CURRENT DEVELOPMENTS IN TAXATION

Prepared by

Ronald D. Aucutt and Steve R. Akers

for

The Heart of America Fellows Institute

St. Louis, Missouri

May 9, 2024

INTRODUCTORY OBSERVATIONS

References in square brackets in these slides refer to page numbers in the "Estate Planning Tax Update—Highlights of Current Developments" **("H")**, "Looking Ahead – Estate Planning in 2024 & Current Developments" **("EP")**, and "Washington Update: Pending and Potential Administrative and Legislative Changes" **("WU")** in the written materials for the Institute.

Trending in 2024 [H1, EP1-4]

- Basic estate planning and coordination
- Transfer planning to use "bonus exclusion"
  - First and foremost, assure retaining sufficient funds for lifestyle needs
  - Transfers with possibility of some continued access to cashflow; SLATs, Sales
  - Grantor trusts with GST planning
  - "Topping off" gifts
  - Defined value clauses
  - Adequate disclosure
  - Utilizing "bonus" GST exemption
  - GRATs still important but not to utilize bonus exclusion

- Ownership planning in 2025 to facilitate gifts in 2026
- Planning for flexibility with grantor trust status
- Corporate Transparency Act
- Decanting; trust modification
- Trust flexibility; directed trusts

Exclusion Amount in 2026? [H2, EP11-12]

Will It Stay?

- Some planners are adamant the exclusion amount will go down in 2026.
- Others are just as adamant it will stay at $10 million (indexed).
- No one knows.

"It Has Never Gone Down"

- It did go down from $100,000 to $50,000 in 1932-1933, and decreased again from $50,000 to $40,000 in 1935-1941. But after increasing to $60,000 in 1942, the estate tax exemption amount has never decreased.

Takeaway

- Clients should understand there is at least a significant chance it will go down in 2026. "Use it or lose it."

CHIEF COUNSEL ADVICE 202352018 (Issued November 28, 2023; Released December 29, 2023)

[H3, EP26-30, WU85-92]

Facts [H3, EP26-30, WU85-92]

- **Irrevocable trust** with independent (not "related or subordinate") trustee.
  - Principal or income to grantor's Child in trustee's "absolute discretion."
  - To Child's issue per stirpes at Child's death.
  - Child has living **children** but **no other descendants**.
- Grantor retains a power that make the trust **a grantor trust** for income tax purposes, but not includible in the grantor's gross estate for estate tax purposes. In other words, a "defective grantor trust."
- Trustee petitioned court to modify trust to add **power to reimburse** the grantor for income tax grantor pays on trust's income.
- Child and Child's children **consented**, and court approved.

Chief Counsel's Office's Conclusion

- By consenting, the beneficiaries "each **have made a gift** of a portion of their respective interest in income and/or principal," described as "a transfer … **for the benefit of [the grantor**]."
- Adds 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**."
- Distinguishes Rev. Rul. 2004-64, where the power to reimburse was in the original trust instrument.
- Acknowledges that PLR 201647001 reached a different result, but states that "[t]hese conclusions no longer reflect the position of this office."

Valuation

- The CCA states: “Although 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.”
- But gives no more guidance on how **to value the gifts** or how **to apportion the gift** among the beneficiaries.
- Have **unborn** contingent beneficiaries made gifts too?
  - CCA says “Child’s **issue** cannot escape **gift tax**,” but Child only has children.
  - Has anyone ever filed a gift tax return for an **unborn** beneficiary?
  - And of course unborn beneficiaries did not “**consent**.”

Nature and Backstory of a CCA

- Typically arises from an ongoing audit or audits.
- Case(s) probably headed for litigation if not settled.
- Presumably part of developing the **strongest case**
  - to present to the court, or
  - to encourage a settlement that is favorable to the IRS.
- We don’t know all the facts.
- This CCA is addressed to two experienced IRS Tax Court litigators (*Estate of Strangi* (2000 & 2005), *Estate of Jones* (2019), *Nelson* (2020)).

Frustrations with CCA 202325018

- Why is the IRS concerned about placing more money in the hands of a **grandparent** where it could be subject to transfer tax in the near future?
- The grantor's arranging to pay income tax on the trust's (i.e., the beneficiaries') income is **not a gift**. How can offsetting it be a gift back?
- Could the grantor have simply **relinquished** the grantor trust power?
  - We don't know.
  - If so, if the beneficiaries' consent to a reimbursement power persuades the grantor not to do that, aren't the beneficiaries **helped, not hurt**?
- And doesn't the trustee have a **fiduciary duty** to the beneficiaries not to reimburse the grantor unless it **helps them**?

FY 2022 BUDGET RECONCILIATION (H.R. 5376) “BUILD BACK BETTER ACT” (Remember it?)

Ways and Means Committee (9/15/21)
Revised Version Passed by the House (11/19/21)
Senate Amendment (“Inflation Reduction Act”) (8/7/22)
House Agreement to Senate Amendment (8/12/22)
Signed by President Biden (Public Law 117-169, 8/16/22)

Ideas Dropped Out [WU16-19]

Ways and Means Committee Ideas Dropped by House:

- **Accelerate** to 2022 the 2026 **sunset** of the doubled Basic Exclusion. Amount, so $6,030,000 in 2022, raising $54 billion over 10 years.
- **Accelerate** to 2022 the 2026 return of the top individual rate of 39.6%.
- Tax capital gains in the top (39.6%) bracket at 25%.
- Cap the section 199A Qualified Business Income Deduction.
- **"Align" transfer tax and income tax treatment of trusts (new §2901).**
- **Ignore grantor trust status in transactions with grantor (new §1062).**
- Value nonbusiness assets in entities on a look-through basis.
- **Increase benefit** of special use valuation.

Committee Idea, Rates Increased by House, but Dropped by Senate:

- "Surcharge" of 5%/8%.

Why Do We Care?

Consider the Consistent Basis Rules

- Part of the Surface Transportation and Veterans Health Care Choice Improvement Act (Public Law 114-41) (**July 31, 2015**) [WU49-51]:
  - Introduced July 28
  - Passed House **385-34** July 29
  - Passed Senate **91-4** July 30
- Senator Bernie Sanders' "Responsible Estate Tax Act," June 2010.
- Rep. Jim McDermott's "Sensible Estate Tax Act," November 2011.
- Ways and Means Chair Dave Camp's Discussion Draft, Feb. 2014.
- Rep. McDermott's "Sensible Estate Tax Act," March 2015.
- Every Obama Administration Greenbook from 2010 through 2015.
- Endorsed as a pay-for by Chairman Ryan on **July 13, 2015**.

