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LOOKING AHEAD – Estate Planning in 2025 & Current Developments (Including Observations from Heckerling 2025)

March 2025

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Introduction

This LOOKING AHEAD summary addresses planning trends and important estate planning issues for 2025, including various current developments in 2024. It includes some observations from the 59th Annual Heckerling Institute on Estate Planning™ that was held January 13-17, 2025, in Orlando, Florida. Items 19 and Items 26-34 include selected observations from some of the presentations at the 59th Annual Heckerling Institute. The remaining items generally discuss recent developments, many of which were also covered (in varying levels of detail) in presentations at the Heckerling Institute.

1. Trending in 2025

a. **Estate Planning 101 and 201.** Basic estate planning, including preparation of wills or revocable trusts (which will likely include appropriate trust planning for management and creditor protection), powers of attorney, health care documents, and coordination of life insurance, retirement benefits and other non-probate assets will always be of primary importance for the bulk of the population. Planning to minimize federal estate tax will also be important for clients with estates larger than $7 million in case the exemption amount decreases to that range in 2026 ($5 million indexed and estimated to be around $7 million). For couples, this will include bypass trust planning, or portability planning (or a combination of the two).

b. **Transfer Planning to Utilize "Bonus Exclusion."**

Following the Republican sweep of the Presidency, the Senate, and the House in the 2024 elections, it seems highly likely that the large exclusion amount will be preserved (at least for some limited number of years). But there is some small chance that Congress will not act to prevent the exclusion amount from going down in 2026. Clients may want to take advantage of the difference (the "bonus exclusion") in case the exclusion amount drops in 2026 (from about $14 million to about $7 million). To make use of the "bonus" amount, the client must make a gift of well over $7 million. For example, if an individual makes a gift of about $7 million in 2024 and if the exclusion amount goes down to about $7 million in 2026, the individual will have simply used up his or her $7 million amount and will have made no use of the bonus exclusion amount. For individuals with over about $30 million or couples with over about $60 million, they may (with an emphasis on "may") be able comfortably to afford making transfers of the exclusion amount, but clients having less than that will likely want to retain ways to keep some type of retained cash flow from or discretionary access to the transferred assets. Alternatively, a couple may want just one spouse to make a gift to utilize his or her bonus exclusion amount, preserving the other spouse's exclusion.

(1) **Cushion for Access to Assets for Lifestyle Needs.** A key aspect of large gifts to utilize the bonus exclusion is financial planning to leave an appropriate cushion for the client's lifestyle needs. An important part of any planning is to give clients assurance that sufficient assets will be available for their lifestyle needs for life.

(2) **Spousal Lifetime Access Trust (SLAT).** One alternative may be for one spouse to make a gift to a trust for descendants, but of which the other spouse is a discretionary beneficiary. If the proverbial "rainy day" hits, distributions could be made to the spouse-beneficiary. The planner must be very sensitive to matrimonial law issues (the SLAT transaction can result in a very substantial wealth shift between the spouses.) Also, the transfer must be made entirely from one spouse's property to the trust of which the other spouse is a discretionary beneficiary. In light of the Republican sweep in the 2025 elections, there may be much less focus on creating SLATs in 2025 than previously anticipated.

(3) **Other Issues.** Other transfer planning issues and planning alternatives include:

- Transfers other than SLATs with continued possible indirect access;
- Non-reciprocal trusts;
- Grantor trust planning, including flexibility if the grantor wants to stop having to pay income tax on trust income;

- Sales to grantor trusts;
- Making ownership transfers between spouses to facilitate later gifts;
- GST planning;
- Topping off gifts:
- Defined value clauses; and
- Adequate disclosure reporting

These issues are highlighted in Item 2 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

c. **Corporate Transparency Act.** Planning regarding Corporate Transparency Act reports were going to be a big issue during this first reporting year until FinCEN limited the reporting to non-domestic entities and provided that U.S. persons would not have to be reported as beneficial owners.. A number of court cases are questioning the constitutionality of the Corporate Transparency Act, but the ongoing status of those cases is unclear because of FinCEN's gutting of the reporting rule by dramatically narrowing its scope of application. See Item 10 below.

d. **Planning with QTIP Trusts.** Two very important cases in 2014 regarding the application of §2519 to modifications of QTIP trusts have focused attention on the difficulties of planning to minimize the eventual estate tax on assets in QTIP trusts. See Items 14 and 15 below.

e. **Decanting and Trust Modification; Governing Law Issues.** Modification of trusts by decanting, nonjudicial modification, or judicial modification transactions continues to be a growing trend to accommodate changing circumstances.

f. **Trust Structuring for Flexibility.** Structuring trusts with provisions for flexibility to accommodate changing circumstances is a continuing trend. Planning considerations include using independent trustees with wide discretion for distributions, the creative use of powers of appointment, using trust protectors with wide powers beyond just trustee removal powers, flexible decanting powers, and the ability to make adjustments for divorce protection of beneficiaries.

g. **Directed Trusts.** The use of directed trusts continues to grow in popularity. The settlor can designate certain persons (or entities) to be responsible for investment decisions (generally or for specific assets) and to make distribution decisions (generally or for certain special distributions).

h. **Resources.** For an overview of planning issues and references to resources about these issues, see Item 2 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

2. Legislative Developments

a. **FY 2025, FY 2024, and FY 2023 Greenbooks.** Tax legislative proposals from the Biden Administration in the FY 2025, 2024, and 2023 Greenbooks included detailed extensive legislative tax proposals (with broad sweeping changes for transfer taxes and grantor trusts), as summarized in Item 3.a. of LOOKING AHEAD-Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

The Trump administration budget proposals during President Trump's first term did not include detailed legislative tax proposals. Whether they will in his second term remains to be seen.

b. **Additional IRS Funding from Inflation Reduction Act.** The Inflation Reduction Act of 2022 included $79.6 billion of additional long-term IRS funding available until September 30, 2031. For a discussion of the matters for which the funds would be used, additional revenues anticipated as a result of the additional funding, and steps that have been taken to "claw back" some of the funds

targeted for enforcement, see Item 3.b of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

The continuing resolution to avert a government shutdown enacted March 15, 2025, rescinded $20.2 billion of funds that had been allocated for enforcement. In total, $41.8 billion of the $45.6 billion in IRS enforcement funds under the Inflation Reduction Act have been clawed back. *See* Cady Stanton, *Senate Passes Stopgap Stripping $20B From IRS, Avoiding Shutdown*, TAX NOTES TODAY FEDERAL (Mar.17, 2025).

