, the issuance of a Chief Counsel Advice repudiating a position taken in a letter ruling does not revoke the letter ruling, in the absence of further action specific to the recipient of that letter ruling. Under section 11.04 of Rev. Proc. 2024-1, 2024-1 I.R.B. 1, 65-66, automatic revocation of a letter ruling is limited to the enactment of legislation, the ratification of a tax treaty, a decision of the United States Supreme Court, the issuance of temporary or final regulations, or the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin. That does not include a Chief Counsel Advice.

f. **Valuation**

(1) The CCA does not say how to value the purported gifts, stating in another footnote that "[a]lthough the determination of the values of the gifts requires complex calculations, Child and Child's issue cannot escape gift tax on the basis that the value of the gift is difficult to calculate." Earlier, in the section titled "Law," the CCA includes this paragraph:

> Section 25.2511-2(a) [of the Gift Tax Regulations] provides that the gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer. Rather, it is a tax upon the donor's act of making the transfer. The measure of the gift is the value of the interest passing from the donor with respect to which they have relinquished their rights without full and adequate consideration in money or money's worth.

(2) Like most CCAs and letter rulings, the CCA makes no immediate or specific application of that paragraph and therefore offers little help with valuation – basically just redundantly reciting that the value "is the value."

(3) Still earlier in the "Law" section, the CCA quotes Reg. §25.2511-1(e) for the proposition that "if the donor's retained interest is not susceptible of measurement on the basis of generally accepted valuation principles, the gift tax is applicable to the entire value of the property subject to the gift." Again, there is no elaboration and the statement is not very helpful. The context of Reg. §25.2511-1(e) is a transfer by gift of "less than [the donor's] entire interest in property," which is awkward to apply to a case in which the purported gift is actually a purported transfer by the donees back to the donor. In any event, taxing the beneficiaries on the entire value of the trust property in this case is an outcome that seems simply too extreme to be entertained, even under the surprising aggressiveness of the CCA.

(4) There are provisions of the Internal Revenue Code, such as sections 2701 and 2702, that are intended and presumably designed to target gifts of less than the transferor's entire interest in

the property, but they may not offer much help. For one thing, section 2701 applies to gifts to "a member of the transferor's family," which seems quite inclusive, except that under section 2701(e)(1) it is limited to the transferor's spouse, descendants of the transferor or the transferor's spouse, and spouses of such descendants. It would not apply to the purported transfer here by the child and grandchildren of the grantor to their parent or grandparent. Section 2702 does apply to transfers to ancestors, under section 2704(c)(2)(B) (incorporated by section 2702(e)), but its focus under section 2701(e)(2) (incorporated by section 2702(a)(1)) on the **retention** of interests only by the transferor, the transferor's spouse, or their **ancestors** or ancestors' spouses reflects the focus on transfers to younger generations with interests retained by older generations.

(a) That is confirmed by the fact that every example in the section 2702 regulations that identifies a transferee mentions only children, or in a couple instances the spouse, of the transferor. *See* Reg. §§25.2702-2(d), 25.2702-3(e), 25.2702-4(d), 25.2702-5(d), and 25.2702-6(c). To be fair, those examples may simply reflect the types of transfers that are most common. But they are consistent with the traditional focus on transfers to **younger** generations illustrated, for example, in Rev. Rul. 81-264, 1981-2 C.B. 185, which held that the running of a state statute of limitations on recovery of a demand loan and accrued interest resulted in a taxable gift by "D" (the lender) to "A" (D's child). The ruling showed its preoccupation with transfers to lower generations by reasoning (emphasis added):

> Here, as in all such familial transactions, there is a presumption that the transfer of wealth from D to A without consideration is not entirely free of donative intent. … A had the resources to pay the debt, and, **as D's child**, was **the natural object of D's bounty**. **On these facts**, D's failing to enforce the debt obligation and permitting it to be barred by the statute has not been shown to be free of donative intent.

(b) Moreover, except under section 2702(a)(3)(ii) and (b) where an interest in a personal residence or an annuity or unitrust interest is involved (which don't appear to be applicable to the reimbursement of income tax paid), the result under section 2702(a)(2)(A) is apparently that the beneficiaries could be treated as making taxable gifts equal to the entire value of the trust assets (an outcome, as stated above, that seems simply too extreme to be entertained), or perhaps only the value of their particular interests at the time, which seems very difficult to determine.

g. **A Radical Alternative: Section 2519**

(1) Section 2519 is another Code section that in effect could impose gift tax on the entire value of the assets in a trust – in this case a QTIP trust if the surviving spouse disposes of only the spouse's life interest, which is only a **part** of the trust. In fact, section 2519 would treat even the "disposition of … **part** of a qualifying income interest for life" as a disposition of the **entire** interest in the trust apart from that income interest.