"Inflation Reduction Act of 2022" (Aug. 16, 2022) [H2, EP9-11, WU20-23]

- Focused on energy, environment, and health care.
- **None of the tax provisions discussed in previous slides.**
- Revenue raisers (effective January 1, 2023), including:
  - Targeted 15% corporate minimum tax on book income.
  - 1% stock "buyback tax."
  - Raised to 21% and 4% in Fiscal Year 2025 budget proposals.
- **$79.6 billion of IRS funding available until Sept. 30, 2031**.
  - Elaborated in 150-page IRS "Strategic Operating Plan" (April 6, 2023).
    - Described 42 objectives with "milestones" for 2023-2028.
    - Assured that "small businesses and households earning $400,000 or less will not see audit rates increase relative to historical levels."

Consequences

- The total of $79,606,533,803 became the **"80 billion"** associated with **"87,000 new agents"** auditing low-income taxpayers and family businesses that became so politically super-charged.
- On January 11, 2023, the IRS announced that it had met its goal of hiring **5,000 new customer service representatives (including people to answer the phone)**.
- Recent statements are similar (including reports of increased proportion of audits of high-income taxpayers).
- So will the IRS now be able to develop and implement durable and workable long-term plans to upgrade taxpayer services, technological modernization, and, yes, enforcement, that it has needed for decades?
- Meanwhile, the debt ceiling legislation on June 3, 2023, rescinded $1.39 billion of the long-term funding and reportedly was conditioned on redirecting an addition $10 billion in each of the next two years.

THE ADMINISTRATION'S FISCAL YEAR 2025 BUDGET PROPOSALS

General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals ("Greenbook") (March 11, 2024) [H1, EP4-8, WU24-46]

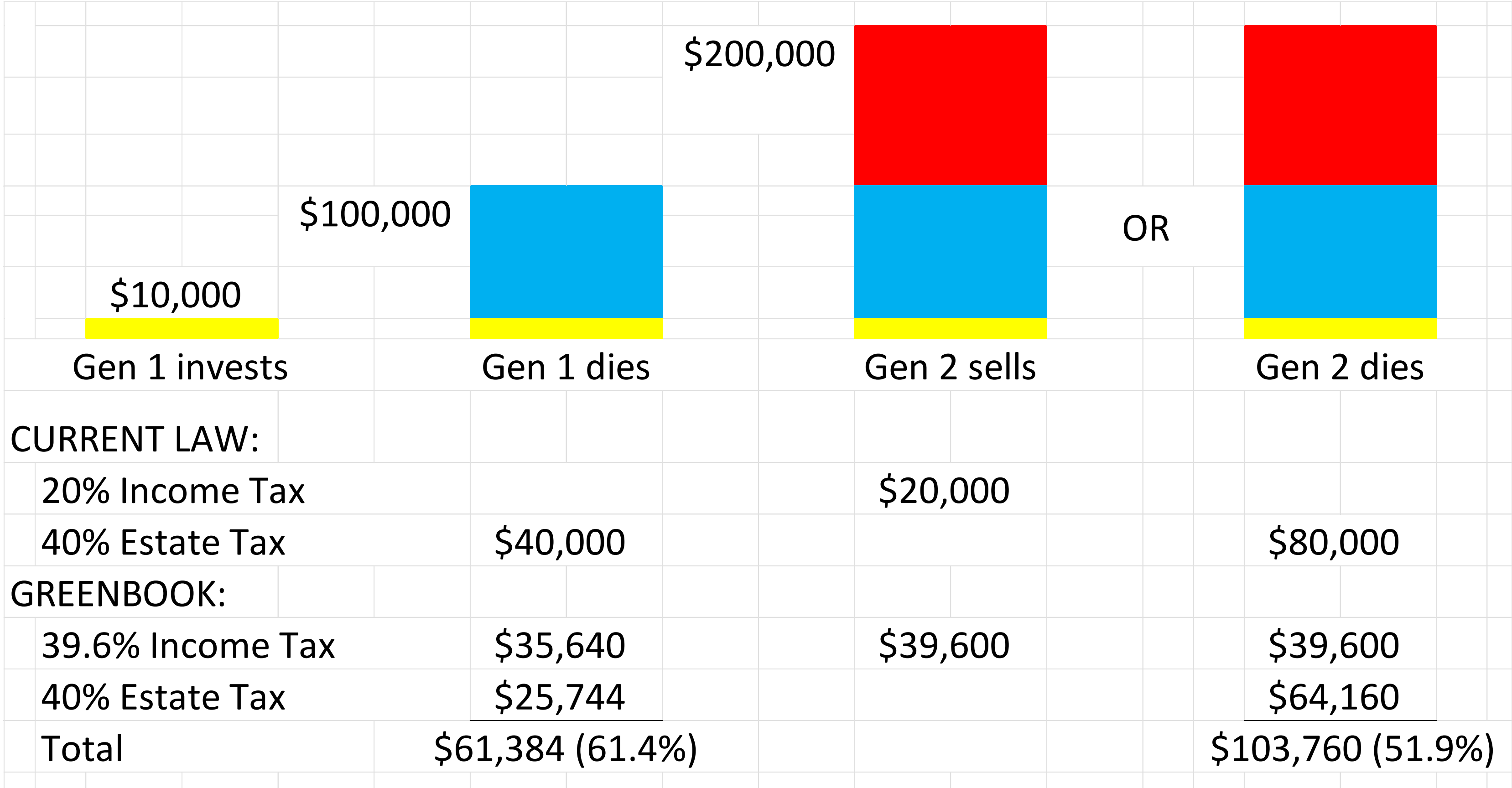
Income Tax Proposals

- Increase corporate rate from 21% to **28%**.
- Accelerate the return of the top individual rate of **39.6%** (in 2026 under current law).
  - **Including** long-term capital gains and qualified dividends.
- Minimum 25% tax on total income if wealth exceeds $100 million.
- Recognize gain on transactions between grantor and grantor trust.
  - Overruling Rev. Rul. 85-13.
  - Not distributions as such.
    - But transfers in satisfaction of an obligation (e.g., GRAT annuity).

Deemed Realization on Gifts and at Death [WU25-28]

- Applies to all appreciation (no "fresh start" as with 1976 carryover basis).
- Excludes tangible personal property and transfers to spouse or charity.
- General unified **exclusion** of **$5 million** of gain.
  - But still a stepped-up basis.
- Elective **deferral** for certain **family-owned and -operated businesses**.
  - But with no stepped-up basis.
- 15-year payment plan for other illiquid assets.
- **Deductible** for estate tax purposes.
  - Thus, combined tax on appreciation = .396+.4 × (1-.396) = **63.76%**.
- Includes transfers into and distributions from trusts (or every 90 years).
  - The current Greenbook adds a "tacking" rule, counting the periods an asset was held by previous transferors.

Illustration



	Gen 1 dies	Gen 2 sells	Gen 2 dies
CURRENT LAW:			
20% Income Tax		$20,000	
40% Estate Tax	$40,000		$80,000
GREENBOOK:			
39.6% Income Tax	$35,640	$39,600	$39,600
40% Estate Tax	$25,744		$64,160
Total	$61,384 (61.4%)		$103,760 (51.9%)

Valuation for Gift and Estate Tax Purposes

- Fractional interests or entity interests in intrafamily transfers [WU39-46].
  - Valued under a new §2704(b) at pro-rata share of "collective" value.
    - An idea traceable at least to the Reagan Administration.
  - Apparently, clumsily, excepting **business** assets [bottom of WU44].