The additional funding included $45.64 billion for enforcement. The anticipated revenue increases from the additional enforcement funds have been estimated anywhere from 2.5-to-1 to as much as 12-to-1 (the higher figure applies to audits of high-income taxpayers). The Congressional Budget Office Economic Outlook Report in January 2025 estimated that the $20 billion of rescinded funds for enforcement "would reduce individual and corporate income tax receipts over the 2025-2034 period by $66 billion—resulting in a net increase in the projected cumulative deficit of $46 billion." Congressional Budget Office, THE BUDGET AND ECONOMIC OUTLOOK: 2025 TO 2035, at 14 (January 2025).

Despite the cost effectiveness of IRS enforcement outlays, the additional IRS funding (especially funding allocated to enforcement) has been very controversial, in particular with House Republicans. Democrats view it differently as summarized by Sen. Ron Wyden (Senate Finance Committee ranking member): "Nothing unites Republicans like helping the ultra-wealthy get away with breaking the law and cheating on their taxes." Stanton, *Wyden Slams House Republicans' Proposed Tax Policy Menu*, 186 TAX NOTES FEDERAL 774 (Jan. 27, 2025). Republicans have decried the legislation as a reckless threat to the economy. Senator Rick Scott (R-FL) summarized the Republican view when the IRA was passed in 2022: "Joe Biden's federal government is coming after every penny you have with more audits," Alexander Rifaat, *Biden, Democrats Relish Passage of Reconciliation Bill*, 2022 TAX NOTES TODAY FEDERAL 152-3 (Aug. 9, 2022) (Sen. Scott stated the funding would allow the IRS to hire 87,000 new agents).

About $20.2 billion of the additional funds for enforcement were deferred in the 2024 omnibus spending bill. A continuing resolution enacted on December 21, 2024, to extend government funding at 2024 fiscal levels until March 14, 2025, did not release the $20.2 billion clawback of enforcement funds, which means those funds remain frozen until a full-year appropriation agreement can be reached. *See* Cady Stanton & Benjamin Valdez, *$20B in IRS Enforcement Funds Set to Remain Frozen into March*, 185 TAX NOTES FEDERAL 2443 (Dec. 23, 2024). A request from the Trump administration sent to congressional spending panels regarding FY 2025 full-year continuing resolution assumptions called for repeating that $20.2 billion reduction in IRS funding. *See* Chris Cioffi, *White House Pushes $20 Billion IRS Enforcement Funding Clawback*, BLOOMBERG DAILY TAX REPORT (Feb. 28, 2025). (As discussed above, the $20.2 billion reduction was made permanent in the continuing resolution enacted March 15, 2025.)

The IRS has taken steps to utilize the additional funding for enforcement that it has been able to access and has added to its headcount for enforcement (including adding estate and gift tax examining officers). All the additional headcount may not be retained if the additional enforcement funding is rescinded. *See* Benjamin Valdez, *Election Results Cast Doubt on Fate of IRS Funding, Direct File*, 185 TAX NOTES FEDERAL 1266 (Nov. 11, 2024).

There are some reports that the Trump administration is aiming to cut up to **half** of the IRS's roughly 100,000 workforce. *See* Erin Stowey, *Trump Aims to Cut IRS Workforce in Half by End of Year*, BLOOMBERG DAILY TAX REPORT (Mar. 4, 2025).

c. **Tax Legislative Impacts of Republican Sweep in 2024 Elections; What Will Happen to the Estate and Gift Tax Basic Exclusion Amount?** The Republican sweep of the Presidency and majorities in the Senate and House in the 2024 elections (the "Republican trifecta") will lead to major anticipated legislative changes.

(1) **Extremely Brief Overview of Tax Proposals.** The Republicans' primary tax focus will be to make permanent the individual and business income tax cuts and the transfer tax cuts in the 2017 Tax Act sometimes referred to as the Tax Cuts and Jobs Act (TCJA). Most of those provisions for individuals would otherwise sunset on January 1, 2026. (As discussed below, however, most likely these cuts could only be extended for 10 years, or even less, because of the legislative "reconciliation" process.)

The Trump administration has not identified its position on transfer taxes other than extending the 2017 TCJA cuts (i.e., keeping the exclusion amount at $10 million, indexed for inflation).

The Trump administration has also suggested additional cuts at various times, including: (1) cutting the corporate income tax rate from 21% to 15% (perhaps only for companies having their activities in the United States); (2) expanding the SALT deduction; (3) providing income exclusions for tips for certain industries (but tipped income would still be subject to payroll taxes), overtime pay (which could cost $750 billion over 10 years), and Social Security payments; (4) creating new tax cuts for made-in-America products; (5) "tax incentives" for shipbuilding; and (6) making interest payments on car loans for American-made vehicles tax deductible. The administration has proposed increasing revenues by adding additional tariffs (which may be in executive orders rather than in a reconciliation act), ending the carried interest break used by private equity fund managers, and ending tax breaks for sports team owners. *See* Gardner et al, *Trump Will Seek to End Carried Interest, Expand SALT in Tax Bill*, BLOOMBERG DAILY TAX REPORT (Feb. 6, 2025); Edmondson & Duehren, *Medicaid and More May Be Cut to Pay for Trump's Agenda*, NEW YORK TIMES, Section A at 15 (Jan. 24, 2025).

(2) **Financial Impact.** Various estimates for the financial impact of extending the expiring tax cuts from the TCJA are emerging (and more will be issued).

(a) **Full TCJA Extension.** The nonpartisan Congressional Budget Office estimated in May 2024 that a full TCJA extension would add $**4.6 trillion** to the deficit over ten years (2025-2034) ($3.973 trillion of tax and $606 billion of interest). *Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues,* Table 2, CONGRESSIONAL BUDGET OFFICE (May 2024).

More recently, the Tax Foundation increased the estimated deficit increase from $4.6 trillion to **$5.429 trillion** for a full TCJA extension for 2025-2034 ($4.719 trillion after considering economic effects). It estimates lost revenues of $4.5 trillion ($3.6 trillion for individual provisions, $240 billion for estate tax provisions, and $648 billion for business provisions), offset by $710 billion of tax revenue from economic growth (16 percent of revenue losses), plus added interest costs of $941 billion, for a combined deficit increase of $5.4 trillion ($4.6 trillion dynamically). (Observe: those numbers add to a combined deficit increase of $5.429 trillion and $4.719 trillion dynamically, rather than the "$4.6 trillion dynamically" number stated in the summary of the report.) *See* Erica York & Garrett Watson, *Making the Tax Cuts and Jobs Act Permanent: Economic, Revenue, and Distributional Effects*, TAX FOUNDATION (Feb. 26, 2025).