(2) The potential mischief of such a rule is illustrated in Chief Counsel Advice 202118008 (issued Feb. 1, 2021; released May 7, 2021), in which the IRS ruled that the agreement of the surviving spouse and the deceased spouse's children (as remainder beneficiaries and as virtual representatives of the contingent and unborn beneficiaries) to distribute all the assets of a QTIP trust to the spouse (in what the CCA called a "commutation") resulted in both (1) a disposition of the surviving spouse's qualifying income interest under section 2519(a), and thus, the surviving spouse's gift of all of the interests in the trust other than the qualifying income interest, and (2) a gift by the remainder beneficiaries of their remainder back to the spouse.

(3) By not permitting any offset of those two opposite or circular gifts, CCA 202118008 attracted considerable attention from estate planners, as imposing unnecessary double taxation. Indeed, on the same day as the commutation, the spouse transferred assets, some by gift and some (including assets received from the QTIP trust in the commutation) in exchange for promissory notes, to irrevocable dynasty trusts that the spouse had created for the benefit of the children and their descendants. Those transfers, plus the observation that other assets received in the commutation and retained by the spouse would be subject to estate tax at the spouse's death, escalated some of the reactions to a perception of **triple** taxation.

(4) Nevertheless, the Chief Counsel's Office seemed to have no problem concluding in CCA 202118008 that "the QTIP statutory scheme and legislative history support the view that … the separate transfers by Spouse and Children cannot be offset by consideration for tax purposes."

(5) There is, however, no similar "statutory scheme" applicable in CCA 202352018, which cites nothing but generally applicable gift tax regulations.

h. **The Challenge of Gift Tax Valuation**

(1) One way to deal with the valuation challenge might be to treat any reimbursement pursuant to the modified trust terms as a gift by the beneficiaries when that reimbursement is made. But that is just not the way the gift tax works (unless the "gift" is treated as "incomplete" until a reimbursement, if any, is made, for which the CCA offers no grounds for optimism). The gift tax depends on projections, maybe actuarial factors, and math – "complex calculations," as the footnote in the CCA puts it. Perhaps appraisals, although an appraisal would undoubtedly raise issues of extraordinary assumptions, hypothetical conditions, and limiting conditions (purportedly imposed by the CCA itself) that at a minimum would require disclosure in any appraisal report under the Uniform Standards of Professional Appraisal Practice (USPAP), and, together with the absence of any "comparable sale" data, might also discourage a qualified appraiser from undertaking the engagement.

(2) And even if the creation of the discretionary reimbursement authority can be credibly viewed as a gift and credibly valued for gift tax purposes, the apportionment of that value among the current, future, contingent, and even unborn beneficiaries would pose still another challenge – not to mention how an unborn beneficiary could be required to file a gift tax return or be liable for gift tax. Ironically, and perhaps unintentionally, the CCA itself seems to envision gift tax liability for unborn beneficiaries by asserting in its footnote that "Child and Child's **issue** cannot escape gift tax on the basis that the value of the gift is difficult to calculate," when in the facts of the CCA "Child's issue" currently include only Child's **children**.

In fairness, the CCA does not **explicitly** state any intention to treat unborn contingent beneficiaries as donors, and the use of "issue" may be just an inclusive drafting convention that estate planners often use as well. Besides, unborn beneficiaries could never personally give their consent anyway. But does that mean that no loss of value attributable to the reimbursement authority is attributed to them? Or that the loss of value attributed to them is deemed to be part of the gift by their parent or other ancestor? Or that the loss of value attributed to them is just not treated as a gift. Of course if no value is attributed to unborn beneficiaries – taking a more or less "qualified beneficiary" approach – valuation might be a bit simpler, because it could bypass very speculative steps such as estimates of fertility.

i. **Reflections and Comments**

(1) **The Role and Backstory of a CCA**

(a) A Chief Counsel Advice typically arises from a specific audit or audits of a specific case or cases that are probably headed to litigation if they are not settled. For that reason, it is always possible that there is a backstory, not revealed in the CCA itself, that would explain the IRS's seemingly excessive reaction. It is also reasonable to assume that a CCA is written to support the strongest possible litigation position, either to reinforce the litigation itself or to encourage the taxpayer to agree to a settlement that is favorable to the IRS, which in this case might be an agreed higher value for the beneficiaries' purported gifts.