- Defined value formula clauses [WU30-32].
  - Ineffective if dependent on **"involvement of the IRS"** – *i.e.*, an **audit**.
  - Okay if based, for example, on a reasonably prompt appraisal.
    - As in *Nelson v. Commissioner*, T.C. Memo. 2020-81.
  - Also apparently okay to use finally determined values for defining a marital or credit-shelter bequest based on remaining exclusion.

Valuation for Estate Tax Purposes

- Promissory notes [EP6, WU37-39].
  - Echoes the 1984 call in §7872(i)(2) for consistent estate tax treatment.
  - Discount rate limited to “the greater of the actual rate of interest of the note, or the applicable minimum interest rate for the remaining term.”
  - Commercial, arm’s-length notes apparently excepted.
- Increased limit on reduction in value from special use valuation [EP6, WU29].
  - Now $1,310,000 (indexed), would become $13,000,000 (indexed).
  - But **would not reduce tax on family farms or businesses as such!** [WU18-19]

Other Transfer Tax Proposals

- GRATs [EP6, WU34]:
  - Minimum term of 10 years
  - Maximum term of grantor's life expectancy plus 10 years
  - Decrease in annuity during GRAT term prohibited.
  - **Minimum 25% or $500,000 remainder value.**
  - Grantor must recognize gain **"in an exchange"** with the GRAT.
- All grantor trusts: Grantor's payment of income tax is a **gift** [EP6, WU35].
- Charitable lead annuity trusts (CLATs) [EP8, WU36]:
  - Annuity payments must be level over the CLAT term (no "shark-fin").
  - Remainder interest must be at least 10% of value (no "zeroed-out").

Limitations on the GST Exemption

- Limiting the duration of allocated GST exemption [EP6, WU33]:
  - Lives of **children and grandchildren**, and
  - Lives of younger generation beneficiaries **alive** at creation of the trust.
- Ignoring certain **tax-exempt organizations** as a "non-skip person" that prevents a taxable termination (*e.g.*, "HEETs") [EP7, WU35-36].
- Adjusting inclusion ratio upon a **purchase** from another trust [EP7, WU35].
- Treating **loans** to **beneficiaries** as **distributions** (for DNI purposes too) and **repayment** of loans by **deemed owners** as **contributions** [EP7, WU36].

Miscellaneous Proposals [EP6, WU29-30]

- Expanded definition of “executor.”
  - Moved from §2203 (just estate tax) to §7701 (general Code).

- Lien extended if taxpayer and IRS agree to deferral of tax payment.

- Annual reporting to IRS by U.S. trusts valued over $300,000 or with gross income over $10,000 (both indexed):
  - Names, addresses, and TINs of trustees and grantors.
  - Nature and estimated value (possibly a range of estimated value) of trust assets.

"Simplify" the Gift Tax Annual Exclusion [EP7, WU32]

- "Eliminate the present interest requirement" (§2503(b)).
- Replace it with a **$50,000 per-donor** annual limit (indexed) on total of:
  - transfers in trust, including transfers subject to "Crummey powers" (other than transfers to "vested" single-beneficiary trusts (§2642(c)(2)),
  - transfers of interests in passthrough entities,
  - transfers of interests subject to a prohibition on sale,
  - transfers of partial interests in property, and
  - other transfers of property that "cannot immediately be liquidated by the donee" (ignoring withdrawal, put, or other such rights).

2023-2024 TREASURY-IRS PRIORITY GUIDANCE PLAN (September 29, 2023)

“Gifts and Estates and Trusts”

ITEM 2
CONSISTENT BASIS RULES
[WU49-56]

Consistent Basis Rules [WU49-56]

- Enacted July 31, 2015.
- Various bills since Senator Sanders' in 2010.
- Regulations proposed in March 2016.
- Some modestly helpful exceptions:
  - Certain tangible personal property (other than collectibles).
  - Cash, IRD, assets sold by executor.
- Some disappointments and exasperations:
  - Report **all** assets 30 days after 706 is filed – statute: "**acquiring**."
  - **Zero basis** for after-discovered assets, omissions – **not in §1014(f)(3)**.
    - For **all assets** if it would have made 706 necessary.
  - **Donors** required to report all retransfers – statute: "**executor**."

Predictions

- Appeared under the heading **"Burden Reduction"** in the Trump Administration 2020-2021 Priority Guidance Plan.
- Guesses about what that meant at the time:
  - Walk-back of the **30-day deadline**.
  - More exceptions and more effective exceptions.
  - Maybe relaxation of the retransfer rule.
  - Possibly even relief from the zero basis rule.

- Predictions for the Biden Administration: Probably not much different.

ITEM 8
RELIEF FOR LATE ACTIONS REGARDING THE ALLOCATION OF GST EXEMPTION [WU68-70]

GST Exemption Allocation [WU68-70]

- Section 2642(g)(1) added to the Code by the 2001 Tax Act to allow late GST exemption actions. **Notice 2001-50** allows "**9100 relief**."
- 2008 proposed regulations would **replace** 9100 relief:
  - "Nonexclusive list of factors" with more weighing. See §2642(g)(1)(B)):

    "[T]he 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."
  - **"Detailed affidavits"** from "[e]ach tax professional who advised or was consulted … 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)."
- Also under **"Burden Reduction"** in the 2020-2021 Plan.
- Prediction: Need for **affidavits** walked back.

Paired Item 7 [WU68]

“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.”

2022-2023 (LAST YEAR'S) TREASURY-IRS PRIORITY GUIDANCE PLAN (November 4, 2022)

ITEM 2
BASIS OF GRANTOR TRUST ASSETS AT GRANTOR'S DEATH [H2-3, EP15-18, WU73-76]

Basis of Grantor Trust Assets at Grantor's Death [H2-3, EP15-18, WU73-76]

- Doesn't step-up (§1014) apply only to transfers at death?
- But basis is an income tax concept, and because the grantor trust is disregarded doesn't the transfer occur at death for income tax purposes?
- But what about a foreign revocable trust? Compare PLR 201544002 (June 30, 2015) with Rev. Proc. 2015-37 (June 29, 2015) (no-rule).
- Then Priority Guidance Plans: 2015-2016 through 2020-2021.
- Rep. Pascrell (D-NJ) wrote to Secretary Yellen on March 8, 2022, about claiming a "stepped-up basis for assets in an irrevocable grantor trust."
- And in a June 8, 2022, hearing, he asked her "specifically how and when."
- And she answered "Very soon. Very soon."
- Then on 2022-2023 Priority Guidance Plan (November 4, 2022).

