Estate Planning Tax Update—Highlights of Current Developments and Observations from Heckerling 2024

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[Page numbers in square brackets refer to Akers & Nipp, "LOOKING AHEAD – Estate Planning in 2024 & Current Developments (Including Observations form Heckerling 2024)" (April 2024) (EP) and Ronald Aucutt, "Washington Update: Pending and Potential Administrative and Legislative Changes" (March 2024) (WU), both available at www.bessemertrust.com/for-professional-partners/advisor-insights.]

1. Miscellaneous Observations from Heckerling 2024

a. Strategies for Mitigating the 'Burn' of Grantor Trust Status [EP3]

b. IRS funding-significantly behind on enforcement funding [EP9-10]

c. GRAT creative planning [EP60-63]

d. Chapter 14 (particularly §2701 and carried interests) [EP73-81]

e. Foreign trusts [EP 83-86]

f. Cybersecurity; international travel [EP87]

g. Below market loans from trusts [EP89-90]

2. Trending in 2024 [EP1-4]

a. Basic estate planning and coordination

b. Transfer planning to use "bonus exclusion" (first assure lifestyle needs, grantor trusts with GST planning, SLATs, defined value clauses, adequate disclosure, "topping off" gifts, utilizing "bonus" GST exemption, GRATs still important but not to utilize bonus exclusion)

c. Ownership planning in 2025 to facilitate gifts in 2026

d. Planning for flexibility with grantor trust status

e. Corporate Transparency Act

f. Decanting; trust modification

g. Trust flexibility; directed trusts

3. Legislative Proposals

a. FY 2025, 2024, and 2023 Greenbooks; Administration Priorities [EP4-8, WU24-46]

(1) The Administration's FY 2025 Revenue Proposal (popularly called the "Greenbook"), released March 11, 2024, does not contain substantial changes from the FY 2024 Greenbook regarding transfer tax and trust related matters.

(2) Income Tax for High-Income Taxpayers – Increased top rates; "Billionaire's tax [EP5, WU24-28]

(3) Estate, Gift, and GST Tax Bold Proposals including GRATs, grantor trusts, defined value clauses, valuation, GST exemption time limit, no zeroed-out or shark-fin CLATs [EP5-8, WU29-46]

(4) S.3988, the "Getting Rid of Abusive Trusts Act (the "GRATs Act") introduced on March 20, 2024, would implement the items regarding GRATs, sales between deemed owners and grantor trusts, and the grantor's payment of income tax on grantor trust income.

b. Additional IRS funding in Inflation Reduction Act-$79.4 billion, reduced to $78 billion, reallocated $20 billion away from enforcement; "way behind" on expenditures to supplement enforcement [EP9-10, WU20-23]

c. Likelihood of Further Tax Legislation; Exclusion Amount in 2026 – remember that big increases in exclusions and portability of the exclusion were passed in 2010 (when **Democrats** controlled the Presidency, Senate, and House) as a result of **negotiation**, but there is at least a significant chance the exclusion amount will be reduced in 2026 (which will lead to a very busy time for estate planners in the fall of 2025) [EP11-12]

4. Miscellaneous IRS Guidance; Proposed Regulations

a. Inflation Adjusted Amounts, (based on information each year through August 31), Rev. Proc. 2023-34 gives the 2024 amounts) [EP20-21]

(1) Basic exclusion amount and GST exemption-$13,610,000 (an increase of $690,000 from 2023); Gift tax annual exclusion-$18,000 (from $17,000 in 2023)

(2) Basic exclusion amount likely to be over $14 million in 2025 (this suggests that if the estate and gift exclusion amount is reduced to $5 million (indexed) in 2026, it would be some amount over $7 million in 2026.)

b. Some pending proposed regulations

(1) Section 2053 (PV administration expenses paid more than three years after death; *Graegin* loans) [EP23-26, WU65-67]

Regarding the deductibility of interest, the proposed regulation lists eleven non-exclusive factors that are considered in determining if the loan is "actually and necessarily incurred … and essential to the proper settlement."

Particularly problematic factors [EP25, WU66-67]

(a) Illiquidity and the estate does not control an entity with sufficient liquid assets or have the ability to compel the entity to sell assets – but the entity may have business reasons to retain liquid assets

(b) "The estate's illiquidity … as a result of the decedent's testamentary estate plan to create illiquidity" (Prop. Reg. §20.2053-3(d)(2)(viii)) or "illiquidity … created intentionally … in the estate planning" (preamble) – effect on family businesses trying to keep business in the family

(c) Choice of lender [Prop. Reg. §20.2053-3(d)(2)(ix) & (x)] (most of the *Graegin* cases have involved loans to an estate from a family entity)

(2) Anti-abuse exception to the anti-clawback regulation [EP22-23, WU56-63]

(3) Keep in mind current legal effect of proposed regulations: "carry no more weight than a position advanced on a brief" [EP22]

c. Rev. Rul. 2023-2 Guidance regarding availability of §1014 basis adjustment at the death of the owner of a grantor trust when the trust assets are not included in the owner's gross estate [EP16-18, WU73-76]

(1) Denies a basis adjustment for assets given to the trust, reasoning that none of the §1014(b) situations apply

(2) Caveats in the facts were [1] liabilities of the trust did not exceed the basis of assets in the trust, i.e., no negative-basis property, and [2] neither the trust nor the grantor held a note on which the other was the obligor; so the Ruling does not address the traditional sale to grantor trust situation