(b) **Extension of Individual Provisions.** Extending the expiring *individual* provisions for 2025-2034 would add $3.256 trillion of deficits from reduced tax revenue and additional interest outlay of $467 billion, for a total of $3.723 trillion. *Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues,* Table 2, CONGRESSIONAL BUDGET OFFICE (May 2024). A more recent report from the Treasury Office of Tax Analysis estimates that revenue estimates for extending the individual and estate provisions of the TCJA for 2026-2035 is $4.154 trillion (an estimate of additional interest outlay is not included). *The Cost and Distribution of Extending Expiring Provisions of the Tax Cuts and Jobs Act of 2017*, U.S. DEPARTMENT OF THE TREASURY OFFICE OF TAX ANALYSIS, at 4, Table 1 (Jan. 10, 2025). Observe that the more recent estimate is for 2026-2035 rather than 2025-2034, but the more recent report prompted one commentator to conclude that estimates of extending all the TCJA will be revised "significantly higher than the $4.6 trillion previously estimated once there is a new

budget baseline." Alexander Rifaat, *Treasury: Republican TCJA Extension Plans Will Cost $5.5 Trillion*, 186 TAX NOTES FEDERAL 591 (Jan. 20, 2025).

The Joint Committee on Taxation's recent unofficial estimate is that extension of the expiring *individual* provisions of the TCJA for 2025-2034 would reduce revenues by $3.37 trillion, and $372 billion of offsetting revenue from extra economic growth would reduce the net revenue effect to about $3 trillion. (Those numbers do not include additional interest outlays.) Staff of the Joint Committee on Taxation, *Overview of JCT Methodology for Analyzing the Macroeconomic Effects of Proposed Changes in Tax Law* (Dec. 2024).

A Treasury Department report estimated in January 2025 that extending the expiring TCJA individual cuts only for individuals with incomes below $400,000 and allowing the business and estate tax cuts to expire would reduce the cost to $1.8 trillion ("less than half the cost of extending all the individual and estate tax cuts and about a third the total cost including business provisions"). *The Cost and Distribution of Extending Expiring Provisions of the Tax Cuts and Jobs Act of 2017*, U.S. DEPARTMENT OF THE TREASURY OFFICE OF TAX ANALYSIS, at 2 (January 10, 2025).

(c) **Extension of Provisions Other Than Individual Rate Brackets.** The Urban Brookings Tax Policy Center has estimated the revenue impact of extending the TCJA provisions other than the income tax rate brackets. If the rate brackets return to their pre-TCJA levels of 10, 15, 25, 28, 33, 35, and 39.6 percent, the revenue cost would be reduced from $4.0 trillion to $750 billion (an 80 percent reduction). If only the top individual bracket were increased from 37 to 39.6 percent, the cost of the TCJA extension would fall by about 10 percent or $360 billion (2025-2034). *Options to Extend the 2017 Tax Act (TCJA) and Modify Individual Income Tax Rates*, URBAN BROOKINGS TAX POLICY CENTER (Feb. 2025).

(d) **Extending Estate Tax Provisions.** The Congressional Budget Office estimated that extending the $10 million (indexed) estate and gift tax exclusion amount for ten years would add $167 billion to the deficit and would increase net interest outlays by another $22 billion (total cost of $189 billion). *Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues*, CONGRESSIONAL BUDGET OFFICE (May 2024). More recently, a January 2025 report from the Department of Treasury estimates that allowing the estate tax cuts to expire would result in a reduction of **$223 billion** of revenues over a ten-year period from 2026-2035 (it did not include an increased net interest outlay). *The Cost and Distribution of Extending Expiring Provisions of the Tax Cuts and Jobs Act of 2017*, U.S. DEPARTMENT OF THE TREASURY OFFICE OF TAX ANALYSIS, at 4, Table 1 (Jan. 10, 2025).

(e) **Extending TCJA and Including Other Trump Administration Changes.** Adding in other possible changes suggested by the Trump administration, including exempting overtime pay from taxation and repealing the state and local tax deduction limitation (which reduces revenues over ten years by $1.2 trillion, as discussed below), offset somewhat by additional broad tariffs, would add **$7.75 trillion** over ten years to the deficit according to the Committee for a Responsible Federal Budget. *The Fiscal Impact of the Harris and Trump Campaign Plans, US Budget Watch 2024*, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Oct. 28, 2024). House Ways and Means Committee Chair Jason Smith (R-MO) says that $5.5 trillion would be the cost to pay for extension of the 2017 TCJA and "Trump's campaign promises" of not taxing tips, overtime or Social Security payments to seniors. *See* Doug Sword, *House Republicans at Odds as Markup of Giant Tax Bill Scheduled*, 186 TAX NOTES FEDERAL 1329 (Feb. 17, 2025). (This is contrasted with the $7.75 trillion and $6.5 trillion estimated by the Committee for a Responsible Federal Budget (see immediately above) and the Tax Foundation (see below).)

The Committee for a Responsible Federal Budget has provided a range of revenue estimates of the various other Trump administration proposals, with the range depending on how broadly the cuts are applied:

- Cutting taxes on tips: $100 billion to $550 billion

- Cutting taxes on overtime: $150 billion to $3 trillion
- Cutting taxes on Social Security: $550 billion to $1.5 trillion
- Cutting corporate tax rate to 15% for domestic manufacturing: $100 billion to $200 billion
- Closing carried interest loophole: Additional revenue of $20 billion to $100 billion

Trump Tax Priorities Total $5 to $11 Trillion, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Feb. 6, 2025), available at **https://www.crfb.org/blogs/trump-tax-priorities-total-5-11-trillion**.

The Tax Foundation has estimated the 10-year revenue loss from extending specific portions of the TCJA as well as tax cuts proposed by the Trump administration.

Tax Cut	**10-Year Revenue Loss (Before Economic Impact), Billions**
TCJA Individual	$3,392.1
TCJA Estate Tax	$ 205.6
TCJA Business	$ 643
SALT Full Deduction	$1,040.5
Lower Corporate Rate to 15% for Domestic Production Activities	$ 361.4
Exempt Social Security Benefits from Income Tax (Not permitted in reconciliation)	$1,189.1
Exempt Overtime Pay from Income Tax	$ 747.6
Exempt Tips from Income Tax	$ 118
Deduction for auto loan interest	$ 61
Total (other than Social Security)	$6,569.2

William McBride, Erica York, & Garrett Watson, *Questions About Tax Cuts, Tariffs, and Reconciliation After the Election*, TAX FOUNDATION (Nov. 13, 2024), available at **https://taxfoundation.org/blog/trump-tax-cuts-tariffs-reconciliation/**.