Rev. Rul. 2023-2 (March 29, 2023)

- Simply goes through the list in section 1014(b) and finds that none apply.
  - Specifically, not a "bequest, devise, or inheritance" as in §1014(b)(1).
- Limitations in the facts of the Revenue Ruling:
  - **The transfer of the asset to the trust was a "completed gift."**
  - At grantor's death, trust's liabilities do not exceed the basis of its assets.
  - **At grantor's death, neither the trust nor the grantor "held a note on which the other was the obligor**."
- Rep. Pascrell's press release the same day "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."
- But still on the No-Rule List, Rev. Proc. 2024-3, sec. 5.01(10).

ITEM 11
ACTUARIAL TABLES UNDER SECTION 7520
[WU76-78]

Actuarial Tables [WU76-78]

- The previous mortality tables, based on 2000 census data, became effective **May 1, 2009**.
- Section 7520(c)(2) mandates revision at least once **every 10 years**.
- In other words, these tables were due **May 1, 2019**.

- Proposed regulations, based on 2010 census data, released **May 4, 2022**.
- "Proposed" to take effect "the first day of the month following the date on which the … final regulations [are] published in the Federal Register."
- With an elective application back to **January 1, 2021**.
- Still left **20 months** (May 1, 2019 - December 31, 2020).

Dilemma for the IRS

- Received new decennial life (Lx) tables from CDC **August 7, 2020**.
- Hoped that a **January 1, 2021**, transition date would minimize complexity (and perhaps tension among beneficiaries and fiduciaries) of requiring amended returns.
- Then it got to be **2022** (about 17 months later).
- **Comments** urged an election back to **May 1, 2019**. For example:

  “Because Code section 7520 **mandates** the adoption of new tables no less frequently than once every 10 years, we believe the regulations **must** allow taxpayers to elect to use the proposed new tables in connection with any transaction occurring on or after May 1, 2019.” [ACTEC, July 5, 2022]

- The final regulations (June 1, 2023) allow elections back to **May 1, 2019**.

Transitional Rules

- From May 1, 2019, until June 1, 2023 [the general effective date], the transferor or executor may elect to use new (**2010** census) or previous (**2000** census) mortality tables.
  - All elements of the same transfer, and all transfers on the same date, must be valued **consistently** – for example, all interests in the same property (income, remainder, partial, etc.), all assets includible in the gross estate, all estate tax deductions claimed.
- The **interest rate** is the monthly section 7520 rate in any event.
- For a **charitable deduction** for a May or June 2019 transfer or death, if the taxpayer elects to use a March or April 2019 rate under section 7520(a), then the **2000** tables must be used for the mortality component.

Help from the Preamble

"The availability of the option to use the revised actuarial tables … for valuation dates during the transition period … 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."

- Avoids *Procter* (4th Cir. 1944) through *Moore* (T.C. Memo. 2020).

CORPORATE TRANSPARENCY ACT

[H3-5, EP30-36]

Beneficial Owners of Trusts [H3-4, EP31-32]

Who Are Beneficial Owners of Trusts That Must Be Reported?

- 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 [Example: 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.

Uncertainties

- 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?

Constitutionality? (*NSBA v. Yellen,* N.D. Ala. March 1, 2024) [H4-5, EP34]

Residential Property Reporting Proposal [H4, EP34-35]

FinCEN Proposal for Reporting Information About Non-Financed Residential Real Estate Transfers

Purpose

- Combat and deter money laundering

Existing GTO Program

- Real estate “all-cash” sales in certain geographic areas must currently be reported pursuant to the existing Real Estate Geographic Targeting Order program (GTO) under the Bank Secrecy Act. Regulated lenders are excluded because banks already are covered by other anti-money laundering disclosure programs.

Proposed Rulemaking (RIN 1506-AB54)

- **"Reporting Persons"** (professionals involved in closing residential real estate transfers, including settlement agents, title insurance agents, escrow agents, and attorneys)
- Would be required to report certain information about "beneficial owners" (similar to the description of beneficial owners for CTA)
- For non-financed transfers of residential real estate (regardless of amount, even gifts)
- To a "transferee entity" (such as LLCs, corporations, or partnerships) or "transferee trust"

What Trusts?

- Would apply to transfers to most foreign or domestic trusts (specifically refers to revocable trusts)
- Exceptions: transfers to trust at death of owner, pursuant to divorce, or to bankruptcy estate

"PATAGONIA TRUSTS"; SECTION 501(c)(4) ORGANIZATIONS

[H5, EP67-73]

Why the Recent Interest in Patagonia Trusts? [H5, EP67-73]

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 gave $366 million of Tesla stock.

Advantages

- No private foundation rules
- No public support tests
- 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%)
- Gift tax not applicable (added by 2015 PATH Act)
- No gain realization (gain is realized for contributions of appreciate property to §527 political organizations)
- Tax-exempt entity
- Privacy

Disadvantages

- No income tax charitable deduction
- Reputational concern (some may view as "dark money")
- Lack of control (No estate tax charitable deduction for 501(c)(4) organizations)
  - (1) Donor must avoid causing §2036(a)(2), §2038 inclusion; or
  - (2) Convert to §501(c)(3) or private foundation at donor's death.
  - Some donors are not willing to give up that much control.
- 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))
  - Because of this uncertainty, donors should require organization to get a determination letter before making large donations.
- Because of disadvantages (mainly lack of control and reputational concerns), such trusts are rarely used.

VALUATION OF S CORP. STOCK: *Estate of Cecil v. Commissioner*, T.C. Memo. 2023-24 (Feb. 28, 2023)

[H6-7, EP93-99]

Valuation of S Corporation Stock, Vanderbilt Biltmore House [H6-7, EP93-99]

Takeaways

- Tax-affecting was allowed based on facts (Estate's and IRS's appraiser both tax-affected income; "We are not necessarily holding that tax affecting is always, or even more often than not, a proper consideration for valuing an S corporation.")
- Discounts for differing block sizes (19% for voting stock; 22% for 15.57% nonvoting stock; 27% for 23.36% nonvoting stock")
- Liquidation value given no weight (about $15 million vs. $147 million) (Gifted stock could not force liquidation; strong evidence of intent to continue operations long term)

Other “Liquidation-Zero-Weight” Cases

- *Estate of Jones v. Commissioner*, T.C. Memo. 2019-101 (timber)
- *Estate of Giustina v. Commissioner*, 586 F. App’x 417, 418 (9th Cir. 2014) (timber limited partnership)
- *Estate of Watts v. Commissioner*, 823 F.2d 483 (11th Cir. 1987) (timber general partnership)

VALUATION OF LIFE INSURANCE: *Dematteo v. Commissioner*, Tax Court Docket No. 3634-21 (Stipulated Decision Feb. 22, 2024)

[H12-13, EP139-140]

Must Interpolated Terminal Reserve Values Be Used To Value Policies? [H12-13, EP139]

Regulations

- Reg. §25.2512-6 says to value life insurance contracts by sale 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 at the date of the gift the proportionate part of the gross premium last paid before the date of the gift which covers the period extending beyond that date. 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.)
- 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.