5. Trust Modification to Add Discretionary Reimbursement Power Results in Gifts by Beneficiaries Who Consent, CCA 202352018 [EP26-30, WU85-92]

a. Judicial modification of an irrevocable grantor trust with beneficiaries' consent, to add a tax reimbursement clause providing the trustee with a discretionary power to reimburse the grantor for income tax attributable to inclusion of the trust's income in grantor's taxable income, would constitute a taxable gift by the beneficiaries of a portion of their respective interest in income and/or principal of the trust.

b. Rev. Rul. 2004-64 is distinguished because no consents are required if the original trust agreement includes the reimbursement power. Rev. Rul. 2004-64 holds that if the original governing instrument provided for a mandatory or discretionary right to reimbursement for the grantor's payment of the income tax, such payment to the grantor would not constitute a gift by the trust beneficiaries.

c. The CCA says the result would have been the same if the beneficiaries had not explicitly consented but if they had notice of the modification and a right to object but failed to exercise their right to object.

d. Changed position from Letter Ruling 201647001

e. Does not address how to value the gift. Entire value? (Reg. §25.2511-1(e)) Various speculative factors affect valuation (appraiser may not want to touch it). What if repeated annual reimbursement is unlikely? How allocate among beneficiaries? Perhaps there would be no reduction of distributions for current beneficiaries.

f. Does this suggest a new trend by the IRS? The gift issue was not raised in PLR 202206008 (judicial modification of trust to add formula general power of appointment).

6. Corporate Transparency Act and Final Regulations (Sept. 29, 2022) [EP30-36]

a. National Beneficial Ownership Registry of "Small" Businesses (For Law Enforcement) – "Reporting Companies" must report "Applicants" and "Beneficial Owners." Purpose – help combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity.

(1) Reporting Companies include corporations, LLCs, and LPs (but not private trusts), but several exemptions apply, including (i) entities that employ more than 20 people and have gross receipts exceeding $5 million, (ii) specified entities already under close federal regulation, and (iii) certain entities with no active trade or business.

(2) Applicants are individuals who applied to form the entity. Final regulations clarify that information about Applicants must be filed only for companies created after the effective date of the regulations (January 1, 2024), and changed information does not have to be reported for Applicants. Final regulations also provide that only one or possibly two individuals have to be identified as Applicants (the individual who files the organizational document and the individual primarily responsible for directing such filing).

(3) Beneficial Owners are individuals who directly or indirectly exercise substantial control over the company or own or control at least 25% of the company (specified exceptions are provided). Final regulations state that for trusts, the Beneficial Owners are (i) trustees "**or other individual (if any) with the authority to dispose of trust assets,"** (ii) a trust beneficiary who is the sole permissible recipient of income and principal [Ex. QTIP trust beneficiary] or who can demand

distribution of or withdraw substantially all of the trust assets, and (iii) the trust grantor or settlor who has the right to revoke the trust or otherwise withdraw all of its assets.

(4) Does that include: investment advisors or distribution advisors for directed trusts, someone who holds a power of appointment, someone holding a veto power over distributions, holder of a swap power, Crummey withdrawal powerholder?

b. Final Regulations regarding beneficial ownership reporting were released September 29, 2022, with an effective date of January 1, 2024.

c. Filing Due Dates. Existing companies, 1 year after final regulations effective date (i.e., by January 1, 2025); New companies, 30 days after formation of the entity (this is extended to 90 days for 2024 only [RIN 1506-AB62]); Various legislative proposals introduced in 2023 (H.R. 4035 and H.R. 5119) would extend the due date for reports.

d. Civil and Criminal Penalties. Willful failure to report or willfully providing false information will result in civil penalties of $500/day the report is outstanding and criminal penalties up to $10,000 and up to two years imprisonment.

e. Final regulations were issued on December 21, 2023, governing the disclosure, access, and safeguarding of beneficial ownership information.

f. A FinCEN Proposal was filed February 7, 2024, that would require reporting by professionals regarding **non-financed residential real estate transfers** to entities or trusts (not individuals). Information about the beneficial owners of the entities or trusts (specifically including revocable trusts) must be reported. The purpose is to combat money laundering. Various exceptions apply including transfers that occur as the result of the death of the property's owner (i.e., transfer to a testamentary trust), that are the result of a divorce, or that are made to a bankruptcy estate. [EP33]

g. *National Small Business United, d/b/a the National Small Business Association v. Yellen*, Case No. 5-22-cv-1448-LCD (N.D. Ala. March 1, 2024). The district court held that the Corporate Transparency Act is unconstitutional "[b]ecause the CTA exceeds the Constitution's limits on the legislative branch and lacks a sufficient nexus to any enumerated power to be a necessary or proper means of achieving Congress' policy goals …" The court examines three sources proposed by the government to support the constitutional authority for Congress' enactment of the CTA: (1) the foreign affairs power, (2) the Commerce Clause authority, and (3) Congress' taxing power. The bulk of the opinion analyzes the Commerce Clause, and the focus of the analysis is on the distinction between regulating the mere formation of entities versus the regulation of entities that actually move in foreign or interstate commerce. The court expressed the view that "Congress would have written the CTA to pass constitutional muster … [by] imposing the CTA's disclosure requirements on State entities as soon as they engaged in commerce, or … prohibiting the use of interstate commerce to launder money, 'evade taxes, hide … illicit wealth, and defraud employees and customers.'" The court did not address the plaintiff's allegations that the CTA violates the First, Fourth, Fifth, Ninth, and Tenth Amendments.