The Urban Brookings Tax Policy Center estimates that excluding Social Security benefits from gross income for 2025-2034 fiscal years would decrease revenues by $1.4705 trillion. *Taxation of Social Security Benefits* (August 2024), URBAN BROOKINGS TAX POLICY CENTER (Feb. 27, 2025).

(3) **Do Tax Cuts Pay for Themselves?** The Committee for a Responsible Federal Government has recently summarized the conclusions of various studies about the effects of revenues from future economic growth resulting from extending various provisions of the TCJA. *Putting Numbers to TCJA Dynamic Feedback Estimates*, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Jan. 9, 2025). The following is a table from that report.

Dynamic Feedback Estimates of TCJA Extension (ten years, billions)

	Conventional Estimate	Dynamic Estimate	Total Dynamic Feedback	% Dynamic Feedback
Congressional Budget Office*'	$3,700	~$3,760	-$60	-2%
Joint Committee on Taxation'	$3,368	$2,996	$372	11%
The Budget Lab at Yale'	$2,816	$2,801	$15	1%
Tax Foundation+	$4,047	$3,466	$581	14%
Penn Wharton Budget Model+	$4,011	$3,834	$177	4%
Pomerleau-Schneider+	$3,817	$3,635	$182	5%

* The Congressional Budget Office's latest figures do not include an explicit estimate of the dynamic effect of TCJA extension, but their economic estimates imply a possible slightly negative effect that we've estimated here. CBO's estimates incorporate interest rate effects.
' These estimates do not include extension of expiring or expired business provisions.
\+ These estimates do include extension of expiring or expired business provisions.

This chart is found at **https://www.crfb.org/blogs/putting-numbers-tcja-dynamic-feedback-estimates.**

The Joint Committee on Taxation's unofficial conventional revenue estimate for extension of just the individual expiring provisions of the TCJA is a loss of $3.37 trillion, and **$372 billion** offsetting revenue from extra economic growth would reduce the loss to about $3 trillion. Staff of Joint Committee on Taxation, *JCT Methodology for Analyzing Macroeconomic Effects 2024* (Dec. 2024), available at **https://www.jct.gov/publications/2024/jct-methodology-for-analyzing-macroeconomic-effects-2024/**, Accordingly, the beneficial effects of tax cuts on the economy are an **11%** reduction of the revenue cost, far short of the 100% needed to claim that tax cuts pay for themselves. In 2017, the Joint Committee on Taxation had estimated a 26% dynamic revenue effect; a main reason for the difference is "the widely accepted economic fact that individual tax cuts (like those in the upcoming 2025 legislation) stimulate less economic growth than legislation with both business and individual tax cuts (like we had in 2017)." Sullivan, *JCT Estimates Small Dynamic Effect from TCJA Extension*, 186 TAX NOTES FEDERAL 413 (Jan. 20, 2025).

Republican leaders have stated that the Congressional Budget Office underestimated by $1.5 trillion in 2017 how much revenues would grow under the 2017 TCJA. *See* Doug Sword, *House Leans Toward Two Bills With Tax Second, Budget Chair Says*, 185 TAX NOTES FEDERAL 2445 (Dec. 23, 2024) (statement by House Budget Committee Chair Jodey Arrington (R-TX)). The CBO acknowledged the underestimation but blames $900 billion of the underestimate on higher than expected inflation and much of the rest on unexpectedly high tariff revenues not included in the original projection. *See* Doug Sword, *Top House Taxwriter Calls Current-Policy Approach 'a Fraud,'* 186 TAX NOTES FEDERAL 1129 (Feb. 10, 2025).

A recent report from the Committee for a Responsible Budget, a nonpartisan fiscal watchdog group, concludes that an extension of the TCJA tax cuts would do little to grow the economy.

> New data from the Congressional Budget Office (CBO) finds that economic feedback may not cover *any* of the revenue loss and that TCJA extension might even add ***more to the debt on a dynamic basis, particularly over the long run,*** than under conventional scoring.
>
> … CBO finds that "the dynamic budgetary effects of [TCJA] expiration … would be very similar to the conventional estimate," as ***the positive effects of lower taxes would be counteracted by the negative effects of higher debt.***

TCJA Extension Might Not Pay for Any of Itself, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Dec. 10, 2024) (emphasis in original), available at **https://www.crfb.org/blogs/tcja-extension-might-not-pay-any-itself**.

A study by economists at Harvard, Princeton, and the University of Chicago concluded that the TCJA's lower corporate tax cuts did stimulate more corporate investment, but they estimated that the law would cause the economy to grow 1% larger over 10 years, generating roughly $750 more in wages for each American worker, less than the $4,000 per employee that had been predicted by the Trump administration. The study concluded that this largest corporate tax cut in U.S. history would result in a long-run increase of domestic corporate capital but would produce small dynamic revenue effects; it would increase corporate income and labor payments, but the extra tax revenue from that activity would be offset by the higher cost of depreciation deductions, which would be immediately expensed. Gabriel Chodorow-Reich, Owen Zidar, and Eric Zwick. 2024. *Lessons from the Biggest Business Tax Cut in US History*, 38 JOURNAL OF ECONOMIC PERSPECTIVES No. 3 (Summer 2024).

The Congressional Budget Office predicts that extension of the individual income tax provisions of the TCJA would have **little budgetary impact** from increased revenues from economic growth and higher interest rates. *How the Expiring Individual Income Tax Provisions in the 2017 Tax Act Affect the CBO's Economic Forecast*, CONGRESSIONAL BUDGET OFFICE (Dec. 2024) ("Because the expiration of the provisions does not significantly change CBO's economic projections, the dynamic budgetary effects of that expiration (that is, the budgetary effects after accounting for changes in the size of the economy stemming from expiration) would be very similar to the conventional estimate -- a $3.7 trillion reduction in the cumulative deficit over the 2025–2034 period.")