Professional Appraisal

- Donor used an independent experienced appraiser, the Ashar Group, to value the policies.

IRS Position

- The IRS position was that the regulations **mandate** using interpolated terminal reserve values plus unexpired premiums to value policies.

Summary Judgment Denied

- Court refused summary judgment that the regulations do not require using interpolated terminal reserve values to value policies, reasoning that this “question of law may become moot depending on the evidence of the nature of the policies and the quality of the respective valuations.”

Settlement

- A Stipulated Decision entered 2/22/24 reports an agreed gift tax deficiency of $4,291,077. How much (if any) of that deficiency is attributable to gifted life insurance policies is unknown.

REVERSE SPLIT DOLLAR LIFE INSURANCE: *Cinader v. Commissioner* (Settlement)

[H13, EP140]

Cinader v. Commissioner [H13, EP140]

Basic Facts

- Trust owned life insurance policy on decedent's life. Decedent agreed to pay trust for the right to designate the beneficiary (of death proceeds minus greater of CSV or premiums paid). Table 2001 rate was used to determine each year's repayment amount. Decedent owed the trust $41,168,849 at his death, which was deducted for estate tax purposes.

IRS Position

- 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)
- Debt to trust is not bona fide indebtedness, and therefore is not deductible under § 2053.

Settlement

- Stipulated Decisions entered Jan. 3, 2024, report agreed gift tax deficiencies of $3,327,230 for 2002, $99,213 for 2003, $1,424,814 for 2012, $8,433,707 for 2013, and $1,527,836 for 2015 (total gift tax deficiencies of $14,812,800) and estate tax deficiency of $14,298,629.

GIFT TAX DISCLOSURE: *Schlapfer v. Commissioner*, T.C. Memo. 2023-65 (May 22, 2023)

[H7-8, EP53-60]

Schlapfer v. Commissioner [H7-8, EP53-60]

Statute

- Section 6905(c)(9): To start statute of limitations, must be disclosed "in a manner adequate to apprise the Secretary of the nature of such item." (Taxpayer Relief Act of 1997)

Regulations (November 1999)

- 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."
- Second sentence: will be "considered adequately disclosed" if includes five listed elements (or a proper appraisal is provided).

Historical Context and Significance

- No cases with any significant discussion of gift tax adequate disclosure for over 25 years.
- IRS has taken a strict approach. Example: LAFA 20152201F (missing one digit from EIN of partnership).

First Decade: Transfers

- Swiss citizen living in U.S. since 1979.
- 2002: Created European Marketing Group (EMG) (a Panamanian manager of marketable securities, cash).
- 2006: Obtained a universal variable life (UVL) insurance policy on mother, aunt, and uncle.
  - Premium: $50,000 plus all of the stock of EMG.
- Jan. 2007: Asked that policy be assigned to mother.
- April 2007: He and his mother jointly requested that policyholders be his mother, aunt, and uncle.
- May 2007: Applied for U.S. citizenship.
- 2008: Became a U.S. citizen.

Second Decade: IRS

- **2012**: Entered Offshore Voluntary Disclosure Program (OVDP).
- **Nov. 2013**: Filed OVDP package, including 2006 gift tax return.
  - "Protective": Not subject to gift tax because he was not a U.S. citizen and did not intend to remain in the U.S.
  - Showed gift of EMG stock to his mother.
  - Back and forth with IRS, affidavits about his non-U.S. claim.
- **May 2016** (30 months after filing): Interview by IRS attorney about non-U.S. claim and nature, timing, and value of gift.
- **June 2016**: Extended statue of limitations until Nov. 30, 2017.
- **Aug. 2016**: Received Report of Gift Tax Examination.
  - Asserting gift in 2007, not 2006, because he retained control.
- **Oct. 2019** (over 3 years later – almost 2 years after Nov. 30, 2017): Notice of deficiency: $8.75 million in gift tax and penalties.

Third Decade: Tax Court

- 2006 or 2007 doesn't matter: **Reported as a completed gift in 2006.** Reg. §301.6501(c)-1(f)(5).
- General rule: Manner adequate to apprise the IRS of the nature of the gift and basis for the value.
- Safe harbors?: Court referred to "requirements," but also said "not mandatory but … guidance to taxpayers to inform them on a way to satisfy adequate disclosure."
- Substantial compliance okay:
    1. Description of property: Shares, not policy – **"underlying property"**
    2. Identity of donees: Mother, not aunt and uncle – **"member of the family"**
    3. Method used to determine value: **Portfolio valuation** (OVDP required disregard of entities)
- So … **"adequate"** … statute of limitations ran … **no deficiency**.

Reflections

- Was he lucky?
  - Better if he had done a lot more.
  - And he applied for U.S. citizenship soon after gift.
  - Don’t use this case as a model.
  - But good to have a case in case IRS gets picky.

- Was the IRS hoping to be lucky?
  - Interview by IRS estate tax attorney
  - Report of Gift Tax Examination
  - Request to extend the statute of limitations
  - **ALL LESS THAN 3 YEARS AFTER HE FILED THE OVDP PACKAGE INCLUDING FORM 709!**
    - But the IRS may push hard if cornered.
    - And the court didn’t mention that.

2023-2024 TREASURY-IRS PRIORITY GUIDANCE PLAN (September 29, 2023)

"Gifts and Estates and Trusts"

ITEM 5
ESTATE TAX DEDUCTIONS FOR EXPENSES AND CLAIMS: PRESENT VALUE CONCEPTS AND GUARANTEES

[H2, EP23-26, WU65-67]

Present Value Concepts in Estate Tax Deductions [H2, EP23-26, WU65-67]: History

- From final section 2053 regulations of **October 2009**.
- Proposed regulations of April 2007 provided for deduction of:
  - **Noncontingent** obligations at **present value**.
  - **Contingent** obligations **dollar-for-dollar as paid**.
- Public comments criticized that distinction as inequitable.
- Treasury agreed that the issue "**merits further consideration**," and reserved Reg. §20.2053-1(d)(6) for that issue.
- Prop. Reg. §20.2053-1(d)(6) (plus other regs) published June 28, 2022.
  - Applicable to estates of decedents dying on or after the date final regulations are published.

Proposed Reg. §20.2053-1(d)(6)

- Present-value discounting after a **3-year "grace period."**
  - Some public comments have recommended, say, 5 years.
- Applies to claims and expenses other than mortgages, etc. covered by Reg. §20.2053-7.
- Uses the section 1274(d) applicable federal rate, compounded annually:
  - Mid-term (3-9 years), or
  - Long-term (over 9 years).