FinCEN issued a notice on March 4, 2024, that it will continue to implement the CTA generally but will not enforce the Act against specific plaintiffs in the case including members of the National Small Business Association as of March 1, 2024.

The government filed a notice of appeal with the Eleventh Circuit on March 11, 2024.

At least two other cases have been filed in federal courts challenging the constitutionality of the CTA. *Boyle v. Yellen*, No.24-00081 (D. Maine) (business owner seeking injunctive relief from CTA for himself); *Gargasz v. Yellen*, No. 23-cv-02468 (N.D. Ohio) (arguing invalidity of CTA and its regulations

under the Constitution, the Paperwork Reduction Act, and the Administrative Procedure Act and seeking nationwide injunction).

7. "Patagonia Trusts"; Section 501(c)(4) Organizations [EP67-73]

a. Much recent publicity. (Patagonia founder-transferred $3 billion of nonvoting shares; Barre Seid-donated stock subsequently sold for $1.65 billion; Google co-founder Sergey Brin-$366 million of Tesla stock) [EP67]

b. Advantages.

(1) No private foundation rules

(2) No public support tests

(3) Broader array of permissible activities (including lobbying and some degree of political activity; not clear whether permissible political activity is 49.9%, 40% or just 10%-15%)

(4) Gift tax not applicable (added by 2015 PATH Act)

(5) No gain realization (gain is realized for contributions of appreciated property to §527 political organizations)

(6) Tax-exempt entity

(7) Privacy

c. Disadvantages

(1) No income tax charitable deduction

(2) Reputational concern (some may view as "dark money")

(3) Lack of control (see below regarding estate tax issue)

(4) Uncertainty (regarding whether the purposes of the organization qualify as appropriate "social welfare" purposes under §501(c)(4); "common good and general welfare of the people of the community" Reg. §1.501(c)(4)-(a)(2)(i))

d. Gift tax. Before PATH Act in 2015, IRS sent letters to various donors saying gifts to 501(c)(4) organizations may be taxable gifts. Section 2501(a)(6) now makes clear not a gift. Donors should confirm organization has a determination letter before making a large gift.

e. Estate tax. Big trap because §501(c)(4) organization assets do not qualify for estate tax charitable deduction. Solutions: (1) Donor not keep control that causes §2036(a)(2), §2038 inclusion; or (2) Convert to §501(c)(3) or private foundation at donor's death. Some "mega-donors" are not willing to give up that much control.

f. Taxes applicable to §501(c)(4) organization. Unrelated business taxable income tax, political activities tax (21% times lesser of (i)amounts used for political activities or (ii) net investment income)

g. Often discussed, rarely used. (Major sticking points are the estate tax issue and possible perceived reputational risk)

8. *Wandry* Clause Gift Tax Case Settled, *Sorensen v. Commissioner*, T.C. Docket 24797-18, 24798-18, 20284-19, 20285-19 (Decision Entered Aug. 22, 2022) [EP40-46]

a. Recent Example of IRS Arguments Against a *Wandry* Clause

b. Basic Facts; Transfers by Each Brother. *Wandry* gift of $5.0 million worth of stock on 12/31/14. Appraisal as of 12/31/14 of $532.79/share indicated transfer of 9,385 shares (unless adjusted). Used the same 12/31/14 appraised value to sell 5,365 shares for a note on 3/31/15. In a gift tax audit, IRS said $2,076.86/share. Entire company sold for $1 billion on 11/15/21, and each brother's trust received about $153 million.

c. Settlement – Shares valued at $1,640/share on 12/31/14 (gift date) and at $1,722/share on 3/31/23(sale date). Defined value clause did not control gift of shares (enforcement of the clause would have caused an adjustment of the number of shares gifted, and each brother's trust would have received only about $87 million from the sale of the company rather than about $153 million).

d. Planning Observations

(1) Treatment of *Wandry* transfers varies among IRS estate and gift tax attorneys

(2) For late-year gifts (when impossible to get appraisal by year end), could use *Nelson* approach

(3) Beware of *Wandry* transfer if transferred asset could explode in value (but a combined "*Wandry*/*King*" transfer would resolve that problem) [EP41-42]

(4) Reporting consistency (stock ledger, distributions, donee acknowledgment of stock power, third parties) [EP43-44]

(5) Use updated appraisals (using a 3-month-old appraisal may have resulted in 10% penalty where conditions changed)

(6) Use a grantor trust

9. Tax Affecting; Differing Marketability Discounts for Different Block Sizes of Stock, Zero Weight Given to Asset Value in Valuing Ongoing Business, *Estate of Cecil v. Commissioner*, T.C. Memo. 2023-24 (Feb. 28, 2023) [EP93-98]

a. Gift tax valuation of voting and nonvoting stock of S corporation that owned Vanderbilt Biltmore House in Asheville, North Carolina

b. Prior audits – This family has been through three gift tax audits: (1) 1999; (2) 2005-2006; and (3) 2010 (the gift tax audit resulting in this case). In 1999, the donors and IRS agreed on an earnings/asset hybrid valuation formula. In the 2005-2006 audit, the IRS initially rejected that approach but ultimately agreed to use the same approach. In the 2010 audit, the donors used the same settlement formula, but the IRS rejected the approach and issued a $26 million Notice of Deficiency, valuing the stock solely using an asset approach and claiming that the ongoing business operation (with over 1,300 employees and over $70 million of annual revenue) had no economic substance.