The Tax Foundation estimates that an extension of the TCJA, plus reinstatement of 100 percent research and development expensing and bonus depreciation would generate $660 billion in added federal revenues over 10 years (meaning that economic gains offset 16 percent of the lost tax collections). The Tax Foundation report also estimates that all Trump's tax cut proposals would cause tax losses of about $6.7 trillion from 2025 to 2034, and the dynamic score (including increased tax collections from economic gains) would be about $500 billion lower (or about **7.5%**). William McBride, Erica York, & Garrett Watson, *Questions About Tax Cuts, Tariffs, and Reconciliation After the Election*, Tax Foundation (Nov. 13, 2024), available at **https://taxfoundation.org/blog/trump-tax-cuts-tariffs-reconciliation/**.

The Urban-Brookings Tax Policy Center estimates that an extension of the TCJA would cost about $4 trillion (not including over $600 billion additional interest costs), and that tax collections from economic growth would be about **$222 billion** (**about 6%**). It attributes the modest tax collections from economic benefits that arise from the TCJA individual tax cuts to several factors: (1) the tax cuts disproportionately benefit high-income households, who tend to save rather than spend the extra income, (2) the Federal Reserve would likely maintain higher interest rates to prevent the economy from overheating after this infusion of cash, and (3) the reduced tax revenue would cause larger deficits and increased federal borrowing, pushing up interest rates and crowding out private investment and slowing economic growth over time. *See* Benjamin Page, *Extending TCJA Provisions Would Modestly Boost the Economy, But Not Enough to Offset The Cost*, URBAN INSTITUTE & BROOKING INSTITUTION TAX POLICY CENTER (Feb. 6, 2025).

A Penn Wharton University of Pennsylvania Budget Model estimates economic effects of the House budget resolution and the Trump administration tax proposals and concludes that economic effects would be **low**. It concludes that "incorporating the Trump administration's major tax proposals into the FY2025 House budget reconciliation would require that the provisions mostly sunset by December 31, 2033. Even so, primary deficits would increase by $5.1 trillion before economic effects and by $4.9 trillion after modest, positive economic effects." *The FY2025 House Budget reconciliation and Trump Administration Tax Proposals: Budgetary, Economic, and Distributional Effects*, PENN WHARTON BUDGET MODEL (Feb. 27, 2025), available at

https://budgetmodel.wharton.upenn.edu/issues/2025/2/27/fy2025-house-budget-reconciliation-and-trump-tax-proposals-effects.

A report from the Congressional Research Service dated Feb. 27, 2025, summarized issues regarding dynamic scoring of tax reform proposals, and concluded that studies from the Joint Committee on Taxation, Congressional Budget Office, Budget Lab at Yale, and Tax Policy Center "all imply that an extension [of the TCJA] would likely offer a lower [dynamic scoring] effect than the original TCJA." *See CRS Reviews Dynamic Scoring Models for Tax Bills*, TAX NOTES TODAY FEDERAL (Feb. 27, 2025).

The House Budget resolution assumes $2.6 trillion in revenue from macro-economic effects of the TCJA extension. See Item 2.c(13) below.

(4) **Deficit and National Debt Concerns Are Growing.** "In 2001, the U.S. federal government ran a $128 billion budget surplus and was on course to pay off the national debt by 2009." *From Riches to Rags: Causes of Fiscal Deterioration Since 2001*, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Jan. 10, 2024). The nation's debt has risen from $4.6 trillion in 2005, to $13.1 trillion in 2015 (in large part, resulting from the financial crisis of 2007-2009), to $36 trillion today (counting debt held by the public and intragovernmental holdings). Even without any extension of the tax cuts, the federal annual deficit will grow to $2.7 trillion by 2034, the federal debt will rise from 100% of GDP in fiscal 2025 to **118%** in fiscal 2035, surpassing its previous high of 106% of GDP set in 1946; "the deficit for the 2025-2034 period is projected to total $22.1 trillion, $2.1 trillion more than the CBO projected in February." *An Update to the Budget and Economic Outlook*: 2024 to 2034, CONGRESSIONAL BUDGET OFFICE (June 2024); *see* Andrew Duehren, *Trump's Agenda-Three Paths for Taxes*, NEW YORK TIMES THE MORNING (Nov. 15, 2024). That would result in a **$58 trillion national debt** by 2036 (not including debt that would be added from extending the 2017 tax cuts).

The budget deficit for the current fiscal year, through February 2025, is $1.15 trillion, 17% larger than the prior year after adjusting for differences in the calendar. Revenue is up an adjusted 2%, but outlays were up 7% for the fiscal year through February 2025, adjusting for calendar differences. The biggest increases in spending, compared to the prior fiscal year through February, came from the Medicare program ($124 billion more), interest on public debt ($45 billion), and Social Security ($49 billion more). (These outlays largely reflect the anticipated ever-increasing costs due to the aging U.S. society.) These significant deficit increases in the current fiscal year suggest that "[f]iscal hawks among congressional Republicans may press for further offsetting steps to ensure the fiscal trajectory doesn't worsen further. Christopher Anstey & Daniel Flatley, *U.S. Budget Gap Hits Record $1.1 Trillion for Fiscal Year So Far*, BLOOMBERG DAILY TAX REPORT (Mar. 12, 2025); *see* U.S. Department of the Treasury, *Monthly Treasury Statement, Receipts and Outlays of the United States Government For Fiscal Year 2025 Through February 28, 2025, and Other Periods* (released Mar. 12, 2025).

The Congressional Budget Office (CBO) estimated in March 2025 that the debt will grow from 100% of GDP in 2025, to 107% in 2029 (exceeding the historical peak of 106% of GDP it reached in 1946 immediately after World War II), to 118% of GDP in 2035, and to 156% of GDP in 2055. The CBO's prediction is that GDP would grow at an average rate of 1.8%, down from a predicted rate of 2% a year ago, because of projections of lower growth in private investment and consumer spending. Congressional Budget Office, THE LONG-TERM BUDGET OUTLOOK: 2025 TO 2055 (Mar. 2025) ("Mounting debt would slow economic growth, push up interest payments to foreign holders of U.S. debt, and pose significant risks to the fiscal and economic outlook; it could also cause lawmakers to feel constrained in their policy choices.").

The CBO economic outlook dated January 17, 2025, stated that the debt held by the public was $28.2 trillion in 2024 and would increase by $23.0 trillion to $52.1 trillion in 2035. Its conclusion was that "[f]ederal debt held by the public rises from 100 percent of GDP this year to 118 percent in 2035, surpassing its previous high of 106 percent of GDP in 1946." Congressional Budget Office, THE BUDGET AND ECONOMIC OUTLOOK: 2025 TO 2035, at 1 (Jan. 2025). The report estimated that the annual deficit would grow to $2.7 trillion by 2034. Its analysis assumed that

the TCJA provisions would expire as scheduled by current law. If the TCJA tax cuts were extended, the national debt would be increased commensurately unless revenue offsets were passed along with the extension of the tax cuts. *See generally* Tran, *CBO Projects Rising Debt, Deficit as GOP Considers Economic Plan*, BLOOMBERG DAILY TAX REPORT (Jan. 17, 2025).