Three Years Is a "Cliff"

- Example (death in May 2024):

$1,000 Claim or Expense, Expected To Be Paid …	AFR (May 2024)	Estate Tax Deduction (rounded)
35 months after death	N/A	$1,000
3 years after death	4.42%	$878
10 years after death	4.55%	$641
15 years after death	4.55%	$513

- *Graegin* loans (prepayment of principal and interest prohibited).
  – Could have been making a comeback with rising interest rates.
  – **Now deductions of interest will be discounted.**

Interest on Taxes (Prop. Reg. §20.2053-3(d)(1))

- Not on deferral under §6166 (affirming §2053(c)(1)(D) (enacted 1997)).
- Must be "**actually and necessarily incurred in the administration of the estate**" (affirming and amplifying Reg. §20.2053-3(a) (1958)).
- Interest on federal tax (unless §6166 applies) "**generally**" meets that standard, but not "to the extent the interest expense is attributable to an executor's negligence, **disregard of applicable rules** or regulations … or fraud with intent to evade tax."
- But the preamble distinguishes "legitimate disagreements with the IRS, inadvertent errors, or reasonable reliance on a qualified professional."

Interest on Loans (Prop. Reg. §20.2053-3(d)(2))

- Requirements: "indebtedness," "bona fide," "actually and necessarily incurred in the administration of the decedent's estate."
- Nonexclusive list of 11 favorable factors, including, for example:
  - (viii) Not resulting from "testamentary **estate plan to create illiquidity**."
  - (ix) Lender is not "a beneficiary of a substantial portion of the value of the estate" or "**an entity** over which such a beneficiary has control."
- **Possibly raising serious questions for family-owned businesses.**

- And there might be greater occasion for the IRS to assert that the interest on a *Graegin* loan is **entirely nondeductible**, not just discounted.

Required "Appraisal Document"

- Proposed changes to Reg. §20.2053-4(b) and (c):
  - Undo the 2009 incorporation of "qualified appraisal" and "qualified appraiser."
  - Replace it with a list of requirements for an "appraisal document" more focused on the section 2053 context.
- One of these requirements is that the appraisal document be signed "**under penalties of perjury**."
  - Unprecedented.
  - Impractical? (Preparers of these appraisal documents must be unrelated. Will they know the facts first-hand?)

Personal Guarantees

- Proposed Reg. §20.2053-4(d)(5)(ii) would provide that the adequate and full consideration test would be met by a decedent's agreement to guarantee a debt of an entity **if**, at the time the guarantee is given, the decedent had an interest in the entity and either
  - 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.

Big Problem for **ANY** Taxable Estate

- **Artificial timing** (acceleration) of payments.
  - Prudent to determine all assets and liabilities (including estate tax) first.
  - Not in the best interests of the beneficiaries to rush.

- Annoying to beneficiaries.
  - Especially executors' and attorneys' **fees**.
  - And especially when compared to the timing of **distributions**.

- Need for borrowing? – Anxiety about deductibility of interest.
  - Again, could produce **artificial** choice of lender, for example.
  - **Not in the best interests of beneficiaries.**

- How to get claims and expenses valued (for “Appraisal Document”)
- Litigation? Attorney is probably best.
- “Under penalty of perjury”?
  - Who would do that? (Must be unrelated.)
- More work, more care, therefore **more expense**.
- Therefore more frustration.
- And **“subject to adjustment”** of the amount or the actual or expected timing of the payment (within the statute of limitations).

- A grace period longer than three years might help.
  - But would create complications with the statute of limitations.

ITEM 3
PROPOSED EXCEPTION TO ANTI-CLAWBACK RULES

[H2, EP22-23, WU56-63]

Anti-Clawback Rules [H2, EP22-23, WU56-63]

- The 2017 Tax Act added **section 2001(g)(2)**, directing Treasury to issue "such regulations as may be **necessary** or **appropriate**" to avoid clawback after the sunset of the doubled exclusion amount in 2026 for gifts made before then.
- Anti-clawback regulations were proposed in November 2018 and finalized in November 2019.
- The preamble to the 2019 final regulations warned of future **"anti-abuse" additions to prevent the application of the regulations to gifts included under section 2036, etc.**
- Those proposed "anti-abuse" additions were published April 27, 2022.

Proposed Exceptions from Anti-Clawback Rules

- Prop. Reg. §20.2010-1(c)(3)(i): "[T]ransfers includible in the gross estate **or treated** as includible in the gross estate for purposes of section 2001(b), **including without limitation** the following transfers:"
  - (A) Traditional **"string gifts"** (under section 2036, etc.), ignoring charitable or marital deductions [Prop. Reg. §20.2010-1(c)(3)(i)(A)].
  - (B) **Enforceable promises** [Prop. Reg. §20.2010-1(c)(3)(i)(B)].
  - (C) Certain interests to which **chapter 14** applies [Prop. Reg. §20.2010-1(c)(3)(i)(C)].
  - (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." [Prop. Reg. §20.2010-1(c)(3)(i)(D)].

(A) Traditional "String Gifts" – Makes Sense

Comparing Estate Tax Return (Form 706) With and Without Clawback [WU58]		Before 2019 Regulations	Under 2019 Regulations
Numbers (including the assumed 2026 BEA of $6,800,000) are from Example (1) in Reg. §20.2010-1(c)(2)(i) (also used in the 2022 proposed regulations).			
Line 3c	Taxable estate **(death in 2026)**	20,000,000	20,000,000
Line 4	Adjusted taxable gifts **($9,000,000 gift made in 2019)**	9,000,000	9,000,000
Line 5	Add lines 3 and 4	29,000,000	29,000,000
Line 6	Tentative tax on amount on line 5	11,545,800	11,545,800
Line 7	Total gift tax paid or payable	0	0
Line 8	Gross estate tax (subtract line 7 from line 6)	11,545,800	11,545,800
Lines 9a & 9d	**Basic exclusion amount [BEA]**	**6,800,000**	***9,000,000**
Lines 9e & 11	Allowable applicable credit amount (tentative tax on line 9d)	2,665,800	3,545,800
Lines 12 & 16	Net estate tax (subtract line 11 from line 8)	8,880,000	8,000,000
*** The greater of 2026 BEA or BEA used to calculate the credit in 2019**	Intuitively correct tax (40% × $20,000,000)	8,000,000	8,000,000
	Clawback penalty	**880,000**	0

Preserving “String” Effects (Some Dating from 1930s)

Same Comparison, Except That the 2019 Gift Is a “String Gift” [WU61]

Numbers (including the assumed 2026 BEA of $6,800,000) are from Example (1) in Reg. §20.2010-1(c)(2)(i) (also used in the 2022 proposed regulations).		Before 2019 Regulations	Under 2019 Regulations
Line 3c	Taxable estate **(death in 2026, including 2019 $9M string gift)**	29,000,000	29,000,000
Line 4	Adjusted taxable gifts (**string gift omitted** under §2001(b))	0	0
Line 5	Add lines 3 and 4	29,000,000	29,000,000
Line 6	Tentative tax on amount on line 5	11,545,800	11,545,800
Line 7	Total gift tax paid or payable	0	0
Line 8	Gross estate tax (subtract line 7 from line 6)	11,545,800	11,545,800
Lines 9a & 9d	**Basic exclusion amount [BEA]**	**6,800,000**	***9,000,000**
Lines 9e & 11	Allowable applicable credit amount (tentative tax on line 9d)	2,665,800	3,545,800
Lines 12 & 16	Net estate tax (subtract line 11 from line 8)	8,880,000	8,000,000
*** The greater of 2026 BEA or BEA used in 2019 to calculate credit**	Intuitive (40% × ($29,000,000 - $6,800,000))	8,880,000	8,880,000
	Unintended anti-clawback bonus	0	**880,000**

(B) "Enforceable Promise" Not Satisfied Before Death

- Also makes sense in general.
  - Donor/promisor **retains enjoyment of the property** until the promise is satisfied at death – resembling section 2036, etc.