c. The donors had the stock appraised by two different appraisers who both said the values under the 1999 and 2005-2006 settlement formulas were too high, and the donors claimed they were entitled to a substantial refund of gift tax paid.

d. Shortly before trial (on the 30-days-before-trial deadline for offering valuation opinions) the IRS backed off substantially by offering their expert's appraisal that gave only a 10% (down from 100%) weighting to the asset value approach, reducing the alleged deficiency to $3 million (down from $26 million!). *See* Paul Hood, *Estate of Cecil v. Commissioner: Appalling IRS Valuation Shakedown Effort Averted in the Tax Court, Finally!*, LEIMBERG ESTATE PLANNING NEWSLETTER (September 7, 2023) (concluding "Houston, we have a problem. Steps must be taken to ensure that this never happens again.").

e. Taxpayer's Brief:

> With interest through the trial date, the total demand exceeded $30 million. Respondent left this 84 and 87 year-old couple living with that Sword of Damocles swinging over their heads for nearly two years. [The donors both died before trial.]
>
> Despite knowing his Notice lacked any rational basis, Respondent stubbornly refused to concede "economic substance" in his Answer, his informal responses, his formal discovery responses, and various motions. For the first time 30 days prior to trial, he tendered an appraisal proving his Notices overstated the tax by at least $22,989,798. Even though he adopted that valuation in his trial memorandum, he never amended his pleadings or admitted he overstated his claims by 90 percent. To this day, he will not concede the words "economic substance" in writing.

f. Seven year delay from completion of the trial to when the opinion was delivered

g. Taxpayer and IRS experts both tax affected earnings of the S corporation in valuing the company under the income approach because the data used for the valuation were based largely on data from C corporations

h. No total bar to using tax affecting (after reviewing prior cases that rejected or allowed tax affecting)

i. Holding based on fact that experts on each side agreed to using tax affecting and used the same specific tax affecting method

j. "[W]e are not necessarily holding that tax affecting is always, or even more often than not, a proper consideration for valuing an S corporation."

k. Other recent tax affecting cases: *Estate of Michael Jackson*, T.C. Memo. 2021-48 (rejected tax affecting because taxpayer's experts had not persuaded the court that the buyers would be C corporations) [EP146]; *Estate of Jones*, T.C. Memo. 2019-101 (allowed tax affecting; "we do not have a fight between valuation experts but a fight between lawyers"); *Kress v. United States*, 123 AFTR 2d 2019-1224 (E.D. Wis. March 26, 2019) (taxpayer's and IRS's appraisers both tax affected earnings; court accepted most of taxpayer's expert's conclusions, including regarding tax affecting) [EP144-145]

l. Marketability Discounts: 19% for voting stock; 22% for 15.57% nonvoting stock; 27% for 23.36% nonvoting stock

m. Business was valued at its going concern value with **zero** weight given to its asset value (roughly $15 million vs. $147 million); the transferred stock could not force liquidation; documentation supporting the unlikelihood of liquidation was an important factor.

n. Other cases that have given no or minimal weight to liquidation value include *Estate of Jones v. Commissioner*, T.C. Memo. 2019-101 (timber valued under income method); *Estate of Giustina v. Commissioner*, 586 F. App'x 417, 418 (9th Cir. 2014) (timber partnership, no weight given to liquidation value); *Estate of Watts v. Commissioner*, 823 F.2d 483 (11th Cir. 1987) (15% interest in general partnership with timberland that could not force liquidation was valued based on its going concern value, not its liquidation value; conclusion based on absence of right to force liquidation, not on the remaining partners' intent to continue the partnership). [EP47, 96]

10. Gift Tax Adequate Disclosure, *Schlapfer v. Commissioner,* T.C. Memo. 2023-65 (May 22, 2023) [EP53-60]

a. **First reported case** with detailed discussion of disclosure requirements under gift tax adequate disclosure regulations

b. IRS Counsel advice has taken a strict approach; this first reported case takes a reasonable approach

c. Does not matter if gift was not actually a completed gift until a later year, Reg. §301.6501(c)-1(f)(5)

d. Statute: "in a manner adequate to apprise the Secretary of the nature of the item" §6501(c)(9)

e. Regulations first sentence: "only if it is reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported" Reg. §301.6501(c)-1(f)(2)

f. Regulations second sentence: "will be considered adequately disclosed … if the return provides the following information [listing five elements of information]." Court reasoned that those requirements are" not mandatory but … guidance to taxpayers to inform them on a way to satisfy adequate disclosure."

g. Substantial compliance analysis applies

h. Court held that there was substantial compliance despite "glitches" in strictly complying with disclosure elements: (1) description of property; (2) identity of donees; (3) valuation information

i. This Tax Court case was not appealed.