Annual revenues as a share of gross domestic product (GDP) fell from about 19.5 percent in the years immediately preceding the Bush tax cuts to just 16.3 percent in the years immediately following. Revenues in 2025 would be $700 billion higher if they were 19.5 percent of GDP, as in the years before the Bush tax cuts. Chuck Marr & Samantha Jacoby, *House Republican Budget's $4.5 Trillion Tax Cut Doubles Down on Costly Failures of 2017 Tax Law*, CENTER ON BUDGET AND POLICY PRIORITIES (Feb. 28, 2025).

Annual deficits are at a very high percentage of GDP. In January 2025, the CBO projected the deficit would grow from $1.9 trillion in fiscal 2025 to $2.7 trillion in 2035 (under the assumption the TCJA provisions would be expiring after 2025). That adjusted deficit would equal 6.1 percent of the projected GDP in 2035, significantly more than the 3.8 percent that deficits have averaged over the past 50 years. Philip Swagel, Director of the CBO, recently stated: "This is historically unusual, that the deficit is so wide at a time when we don't have a crisis, we don't have a global war, we don't have a financial crisis, we don't have a pandemic." An economist with T. Rowe Price said: "When you look historically for the U.S., this kind of primary deficit is normal around recession periods when the unemployment rate is 8 percent, not 4 percent," *See* Katie Lobosco, *Nonpartisan Group Blasts House Tax Bill as Irresponsible*, 186 TAX NOTES FEDERAL 1916 (Mar. 10, 2025). The Tax Foundation estimates that over $2 trillion in net annual savings will be needed by 2034 to stabilize the budget deficit at 3% of GDP. See Daniel Bunn & Garrett Watson, *All About That Base(line)*, TAX FOUNDATION (Dec. 5, 2024) available at **https://taxfoundation.org/blog/extending-tax-cuts-budgetary-impact/**.

Extending the TCJA would add to these deficits. The CBO estimates (as of March 2025) that if the TCJA were extended and there were no other changes to fiscal policy, debt held by the public would reach 214% of GDP in 2054 (47 percentage points higher than if the TCJA were not extended). Letter from Phillip L. Swagel, Director of Congressional Budget Office to Rep. David Schweikert (Mar. 21, 2025). The CBO had estimated in May 2024 that extending the 2017 tax cuts would result in annual deficits exceeding $2 trillion (6.6 percent of projected GDP) starting in 2027 and rising from there. The budget deficit for FY 2024 (ending Sept. 30, 2024) was $1.8 trillion (6.4 percent of GDP). *See* Daniel Bunn & Garrett Watson, *All About That Base(line)*, TAX FOUNDATION (Dec. 5, 2024).

Treasury Secretary Scott Bessent has argued that reducing annual deficits below 3 percent of GDP should be a priority. Under a current policy baseline (with the TCJA in place), Congress would need to achieve nearly $1.5 trillion in annual deficit reduction to meet that goal. That would require serious cuts to mandatory programs like Social Security, Medicare, and Medicaid. *Id.*

(5) **Interest Payments.** Interest payments on the national debt have grown dramatically. The nation's debt service in 2020 was $345 billion annually when the pandemic relief was being negotiated. Because of the subsequent increase in the debt and the increase in interest rates (the rate on 10-year Treasury notes fell as low as 0.52% in 2020 and is 4.78% as of January 19, 2025, up from 3.96% in January, 2024), the net interest on the public debt grew to $950 billion in FY 24 (a growth of 34% from FY 23). Interest on the public debt is now the second largest federal expenditure after Social Security (which costs $1.5 trillion), surpassing defense spending of $826 billion and Medicare spending of $869 billion. William McBride, *Another Huge Federal Deficit in Fiscal Year 2024 Despite Surging Corporate and Other Tax Collections*, TAX FOUNDATION (Oct. 10, 2024), available at **https://taxfoundation.org/blog/federal-budget-deficit-tcja-revenue-spending/**.

(6) **Inflation.** Inflation was a major issue in the 2024 elections. Tax cuts can be inflationary by increasing demand in an already tight economy, though their actual impact on inflation can vary based on how they are implemented and the prevailing economic conditions. *See generally* Cloyne, Martinez, Mumtaz & Surico *Do Tax Increases Tame Inflation?*, 113 AMERICAN ECONOMIC

ASSOCIATION PROCEEDINGS 377 (May 2023). "Tariffs, [cutbacks on] immigration, and the huge fiscal impulse they're going to create by borrowing more – all of those are inflationary." Statement by Maya MacGuineas of the Committee for a Responsible Federal Budget on Nov. 11, 2024, at an AICPA event.

Even with the Republican trifecta, many members of Congress may be concerned about the deficit impact of extending all the TCJA tax cuts for another ten years (and possibly adding other tax cuts as well).

Thin Political Margins. There are razor-thin margins in the House and Senate. In the House, the Republicans hold a 218-213 majority. The margin was 218-215 prior to the deaths of two Democratic Representatives, who will be replaced in special elections. Elections in April 2025 will fill two Republican seats. After the elections to replace the two Republican seats and one Democratic seat, the margin will be 220-214, if elected replacements are from the same party. If Democrats should win all three seats, the margin would be 218-216.

(The Texas governor has delayed calling a special election to replace another deceased Democratic Representative from Texas, and the time has likely passed to be able to use the next scheduled election on May 3; it is a solidly Democratic district and a Democratic successor is likely. Rep. Elise Stefanik (R-NY) will remain in the House rather than being appointed as ambassador to the United Nations to assure that her seat remains Republican.) If the margin is 220-214 or 220-215, any three Republican Representatives could prevent a bill from passing because there is no method for breaking a tie vote in the House.

Republicans hold a 53-47 edge in the Senate.