- But raises some concerns:
  - Not limited to promises that give rise to a current gift (besides being "enforceable")?
  - No exclusion to the extent the decedent received consideration?

(C) Certain Interests to Which Chapter 14 Applies

- Expressed as “Transfers described in §25.2701-5(a)(4) or §25.2702-6(a)(1) of this chapter [of the regulations].”
- Sections 2701 and 2702 have some provisions that operate **similarly** to section 2036 (for example), but are **not identical** to section 2036.
- As a result, the reference to the chapter 14 regulations (especially the section 2701 regulations) might be **too abrupt and vague**.
- The regulations would at least be helped by some examples.

(D) 18-Month Rule

- Expressed as "Transfers that would have been described in paragraph (c)(3)(i)(A), (B), or (C) of this section 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**."
  - Resembles the **3-year** "clawback" in the "relinquishment" clause of section 2035(a) – **but with actions "by any other person" added**.
  - Also resembles the 18-month non-deathbed (more precisely, "not terminally ill") presumption in Reg. §§1.7520-3(b)(3), 20.7520-3(b)(3)(i), and 25.7520-3(b)(3) – **except that it is not rebuttable**.
- Needs clarification, especially where **no other "string" provision applies**, or where there is **consideration**.

Exceptions

- **Exception from 18-Month Rule:**
  - "Transfers, relinquishments, or eliminations … 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." [Prop. Reg. §20.2010-1(c)(3)(ii)(B)]
- **General Exception from "Anti-Abuse" Rule:**
  - "Transfers 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." [Prop. Reg. §20.2010-1(c)(3)(ii)(A)]
  - Uses little exclusion amount.
  - Preamble analogizes to reversions (*e.g.*, §§2037(a)(2) & 673(a)).

Effective Date

- Would apply to estates of decedents dying **on or after April 27, 2022**, the date the proposed addition was published in the Federal Register.
  - In other words, under current law, **after December 31, 2025**.
- But the effective date 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**.
  - In other words, gifts **since January 1, 2018**.
    - Seems correct, but some might be surprised or disappointed.
- For the 18-month rule: transfer, relinquish, or eliminate **before July 1, 2024**, **IF WE HAVE FINAL REGULATIONS BY THEN**.

IRS VIEW OF DECANTING
Estate of Horvitz v. Commissioner, T.C. Dkt. No. 20409-19 (Order, Feb. 7, 2023)

[H11-12, EP91-93]

Estate of Horvitz v. Commissioner [H11-12, EP91-93]

- Harry Horvitz died in 1992, two QTIP trusts were funded to pay income and, in the trustees' discretion, principal to his spouse, Lois, for her life and then distribute the trust assets among Harry's issue as Lois may have appointed by her will.
- In 2013, those trusts were **decanted** under Ohio law into new trusts that were identical to the original trusts except for the **addition of qualified charities as potential appointees** under Lois's power of appointment, as well as Harry's issue.
- Lois exercised that power of appointment.
- After Lois died in 2015 the trustees, pursuant to her exercise of the power, made distributions to charities, for which her executor claimed **about $20 million** as an estate tax charitable deduction.

- The estate sought partial summary judgment that charitable deduction was allowed.
- The IRS seemed focused on documents around time of the decanting in 2013 – IRS also cited Harry's intent **[in 1992]**.
- Tax Court (Judge Gustafson):
  - No one disputed the decanting or the payments to charity.
  - **Even IRS did not dispute that the payments were made.**
  - Did not make a decision, even about motions (estate's summary judgment; IRS's discovery).
  - But expressed skepticism.
  - Gave parties 10 days to start discussing settlement and 17 days to report to the court.
- On the **15th day**, they filed a stipulation in which IRS conceded.
- But why did the IRS do this?

OPTION AGREEMENT DOES NOT MEET SECTION 2703(b) SAFE HARBOR: *Huffman v. Commissioner*, T.C. Memo. 2024-12

[H8, EP135-139]

Huffman v. Commissioner [H8, EP135-139]

Facts

- 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.

Analysis of §2703(b)'s Three Requirements

- 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.
- 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, the court expressed no concern about the pricing provisions) – all in all, a lot of similarities.

Valuation

- The court valued the stock, generally adopting the positions of the IRS's expert (it did allow one adjustment, which may have been substantial).
- Valuation included 10% lack of control and 20% lack of marketability discounts.

Gift

- Difference between determined value and consideration paid was gift by parents.

CORPORATE REDEMPTION FUNDED WITH LIFE INSURANCE: *Connelly v. United States*

Supreme Court Reviewing Whether Life Insurance Proceeds Are Included in Considering Valuation of Stock Subject to a Redemption Arrangement

[H9-10, EP123-133]

Connelly v. United States [H9-10, EP123-133]

Facts

- A buy-sell agreement required that a company purchase a decedent's shares of a corporation owned by two brothers. The pricing provision called for the parties to agree annually on the company value, and if an annual value had not been agreed on, the price would be determined by securing two or more appraisals (which would not consider control premiums or minority discounts). The company funded the agreement with life insurance policies on the two brothers' lives.
- The brothers never entered into any agreement about the company value, and on the death of the brother owning about 77% of the company, the estate and the company did not comply with the appraisal requirement in the agreement but agreed to pay the estate $3 million (using part of the $3.5 million of life insurance proceeds paid to the company) (as well as providing other benefits for the deceased brother's son).

Connelly v. United States [H9-10, EP123-133]

Stock Valuation

- A buy-sell agreement did not meet the § 2703(b) safe harbor (it failed to meet the device test and comparability test). It also did not meet the court-established requirements for buy-sell agreements to set the value for estate tax purposes.
- In determining the stock value, the court concluded that the life insurance proceeds should be considered, disagreeing with the Eleventh Circuit's rationale in *Estate of Blount v. Commissioner* that the contractual obligation of a company to purchase a decedent's shares offsets the life insurance proceeds on the decedent's life paid to the company. A hypothetical willing buyer of a company would not factor the company redemption obligation into the value of the company because the buyer would merely be obligated to redeem the shares the buyer then held, and "the buyer would not consider the obligation to himself as a liability that lowers the value of the company to him." The Eighth Circuit affirmed, expanding on the district court's rejection of the rationale of *Estate of Blount*.