11. Option Agreement Not Recognized for Gift Tax Purposes Under §2703, *Huffman v. Commissioner*, T.C. Memo. 2024-12 (Jan. 31, 2024) [EP135-139]

a. CEO of Company (in aerospace industry) signed option agreement in 1993 to purchase parents' Company stock that was in trusts (presumably revocable trusts). Strike price ($5 million) was over 23 times the current value of the stock at time the option agreement was signed. (Apparently a significant purpose was to incentivize the son to build the Company.) The original option agreement was to purchase at the deaths of the parents with a right of first refusal. It was revised to allow the son to exercise the option at any time with the consent of various family members. Son exercised the option in 2007, paying with a $5 million note. The IRS alleged the stock was worth much more than $5 million, and parents made a gift in the amount of the difference.

b. Section 2703(b) safe harbor does not apply. The (1) business purpose and (2) not a testamentary device to transfer for less than full value tests were satisfied. Test (3), the comparability test, was not satisfied. A similar option agreement with the same company was offered as a comparable, but it was not submitted into evidence. Aside from the evidentiary issue, the similar option was not comparable enough because it was only exercisable at death, not at any time.

c. The court valued the stock, generally adopting the positions of the IRS's expert (which included 10% lack of control and 20% lack of marketability discounts).

d. This case is another example of courts applying the comparability test rather strictly. There were a lot of similarities with the offered comparable in this case (same company, options rather than a mandatory purchase, right of first refusal, options available through deaths of sellers, signed in same general time frame, both agreements were transferable (though different consents were required), no put rights, no drag along rights, no tag along rights) – all in all, a lot of similarities.

12. Buy Sell Agreement Value Not Respected; Life Insurance Proceeds Payable to Corporation Under Corporate Redemption Arrangement Included in Estate Tax Value, *Connelly v. United States*, 128 AFTR 2d 2021-5955 (E.D. Mo. Sept. 2, 2021), *aff'd*, 131 AFTR 2d 2023-1902 (8th Cir. June 2, 2023), *cert. granted* (U.S. Dec. 13, 2023) (No. 23-146) [EP123-133]

a. Buy-sell agreement did not fix estate tax value. District court reasoned that it did not satisfy the device test or comparability test under the §2703(b) safe harbor and did not meet case law requirements (no determinable price, not binding on estate, and was a substitute for a testamentary disposition for less than full consideration). Eighth Circuit reasoned that neither of the two pricing mechanisms in the agreement were followed and they did not constitute a "fixed or determinable price for valuation purposes." (Those two pricing mechanisms are often found in buy-sell agreements – [1] annual agreement, and [2] appraisal process.) A determinable price is "arrived at" by "formula," "a fair, objective measure," or "calculation."

b. Corporate purchase obligation funded with corporate-owned life insurance; value increased by life insurance proceeds used to fund purchase of decedent's shares. Disagreed with the Eleventh Circuit's rationale in *Estate of Blount v. Commissioner*, 428 F.3d 1338 (11th Cir. 2005), that the contractual obligation of a company to purchase a decedent's shares offset the life insurance proceeds on the decedent's life paid to the company. Eighth Circuit affirmed. ("In sum, the brothers' arrangement had nothing to do with corporate liabilities. The proceeds were simply an asset that increased the shareholders' equity.")

c. U.S. Supreme Court granted the estate's petition for writ of certiorari on December 13, 2023.

d. Major arguments in the estate's brief to the Supreme Court:

   (1) The willing-buyer/willing-seller test accounts for all relevant facts concerning the relevant property.

   (2) The willing buyer and willing seller valuing a closely held corporation would disregard life-insurance proceeds used by the corporation to fulfill an offsetting obligation to redeem the insured's stock.

   (3) The proper valuation of a block of corporate shares does not include value available only to a purchaser of the entire company.

   (4) Increasing the value of an estate's stock based on corporate insurance proceeds designated for a stock redemption would create negative practical consequences.

e. An amicus brief filed by the Chamber of Commerce of the United States of America and National Federation of Independent Business Small Business Legal Center, Inc. makes the following major points.

   (1) Closely held companies play a vital role in the economy.

   (2) Redemption agreements and life insurance are critical, prudent planning tools that the decision below improperly threatens.

      (a) Redemption agreements paired with life insurance are a prudent solution to a pressing problem frequently faced by closely held companies.

      (b) The court of appeals and IRS distort the operation and object of redemption-plus-life insurance arrangements.

      (c) The IRS's and Eighth Circuit's position would imperil a vital planning tool.

(3) The IRS's current interpretation is not entitled to deference because of its inconsistent positions and lack of reasoned explanation.

(4) The brief discusses the IRS's shifting positions in the history of relevant cases, cited in chronological order *Newell v. Commissioner*, 66 F.2d 102 (7th Cir. 1933); *Estate of Huntsman v. Commissioner*, 66 T.C. 861, 872 (1976); *Estate of Cartwright v. Commissioner*, 183 F.3d 1034 (9th Cir. 1999); *Estate of Blount v. Commissioner*, 428 F.3d 1338 (11th Cir. 2005).

f. Amicus briefs filed by Professors Chodorow and Hellwig point out that treating redemption obligations as value-reducing liabilities results in irrational results (an individual could transfer wealth to a wholly owned corporation and enter into an obligation for the corporation to buy all the individual's stock at death (effecting a liquidation), which would result in a zero estate tax value for the stock) and yield divergent estate tax consequences across economically similar transactions.

g. At oral argument some Justices found the issues in the case "extremely difficult." Justice Thomas observed that the $3 million of life insurance proceeds used to redeem the stock "has to go someplace. Does it go into the value of the remaining stocks? And if it is there, why isn't the appropriate valuation [of the entire company] $6.86 million [which would include the $3 million of insurance]?" *Id*.

Justice Kagan focused on the fact that the surviving brother's value quadrupled after the redemption (going from 22.82% x $3.86 million, or $880,852, to $3.86 million, reflecting an increase of 4.38 times). She reasoned: "It seems the fundamental problem with your approach is that Thomas's [the surviving brother's] asset has quadrupled in value. And it's quadrupled in value without him putting a single cent more into the company…." She viewed that fact as "a tell that your way of calculating the thing is wrong."