Exacerbating the thin margin in the House is that some members of Congress are deficit hawks who campaigned primarily on reducing the federal deficit. One of those budget hawks, Rep. David Schweikert (R-AZ) who chairs the House Ways and Means subcommittee on oversight, has said he would oppose his party's signature tax bill this year if it is "debt-financed." He warns against addressing expiring TCJA provisions without addressing the bill's impact on increasing debt and deficits. *See* Cohen & Cioffi, *Key House Tax Writer Urges Against Using Debt to Finance Big Cuts*, BLOOMBERG DAILY TAX REPORT (Feb. 7, 2025). Rep. Chip Roy (R-TX) is one of the leaders of the House budget hawks "who are insisting that a reconciliation bill be largely paid for by spending cuts." Doug Sword, *Graham Releases Senate Budget Resolution; House Movement Awaited*, 2025 TAX NOTES TODAY FEDERAL 27-3 (Feb. 10, 2025).

Another contingent that could pose hurdles in negotiations is a group of Republicans in high-tax states who have demanded an expansion of SALT deductions.

President Trump can be expected to exert significant pressure on Republicans to stay unified in their voting. House Majority Leader Steve Scalise (R-LA summarizes it this way: "Donald Trump is the whip now. You don't have to worry about me; I'm actually a nice guy. The guy at 1600 Pennsylvania is going to send out a tweet, a truth, or whatever, and it's not going to be as nice." *See* Doug Sword, *Tax Bill Should Include Tips; SALT Solution Unclear, Scalise Says*, 185 TAX NOTES FEDERAL 2256 (Dec. 16, 2024). Even so, "[t]he paper-thin GOP majority will introduce complications not seen in 2017, leaving little room for disagreement with the ranks…. Last month's government funding debate provided an early taste of what's likely to come." Joseph Boddicker, *When Campaign Promises Meet Political Reality: This Year's Super Bowl of Tax*, 186 TAX NOTES FEDERAL 131 (Jan. 6, 2025).

One article (about whether a single reconciliation act or multiple acts will be used in 2025) refers to "the reality that the tiny House GOP majority – a fractious group of lawmakers willing to torch members of their own party during heated disputes – will have a hard time passing even one bill, let alone two." Cook, Dennis & House, *Trump Allies Fret Tax-Cut Plans at Risk with GOP Infighting*, BLOOMBERG DAILY TAX REPORT (Jan. 8, 2025).

Douglas Holtz-Eakin, former director of the Congressional Budget Office, summarizes: "Every House Republican has a veto… Peace in the Middle East will be easier." Cohen & Cioffi, *Key*

House Tax Writer Urges Against Using Debt to Finance Big Cuts, Bloomberg Daily Tax Report (Feb. 7, 2025).

Another political reality is if passage of the Act is not completed by September 2025, some members of Congress will be going into election season for the 2026 Mid-terms, and reaching compromise may be even more difficult.

A further political reality is that addressing border security and immigration issues "has vexed Congress for decades" and could "eat up a great amount of political capital and good will, potentially jeopardizing the size, scope, and ambition of a tax measure." Cook, Dennis & House, *Trump Allies Fret Tax-Cut Plans at Risk with GOP Infighting*, Bloomberg Daily Tax Report (Jan. 8, 2025).

(7) **SALT Cap Repeal.** The Trump administration has indicated that it favors repealing the $10,000 SALT cap (on the deduction for state and local taxes) at least to some degree, and some members of Congress are very focused on repealing the cap. But the SALT cap has been a potent revenue generator from the TCJA. Repealing the SALT cap entirely is estimated to reduce revenue by $1.2 trillion over ten years. *SALT Cap Expiration Could be Costly Mistake*, Committee for a Responsible Federal Budget (Aug. 28, 2024). A compromise, such as boosting the cap to $15,000 for individuals and $30,000 for joint filers, would reduce the revenue impact by $564 billion over ten years. *Policymakers Must Weigh the Revenue, Distributional, and Economic Trade-Offs of SALT Deduction Cap Design Options*, Tax Foundation (Dec. 7, 2023). Doubling the cap to $20,000 for married filers would cost $170 billion. *See* Cohen, *What is SALT, the Tax Deduction Dividing Congress? QuickTake*, Bloomberg Daily Tax Report (Feb. 11, 2025).

The SALT cap could become a hotly debated issue in the 2025 legislative negotiations. While it has a large revenue impact, the very narrowly divided Senate and House means that a few Congressmen from New York, California, and other high income tax states could threaten to buck the entire reconciliation package without a concession on the SALT issue.

> The House's razor-thin majority, especially in the early months of Trump's presidency, means lawmakers critical of the SALT cap have more sway than when the TCJA became law.
>
> House Ways and Means Committee member Brian K. Fitzpatrick, R-Pa., pointed to the much wider majority Republicans had in 2017, when 12 GOP House members from high-tax states voted against the legislation — with some citing the SALT cap as the motivation — and it still passed the chamber.

Stanton, *Cost of SALT Changes Creates Headaches Under GOP's Slim Majority*, 186 Tax Notes Federal 373 (Jan. 13, 2025). Furthermore, "any SALT cap rollback has been invariably scored by government and private analysts as favoring high-income taxpayers." *Id.*

House Majority Leader Steve Scalise (R-LA) points out that in 2017 Republicans had a large majority and could afford 25 defections and still advance a reconciliation bill; in 2025, the Republicans will hold a very slim majority in the House and 24 of the Republican members of the House are from the five states (California, New York, New Jersey, Illinois, and Minnesota) most affected by the $10,000 SALT deduction limitation. *See* Doug Sword, *Tax Bill Should Include Tips; SALT Solution Unclear, Scalise Says*, 185 Tax Notes Federal 2256 (Dec. 16, 2024).

Four House Republicans who had been strong advocates of increasing or eliminating the SALT threshold were defeated in the November 2024 elections. Six House Republicans appear to remain who are strong advocates of the SALT deduction (Reps. Kevin Kiley and Young Kim of California, Tom Kean of New Jersey, and Andrew R. Garbarino, Nick LaLota and Michael Lawler of New York), although at this point none have threatened to withhold their vote on a final tax bill over the issue. *See* Sword, *House Republican SALT Split Is on Full Display at Member Day*, 186 Tax Notes Federal 776 (Jan. 27, 2025); Cohen, *What is SALT, the Tax Deduction Dividing Congress? QuickTake*, Bloomberg Daily Tax Report (Feb. 11, 2025).

Another complication is that the debate may include consideration of various ways to limit the effectiveness of "state work-arounds" that effectively permit paying state and local taxes by entities to reduce the flow-through income to owners for federal income tax purposes by a

commensurate amount. *See* Watson, *Policymakers Must Weigh the Revenue, Distributional, and Economic Trade-Offs of SALT Deduction Cap Design Options*, TAX FOUNDATION (Dec. 7, 2023), available at **https://taxfoundation.org/blog/salt-deduction-cap-design-options/**.