(b) The backstory of CCA 202352018 also includes that fact that it is addressed to two IRS Associate Area Counsels – Janice B. Geier in Portland, Oregon, and Sheila R. Pattison in Austin, Texas – who have been among the IRS counsel of record in a number of Tax Court cases, including cases well-known to estate planners. Ms. Pattison was counsel in the Texas cases of *Estate of Strangi v. Commissioner*, 115 T.C. 478 (2000), *aff'd in part, and rev'd and rem'd in part*, 293 F.3d 279 (5th Cir. 2000), involving the includability in a decedent's gross estate of the value of property that the decedent had transferred to a limited partnership, and

Nelson v. Commissioner, T.C. Memo. 2020-81, *aff'd*, 17 F.4th 556 (5th Cir. 2021), involving a defined value clause limited to appraisals obtained shortly after the dates of the transactions. Ms. Geier was counsel in the *Strangi* case on remand, T.C. Memo. 2003-145, *aff'd*, 417 F.3d 468 (5th Cir. 2005), and the Oregon case of *Estate of Jones v. Commissioner*, T.C. Memo. 2019-101, involving "tax-affecting" in the valuation of interests in timber businesses. Thus, it is hard to view the CCA as a request by inexperienced lawyers for education from the National Office and perhaps more likely that it should be viewed as a more strategic step in the context of anticipated litigation.

(2) **The Frustrating Dilemma of the CCA**

(a) Even so, CCA 202352018 will seem troubling to many. And rightly so. There does not appear to be any reason for the IRS to be concerned about the potential for placing more money in the hands of a grandparent where it could be subject to transfer tax in the near future, rather than continuing to accumulate it free of transfer tax to pass to the grandchildren or potentially even great-grandchildren. The CCA does not say a word to indicate why the IRS would or should be concerned about that.

(b) As noted above, Rev. Rul. 2004-64 confirmed that the grantor's payment of income tax on the income of a grantor trust is not a gift by the grantor to the trust's beneficiaries because it is paid in discharge of the grantor's own liability, imposed by section 671. In other words, when the trust was created as a grantor trust, the grantor gave the beneficiaries the value transferred to the trust, which was a taxable gift, and also gave the beneficiaries a framework within which the grantor would in effect pay the future income tax on **their** income, but that was **not** a taxable gift. If the benefit of the arrangement to pay that income tax is not a transfer to the beneficiaries for gift tax purposes, how, it might be asked, can what amounts to a diminution of that benefit or even the return of that benefit to the grantor, in whole or in part, be a transfer for gift tax purposes?

(3) **What About Simply Relinquishing the Grantor Trust Feature?**

(a) Or suppose the grantor's retained power or other feature of the trust that makes it a grantor trust can be relinquished or renounced by the grantor. Whether, when, and how it can be relinquished or renounced might be difficult to determine and might vary widely, depending on the particular grantor trust power or feature involved, the other specific terms of the trust, the applicable state law, and sometimes the experience and perspective of the observer. The CCA does not clarify whether relinquishment or renunciation was an option in the case or cases it addresses. Of course such relinquishment or renunciation could not possibly be a gift by the grantor – it leaves the grantor better off, not worse off. But neither can it be a gift by the beneficiaries – even though they are left worse off, they didn't do anything. So what if the beneficiaries consent to giving the trustee a discretionary reimbursement authority in order to **deter** the grantor from taking the more decisive action of relinquishment or renunciation? How could that be a gift by the beneficiaries, when they gain, not lose, from avoiding the grantor's more decisive action of relinquishment or renunciation?

(b) Often (although not necessarily always), the grantor's consideration of relinquishment or renunciation of grantor trust status may be prompted by the anticipation of an extraordinary gain, perhaps from the sale of an asset that has been the trust's sole or principal asset, has performed very well, but in the view of the trustee has reached the point where it would be prudent to replace it with other assets, possibly more diversified, that the trustee believes have better income and/or appreciation potential for the future. There might be serious doubt about the grantor's ability under the terms of the trust to suspend the grantor trust feature for only one taxable year. The presence of a discretionary reimbursement authority that would permit reimbursement, perhaps even partial reimbursement, only for the taxable year of that extraordinary transaction (in the trustee's discretion if the trustee finds that to be in the best interests of the beneficiaries to whom the trustee owes a fiduciary duty), would both meet the grantor's concerns and serve the beneficiaries' interests, and would leave in place the

beneficiaries' right to expect the grantor, again, to effectively pay the income tax on those beneficiaries' income in the future.