13. Personal Liability for Unpaid Estate Tax by Successor Trustees and Beneficiaries of Decedent's Funded Revocable Trust, *United States v. Paulson*, 131 AFTR 2d 2023-1743 (9th Cir. May 17, 2023), *cert. denied* (U.S. March 4, 2024) (No. 23-436). [EP108-123]

a. Background regarding personal liability for estate taxes

(1) Executor, 31 U.S.C. 3713.

(2) Transferee liability, §6901 (assessment must be made against the transferee within four years; a remedy if transferees are liable under state law, typically under fraudulent transfer principles)

(3) Personal liability for certain recipients (including spouse, trustee, and beneficiaries) for non-probate property, §6324(a)(2)

(4) Action to collect tax must be brought within 10 years after assessment (which is typically three years, §6501), but the 10-year period is extended during §6161 or §6166 deferral periods, §6502, Reg. §301.6503(d)-1

b. *U.S. v. Paulson* extends personal liability for unpaid estate tax to successor trustees and trust beneficiaries who are appointed or receive property after decedent's death (**first case** to reach this result)

c. Holding is based on technical construction of statutory language ("who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042") but with the illogical result that individuals may become successor trustees or receive distributions at a time after values have declined so much that their personal liability for estate tax exceeds the value of the property when appointed or when received

d. Opinion limited personal liability to value of property when successor trustee is appointed or trust beneficiary received trust distribution (but without statutory authority for that limitation on liability) The petition for certiorari argues: "The Ninth Circuit decision created this new cap on personal liability for estate taxes out of whole cloth. It cites no authority—no statutory language, no tax regulation, no case law, no treatise—to support this extraordinary exercise in judicial law-making."

e. Result is contrary to Rev. Rul. 75-553 (holding that personal liability under §6324(a)(2) does not apply to funded revocable trust assets because they are included in gross estate for this purpose under §2033, not §2036 or §2038, and §6324(a)(2) applies only to estate tax attributable to property included in the gross estate under §2034 - §2042; possible distinction is that trust assets were paid to grantor's estate at grantor's death in the Ruling)

f. Practical Planning Tips: (1) Successor trustees should be careful of possible personal liability beyond value of trust before accepting office; (2) Trust distributions may impact beneficiaries' status with creditors and beneficiaries may have to show potential liability on financial statements; (3) Personal liability exposure could last about 25 years after date of death for estate that elects to defer tax under §6166; (4) If estate taxes are unpaid, consider deferring making distributions to trust beneficiaries until after liability exposure period has ended [EP117-118]

14. Assignment of Income and Availability of Charitable Deduction, *Estate of Hoensheid v. Commissioner*, T.C. Memo. 2023-34 (March 15, 2023); *Keefer v. U.S.*, 130 AFTR 2d 2022-5405 (N.D. Tx. August 10, 2022) (denying motion for reconsideration of Order), 130 AFTR 2d 2022-5002 (July 6, 2022) [EP98-108]

a. *Estate of Hoensheid v. Commissioner* [EP99-108]

(1) Assignment of income doctrine applied ("already fixed or vested right"; "donor must bear at least some risk at the time of contribution that the sale will not close"; sale was "virtually certain to occur"; "bonus payouts and distributions could not be clawed back"; written final consent was "a foregone conclusion"; no substantial "unresolved contingencies"; "formal shareholder approval was purely ministerial"; donor's attorney had incorrectly advised that the test was "before the execution of a definitive purchase agreement," which might have seemed consistent with Rev. Rul. 78-197 and *Rauenhorst v. Commissioner*, 119 T.C. 157 (1993))

(2) Charitable deduction denied because of failure to provide "qualified appraisal"

(3) No penalty because of reasonable reliance on attorney's advice (even though it was wrong)

b. *Keefer v. United States* [EP108]

(1) Assignment of income doctrine applied; the assignment to charity was made soon enough before a sale contract was signed, but donor assigned only a portion of the interest attributable to donated 4% limited partnership interest (proceeds of hotel sale only)

(2) Income tax charitable deduction denied because charity (a donor advised fund) did not properly acknowledge that it had exclusive legal control over donated assets

15. Recognition of Decanting for Tax Purposes, *Estate of Horvitz v. Commissioner*, Dkt. No. 20409-19 (Petition filed Nov. 15, 2019; Order dated Feb. 2, 2023, Judge Gustafson) [EP91-93]

a. QTIP trusts, funded when the predeceased spouse died in 1992, were decanted in 2013 to trusts that expanded the appointees under the surviving spouse's power of appointment to include

charities. The surviving spouse died in 2015, having exercised the power to leave $21 million to charities.

b. IRS denied the $21 million estate tax charitable deduction, taking the position that the decanting was not appropriate and that the assets did not properly pass to the charities

c. Lengthy discovery disputes and estate eventually (on October 14, 2021) filed motion for summary judgment seeking allowance of the estate tax charitable deduction

d. Order dated February 7, 2023 (16 months later) stating that additional factual testimony would not affect the outcome and generally agreeing with the estate's reasons for recognizing the legitimacy of the decanting

e. Within a week, the IRS agreed to the full estate tax charitable deduction.

f. IRS's hostility to a decanting transaction and allowing a deduction when the charities actually received the $21 million is puzzling.

g. Eventually resolved 8 years after decedent's death at considerable expense to the estate

h. Order expressed no reservation about the legitimacy of the decanting transaction

Order suggested that because no one had filed a contest to the decanting transaction or to the distributions to charities (both of which had occurred several years before the Order), the IRS may have no grounds for denying the charitable deduction (even if the charitable transfer by reason of the decanting transaction was not legitimate for some reason). This is reminiscent of Rev. Rul. 73-142 (transfer pursuant to court construction action that had become final and binding before a taxable event was binding on the IRS "regardless of how erroneous the court's application of the state law may have been").