Connelly v. United States [H9-10, EP123-133]

Major Argument in Estate’s Supreme Court Brief

- The willing-buyer/willing-seller test accounts for all relevant facts concerning the relevant property.
- 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.
- The proper valuation of a block of corporate shares does not include value available only to a purchaser of the entire company.
- Increasing the value of an estate’s stock based on corporate insurance proceeds designated for a stock redemption would create negative practical consequences.

Connelly v. United States [H9-10, EP123-133]

Amicus Briefs

- An amicus brief of the Chamber of Commerce of the United States of America and the National Federation of Independent Business Small Business Legal Center, Inc., **supporting the estate**, emphasizes that the lower court view distorts the use of life insurance as a prudent solution to a problem frequently faced by closely held companies.

- Amicus briefs of Law Professors Adam Chodorow and Brant Hellwig, **supporting the IRS**, point out that treating redemption obligations as value-reducing liabilities would result in an irrational zero estate tax value for the stock and yield divergent estate tax consequences across economically similar transactions.

Connelly v. United States [H9-10, EP123-133]

Oral Argument

- At oral argument some Justices found the issues “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 includes the insurance]?”
- 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 [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.”

PERSONAL LIABILITY FOR ESTATE TAX
United States v. Paulson (9th Cir. May 17, 2023, *cert. denied* March 4, 2024).

[H10-11, EP109-123]

United States v. Paulson [H10-11, EP109-123]

Background Regarding Personal Liability for Estate Taxes

- Executor, 31 U.S.C. 3713.
- Transferee liability, §6901 (assessment must be made against the transferee within four years [but that time limit can be suspended for various reasons]; a remedy if transferees are liable under state law, typically under fraudulent transfer principles)
- Personal liability for certain recipients (including spouse, trustee, and beneficiaries) for non-probate property, §6324(a)(2)
- 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.

United States v. Paulson [H10-11, EP109-123]

Basic Facts

- The decedent died in 2000 with most of his assets in a revocable living trust. The executors filed the estate tax return; they paid some estate tax and deferred the rest under §6166. The IRS and the estate in 2005 agreed to a much higher estate tax, which was deferred under §6166. Most of the estate tax was never paid.
- Distributions were made to various trust beneficiaries between 2003 and 2006. Various family members were appointed as successor trustees in 2009 and 2011.
- In 2015, the IRS filed an action against the estate and living trust for the balance of the estate tax liability (then over $10 million). The IRS also sought judgment under §6324(a)(2) against various family members in their capacities as successor trustees and as beneficiaries.

United States v. Paulson [H10-11, EP109-123]

Section 6324(a)(2)

- "If the estate tax … is not paid when due, then the … trustee, … or beneficiary,
- who **receives, or has on the date of the decedent's death**, property included in the gross estate under sections 2034 to 2042, inclusive,
- to the extent of the **value, at the time of the decedent's death**, of such property,
- shall be personally liable for such tax."

Prior Case Law

- Over the last 60 years, prior cases held that §6324(a)(2) and its predecessors applied only to specified classes of individuals who hold or receive (or have the right to immediate receipt of) property in the gross estate **at the time of the decedent's death**.

United States v. Paulson [H10-11, EP109-123]

Majority Holding

- Section 6324(a)(2) applies to the specified persons who **receive** property after the date of the decedent's death in addition to persons who **have** property at the time of the decedent's death.
- The court limited the personal liability to the lesser of (1) the value of assets **on the date of death** that were later received as beneficiaries or accepted as trustees or (2) the value of such assets **when received or accepted**, even though the statute merely provides the first limitation. (There is NO authority in the statute for limiting liability to the value of assets when received rather than at the date of death.)

Dissent

- A dissent argues strongly that personal lability should not extend to persons who receive assets after the date of death. Otherwise, individuals could be personally liable for more than they receive.

United States v. Paulson [H10-11, EP109-123]

Takeaways – Practical Planning Tips

- Successor trustees should be careful of possible personal liability beyond value of trust before accepting office.
- Trust distributions may impact beneficiaries' status with creditors, and beneficiaries may have to show potential liability on financial statements.
- Personal liability exposure could last about 25 years after date of death for estates that elect to defer tax under §6166.
- If estate taxes are unpaid, consider deferring making distributions to trust beneficiaries until after liability exposure period has ended.

ANTICIPATORY ASSIGNMENT OF INCOME
Estate of Hoensheid v. Commissioner, T.C. Memo. 2023-34 (March 15, 2023)

[H11, EP99-108]

Estate of Hoensheid [H11, EP99-108]

- Issue: Anticipatory assignment of income for gift to charity of appreciated property that is subsequently sold.
- Tests mentioned by the court:
  - "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"
- Seems contrary to the "legally obligated" test suggested in Rev. Rul. 78-197.

QTIP Trust Planning
McDougall v. Commissioner,
(Tax Court Petitions Filed Feb. 18, 2022)

[H12, EP133-135]

McDougall [H12, EP133-135]

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.
- Concluding 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 tax exclusion and would have notes from sale included in spouse's gross estate.

CONSERVATION EASEMENT REGS AND ADMINISTRATIVE PROCEDURE ACT
Valley Park Ranch, LLC v. Commissioner
162 T.C. No. 6 (March 28, 2024)

[H14, EP141-143]

Valley Park Ranch, LLC [H14, EP141-143]

- Argument: The treatment of post-donation improvements in the conservation easement extinguishment proceeds regulation is invalid under the "notice-and-comment" rules of the APA, because Treasury did not discuss certain comments.
- The Tax Court rejected that argument in 2020 in *Oakbrook Land Holdings, LLC* and *Hewitt*.
- The Eleventh Circuit reversed *Hewitt* in 2021.
- The Sixth Circuit affirmed *Oakbrook* about 2½ months later.
  - The Supreme Court denied certiorari in *Oakbrook* in 2023.
- In *Valley Park Ranch* the Tax Court reversed itself, finding the reasoning of the Eleventh Circuit in *Hewitt* more convincing.
- 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 that Treasury did not provide a sufficient explanation.

LOANS TREATED AS GIFTS
Estate of Bolles v. Commissioner
9th Cir. April 1, 2024, *aff'g* T.C. Memo. 2020-71

[H14, EP143-144]

Estate of Bolles [H14, EP143-144]

- Issue: Whether advances from a mother to her children (and particularly over $1 million of advances over 23 years to a struggling son) were legitimate loans or were gifts.
  - She documented the advances, but there were no loan agreements, security, or attempts to force repayment.
  - She forgave the "gift tax exemption amount" of debts each year.
  - In 1989, realizing that the son would never be able to repay the advances, 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.
- The Ninth Circuit Court of Appeals affirmed per curiam in an unpublished opinion.

Questions and Comments?

Copyright 2024 by Ronald D. Aucutt
All Rights Reserved

ronaucutt@gmail.com