(4) **The Importance of Fiduciary Duty**

In fact, wouldn't the strong principle of **fiduciary duty** that governs all the trustee's actions always govern **any** discretionary reimbursement by the trustee of the grantor pursuant to the type of discretion added to the terms of the trust in the facts of CCA 202352018? (And wouldn't that also include a fiduciary duty to ensure that the value of the trust assets is not included in the grantor's gross estate, especially if that would expose the trust to apportionment of estate tax?) If so, shouldn't that lead to the conclusion that **any** exercise by the trustee of a discretionary power to reimburse the grantor for income tax paid would occur only if the trustee determined it to be in the beneficiaries' best interests? Therefore, isn't it true that in fact the beneficiaries are not **hurt** but **benefited** – that is, they **will not lose** and they **may gain** – by the presence of such a power? So how can the creation of such a power be a gift by beneficiaries? Again, the CCA does not say a word to indicate that the IRS has considered such obvious facts of life.

j. **So What's Next?**

As noted above, CCA 202352018 is probably a step in the audit of an actual case or cases headed to settlement or to litigation. If settled, there will be no public release of any kind, as there was of the CCA itself, which did not identify names, dates, amounts, or other details. Sometimes advisors involved in such settlements receive permission from the taxpayers to discuss the cases publicly, but that is rather rare.

If the case or cases go to litigation, there will probably be unredacted public documents that shed more light on the case, including possibly a court opinion or, alternatively, a stipulated decision to reflect a settlement reached after the litigation is commenced. And we might learn more about the "backstory" from such documents, especially an opinion. More interestingly, if the outcome is anything but a complete taxpayer victory, we could learn more about how such an outcome could possibly be explained and justified.

(1) **The Example of CCA 201939002**

(a) This waiting game recalls the case of Chief Counsel Advice 201939002 (issued May 28, 2019; released Sept. 27, 2019), which concluded that stock on a listed exchange transferred to a GRAT by the co-founder and chairman of the board of the corporation had to be valued for gift tax purposes by taking into consideration an anticipated merger of the underlying company that was expected to increase the value of the stock. The CCA failed to even mention that because the donor was the chairman of the board of the publicly traded corporation, federal securities laws may have prohibited him from disclosing confidential information regarding the merger. Because securities laws probably prohibited what the CCA appeared to require, the estate planning community generally regarded the CCA as unreasonable.

(b) The case addressed by the CCA turned out to be *Baty v. Commissioner* (Tax Court Docket No. 12216-21, petition filed June 23, 2021). On June 15, 2022, after the petitioner had filed a motion for summary judgment and a memorandum in support (arguing, among other things, the application of the restrictive securities laws) and 12 days before the IRS's response was due, **the IRS conceded**, and the parties filed a proposed stipulated decision. On June 17, 2022, the court entered the stipulated decision and denied the motion for summary judgment as moot.

(2) **The Example of CCA 202152018: Section 2702 Reprised**

(a) Chief Counsel Advice 202152018 (issued Oct. 4, 2021; released Dec. 30, 2021) also involved the valuation of shares of a company transferred to a GRAT, in this case by the founder of what the CCA described as a "very successful company." In this case, the IRS's concerns may have seemed more justified than in CCA 201939002, because they appeared to be based on the donor's choice to rely on an appraisal obtained about seven months earlier to

report the value of a nonqualified deferred compensation plan under section 409A, rather than to obtain an appraisal for purposes of the GRAT as of the date of funding of the GRAT that presumably would have taken account of merger negotiations and offers in the previous few weeks.

(b) Surprisingly, however, the conclusion of CCA 202152018 was not just that the IRS disagreed with the value. The CCA reasoned that what it described as "intentionally basing" the annuity payments "on an outdated and misleading appraisal" was an "operational failure," and "because of this operational failure, Donor did not retain a qualified annuity interest under § 2702." It did not seem to matter whether the GRAT document included a formula, specifically authorized by Reg. §25.2702-3(b)(1)(ii)(B), to adjust the annuity payments to a specified percentage of the initial fair market value of assets contributed to the GRAT, "as finally determined for federal tax purposes." Not accepting the retained annuity interest as a "qualified interest" meant that it would be valued at zero under section 2702(a)(2)(A), and the entire value determined to be transferred to the GRAT would be the taxable gift, even though at least a large portion of the value was expected to be returned to the grantor as annuity payments.

(c) Thus, possibly worse facts for the taxpayer, but a much worse result proposed by the CCA. Nothing public has appeared yet. Thus, no clues about a backstory.

(3) **Application to CCA 202352018**

(a) So, in the case of CCA 202352018, we might hear rumors about a settlement at the IRS. Or we might see some court documents that suggest that litigation had commenced but the case was settled and a stipulated decision entered. Or we might be treated to a full-blown court opinion, in which, as stated above, it would be very interesting to see how anything but a complete taxpayer victory is justified. Or we might hear nothing more.

(b) Meanwhile, and regardless of the outcome, the CCA has created a lot of turmoil.