16. QTIP Trust Planning, *McDougall v. Commissioner,* Tax Ct. Docket Nos. 2458-22, 2459-22, and 2460-22 (petitions filed February 18, 2022, Judge Halpern) [EP133-135]

a. Pending Tax Court case that was addressed in CCA 202118008 (settlement under which all QTIP assets were distributed to surviving spouse who immediately gave and sold assets to trusts for descendants; concluded that [1] descendants made gift to surviving spouse, [2] surviving spouse made gift of QTIP trust remainder interest under §2519, and [3] spouse used gift exclusion and would have notes from sale included in his gross estate)

b. Planning with large QTIP trusts is difficult. *See* Read Moore, Neil Kawashima & Joy Miyasaki, *Estate Planning for QTIP Trust Assets*, 44th U. Miami Heckerling Inst. on Est. Plan. ch. 12 1202.3 (2010).

17. Valuation of Life Insurance Policies, *M. Joseph DeMatteo v. Commissioner*, Tax Court Docket No. 3634-21 (Stipulated Decision Feb. 22, 2024) [EP139]

a. Regulation §25.2512-6 says to value life insurance contracts by reference to sales of comparable contracts, but often that is not readily ascertainable for policies that have been in existence for some time and for which further premium payments will be made. In that event "the value **may be** approximated by adding to the interpolated terminal reserve [the amount of unexpired premiums]. If, however, because of the unusual nature of the contract such approximation is not reasonably close to the full value, this method may not be used." (Emphasis added.)

b. Interpolated terminal reserve values vary dramatically. They may be much larger or much lower than what one would think is a reasonable value of a policy. Forms 712 from insurance companies may even list several values.

c. In *DeMatteo*, the donor hired an independent professional consultant, the Ashar Group, to value the policies. (They have a great deal of experience with life insurance policies in the secondary market.) The IRS position, though, was that the regulations mandate using interpolated terminal reserve values plus unexpired premiums to value policies. The donor sought summary judgment that the regulations do not require that the life insurance policies be valued at the interpolated terminal reserve values plus unexpired premiums.

d. The court refused summary judgment in an Order dated July 21, 2022, refusing to decide "in the abstract a question of law that may become moot depending on the evidence of the nature of the policies and the quality of the respective valuations."

e. A stipulated decision entered Feb. 22, 2024, reports an agreed gift tax deficiency of $4,291,077. Presumably, the parties offered additional evidence of the values of the policies and eventually agreed on stipulated values of the policies.

18. Reverse Split Dollar Life Insurance, *Cinader v. Commissioner*, Tax Court Docket No. 13491-22 to 13496-22 & 5245-22 (Stipulated Decision Jan. 3, 2024) [EP140]

a. Traditional split dollar arrangement – the insured donor pays premiums on life insurance policies owned by a trust. At the insured's death, the insured receives back certain amounts, but the trust receives the balance of the death proceeds. Table 2001 rates may be used for valuing the pure insurance coverage.

b. Reverse split dollar arrangement – an irrevocable trust owns the policy and the insured pays for the right to designate who receives the death proceeds. In *Cinader,* the insured used the Table 2001 rates to determine the amount paid annually (with a note) to be able to designate the beneficiary in that year (even though, as discussed below, an IRS Notice says the Table 2001 rates cannot be used in the reverse split dollar situation).

c. Basic facts – An irrevocable trust owned a life insurance policy on the insured's life. The insured agreed to pay the trust (with notes) for the right to designate the beneficiary (of death proceeds minus the greater of the cash surrender value or the premiums paid). The Table 2001 rates were used to determine each year's repayment amount. The insured owed the trust $41,168,849 at his death, which amount was deducted on the estate tax return.

d. The IRS's position was that Table 2001 rates cannot be used to value the pure insurance coverage when the insured does not own the policy. Notice 2002-59. (Table 2001 rates often exceed actual premium amounts.) In *Cinader*, the IRS maintained (i) that the insured made gifts to the trust each year when using the Table 2001 rates to determine the payment amount, (ii) that the insured's debts (the notes) to the trust were not bona fide indebtedness, and (iii) that the debts were therefore not deductible for estate tax purposes under §2053.

e. A stipulated decision was entered January 3, 2024, reporting agreed gift tax deficiencies of $3,327,230 for 2002, $99,213 for 2023, $1,424,814 for 2012, $8,433,707 for 2013, $1,527,836 for 2015 (total gift tax efficiencies of $14,812,800) and an estate tax deficiency of $14,298,629.

19. Administrative Procedure Act; Tax Court Reverses Course and Invalidates Conservation Easement Regulation Under APA, *Valley Park Ranch, LLC et al. v. Commissioner*, 162 T.C. No. 6 (March 28, 2024) [EP141-143]

a. Cases have split in the last several years regarding the validity of a conservation easement regulation under the Administrative Procedure Act (APA). Taxpayers have argued that the extinguishment proceeds regulation is invalid regarding its treatment of post-donation improvements, reasoning that the "notice-and-comment" procedures in the APA were not followed because the Treasury did not discuss or respond to comments by commenters to proposed regulations regarding that issue. The Tax Court rejected that argument in *Oakbrook Land Holdings, LLC, et al. v. Commissioner*, 154 T.C. 180 (2020), and about a month later in *Hewitt v. Commissioner*, T.C. Memo. 2020-89.

b. *Hewitt* was reversed by the Eleventh Circuit in 2021, holding that the regulation was **invalid** under the APA.. *Hewitt v. Commissioner*, 21 F.4th 1336, 128 AFTR 2d 2021-7033, at 2021-7039 (11th Cir. Dec. 29, 2021).

c. *Oakbrook Land Holdings* was affirmed about two and a half months later by the Sixth Circuit, holding that the regulation was **valid**. *Oakbrook Land Holdings, LLC. V. Commissioner*, 28 F.4th 700, 129 AFTR 2d 2022-1031 (6th Cir. 2022), *cert. denied*, 143 S. Ct. 626 (2023).

d. Tax Court, in a reviewed opinion, reversed course from its prior positions in *Hewitt* and *Oakbrook Land Holdings*, coming to the conclusion that the extinguishment proceeds provision in the regulations was invalid. *Valley Park Ranch, LLC et al. v. Commissioner*, 162 T.C. No. 6 (March 28, 2024). Even though *Oakbrook Land Holdings* was affirmed by the Sixth Circuit, the Tax Court found the reasoning of the Eleventh Circuit in *Hewitt* to be more convincing. The Tax Court reasoned that after carefully considering the Eleventh Circuit's analysis in *Hewitt*, the court was persuaded that the comment by one commenter "was significant and required a response by Treasury to satisfy the APA's procedural requirements," and the Treasury did not provide a sufficient explanation.

e. Commentators have observed that this history suggests that courts are increasingly open to challenges of regulations under the APA and that taxpayers should examine substantive and procedural challenges to regulations. Treasury will likely be more meticulous in documenting its consideration of significant comments to proposed regulations.

20. Treatment of Advances to Son as Legitimate Loans vs. Gifts, *Estate of Bolles v. Commissioner*, 133 AFTR 2d 2024-XXXX (9th Cir. April 1, 2024) (unpublished opinion), *aff'g per curiam*, T.C. Memo. 2020-71 [EP143-144]

a. The Tax Court in 2020 addressed whether advances from a mother to her children (and particularly, over $1 million of advances to a struggling son) were legitimate loans or were gifts. Although the mother documented the advances, there were no loan agreements, security, or attempts to force repayment. She forgave the "gift tax exemption amount" of the debts each year. Large amounts were advanced to a struggling son ($1,063,333 over 23 years), and at some point, the mother realized that the son would never be able to repay the advances; on October 27, 1989, she prepared her revocable trust to exclude that son from any distribution of her estate at her death. The Tax Court treated advances through 1989 as loans but treated subsequent advances as gifts. *Estate of Bolles v. Commissioner*, T.C. Memo. 2020-71 (June 1, 2020, Judge Goeke).

b. The Ninth Circuit Court of Appeals has affirmed in an unpublished per curiam opinion. *Estate of Bolles v. Commissioner*, 133 AFTR 2d 2024-XXXX (9th Cir. April 1, 2024) (unpublished opinion).

21. Valuation, Formula, Indirect Gift, and §2036-2038 Issues

a. *Smaldino*, T. C. Memo. 2021-127 (indirect gift; "purported" gift of LLC interest to wife followed by gift the next day from wife to trust for descendants [to use wife's exclusion]) [EP3]

b. *Estate of Michael Jackson*, T.C. Memo. 2021-48 (valuation of publicity rights; undervaluation penalties; tax-affecting not appropriate because taxpayer's experts had not persuaded the court that the buyers would be C corporations) [EP96]

c. *Nelson*, T.C. Memo. 2020-81, *aff'd*, 17 F.4th 556 (5th Cir. 2021) (appeal: assignments were not defined value transfers based on finally determined values) [EP41]

d. *Estate of Moore*, T.C. Memo. 2020-40, *aff'd* 124 AFTR 2d 2021-6604 (9th Cir. 2021) (transfer to FLP included under §2036; discussion of §2043; charitable formula transfer not recognized by Tax Court; affirmed, but on narrow grounds) [EP49]

e. *Estate of Warne*, T.C. Memo. 2021-17 (valuation of majority interests in LLCs owning real estate [4% LOC & 5% LOM discounts]; charitable deduction based on values passing to each separate charity) [EP52]

f. *Estate of Levine*, 158 T.C. No. 2 (2022) (intergenerational split dollar life insurance in trust; mother advanced $6.5 million for premiums; unrelated business associate controlled insurance for ILIT and he alone (not in conjunction with decedent) could terminate the split dollar arrangement early; Sections 2036, 2038 not applicable because of fiduciary duties and mere ability to amend contract was not "in conjunction with" under §§2036(a)(2) and 2038); Section 2703 not applicable) [EP50]

g. *Estate of Morrissette*, T.C. Memo. 2021-60 (no §2036, 2038 or 2703; valued reimbursement rights with very little discount; undervaluation penalties applied despite reputable appraisals) [EP50, 53, 136-37]

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