(8) **Pay-Fors.** In some years, Congress has adopted a "pay-for" approach, requiring that tax cuts or spending increases must be offset with other tax increases or spending cuts. Senate Finance Committee Chair Mike Crapo (R-ID) takes the position that extending current tax policy does not require an offset. Furthermore, he has stated that cutting the corporate income tax rate to 15% is an economy-growing policy that does not have to be paid for (but he stated that he does not know if the proposed income exclusion for overtime pay, tips and Social Security count as economy growing). *See* Doug Sword & Cady Stanton, *Cutting Taxes is Easy: Paying for It Is Not*, 185 TAX NOTES FEDERAL 329 (Oct. 14, 2024).

Deficit hawks in the House will likely push for more deficit-conscious legislation; they will want deep spending cuts to avoid deficit spending from the reconciliation act. Offsetting $4.6 trillion of revenue losses, however, will be difficult; instituting structural reform of entitlements would be a heavy political lift. President Trump campaigned to some degree on not touching Medicare or Social Security. *See* Cohen & Cioffi, *Key House Tax Writer Urges Against Using Debt to Finance Big Cuts*, BLOOMBERG DAILY TAX REPORT (Feb. 7, 2025).

Offsets are touchy prior to elections. "No one leads with their offsets. Offsets are released later because they are just not attractive." Statement by Joshua Ordintz, former counsel at the Department of Treasury and the Senate Finance Committee. Doug Sword & Cady Stanton, *Cutting Taxes is Easy: Paying for It Is Not*, 185 TAX NOTES FEDERAL 329 (Oct. 14, 2024).

Pay-fors will likely play a big role at crunch time. Ultimately, cost estimates and analyses from the Joint Committee on Taxation will be critical in determining what provisions will be included or excluded from the legislation.

The House Ways and Means Committee has circulated a 50-page document listing a wide variety of possible spending cuts. Examples of possibilities included in the report are a wide variety of Medicare and Medicaid cuts (including reducing federal Medicaid payment rates), undercutting the Affordable Care Act's Medicaid expansion by reducing the share of Medicaid costs the federal government pays, rollback of clean energy efforts created in the Inflation Reduction Act (although congressmen with projects in their districts will want some of the programs to remain), eliminating the home mortgage interest deduction (which would save $1 trillion over 10 years but would be very unpopular), denying corporations the ability to deduct state and local taxes, and taxing all scholarships and fellowship income. *See* Edmondson & Duehren, *Medicaid and More May Be Cut to Pay for Trump's Agenda,* NEW YORK TIMES, Section A at 15 (Jan. 24, 2025). A political challenge is that "[m]any of the cuts Republicans are contemplating target programs aimed at helping low-income Americans, all in the service of paying for the extension of tax cuts that disproportionately benefit the wealthy." *Id*.

The Republican Study Committee, a conservative GOP House caucus, has presented a plan for massive spending cuts that would cut $14 trillion in spending over 10 years.

Cutting the federal workforce other than the Departments of Defense, Veteran Affairs, and Homeland Security by 10% will save about $11 billion annually. *See* Kamarck, *Trump's Dramatic Plan to Cut the Federal Workforce*, BROOKINGS INSTITUTION (Jan. 30, 2025), available at **https://www.brookings.edu/articles/trumps-dramatic-plan-to-cut-the-federal-workforce/**.

Cutting the *entire* federal workforce by 10% could save $559 to $608 billion over 10 years (including both salaries and health benefits). Note that employees in the Departments of Defense, Veteran Affairs, Homeland Security, and Justice make up approximately 68% of federal workers. *See* Dickerson, *Fiscal Effects of Reducing the Federal Workforce*, ECONOMIC POLICY INNOVATION CENTER (Jan. 28, 2025), available at **https://epicforamerica.org/education-workforce-retirement/fiscal-effects-of-reducing-the-federal-workforce/**

Tariffs may add additional revenue, but tariffs added by executive orders would not be in the reconciliation act and could not be recognized as pay-fors to offset the tax losses from extending tax cuts. Suggested 25% tariffs for Mexico and Canada (except for some Canadian energy and resource imports that will be tariffed at 10%) would raise $1.3 trillion over 10 years and additional 10% tariffs for China would raise $200 billion over 10 years (if they are kept in place for the full 10 years). Accounting for economic effects, the combined tariffs for China, Mexico, and Canada (both enacted and delayed) would raise $1.3 trillion over 10 years. *See How Much Revenue Will Trump's Tariffs Raise?*, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Feb. 4, 2025), available at **https://www.crfb.org/blogs/how-much-revenue-will-trumps-tariffs-raise**.

Other tax increases mentioned by the Trump administration that would act as pay-fors are ending the carried interest break used by private equity fund managers and ending tax breaks for sports team owners. *See* Doug Sword, *Trump Has Pay-Fors Too: Carried Interest, Sports Teams*, 186 TAX NOTES FEDERAL 2092 (Mar. 17, 2025).

(9) **Reconciliation Legislative Process.** The Senate can pass tax legislation with a mere majority (as opposed to 60 votes required for most legislation to overcome the filibuster) under the reconciliation legislative process enacted in the Congressional Budget Act of 1974. That Act was used for the first half of its existence to *reduce* deficits; starting in 2021, it has been used to grow deficits more than half the times it has been used. *See Budget Reconciliation Should Be Used to Reduce the Debt, Not Add to It*, 2024 TAX NOTES TODAY FEDERAL 223-17 (Nov. 19, 2024) (statement from Maya MacGuineas, president of the Committee for a Responsible Federal Budget).

(a) **Budget Resolution; Budget Impact Number; Senate "Vote-a Rama".** The process begins in the House with the passage of a budget resolution that specifies a budget window (at least five, but typically ten years), the maximum amount the bill could add to deficits, and general budget instructions for each committee. The budget resolution must then be passed by the Senate.

Negotiations over the deficit amount can be difficult. The $4.6 trillion deficit estimate for a 10-year extension of the TCJA may be too large for some members of Congress to stomach. The budget resolution for the 2017 TCJA stalled in the Senate for an extended time while negotiating over the deficit number. Congressional leadership had hoped to introduce a budget resolution in May or June 2017, but the House did not pass its budget resolution until October 5, 2017. A bill was introduced on November 2, 2017, and the TCJA was enacted on December 22, 2017. (The three-seat Republican majority in the Senate in 2025 is even less than the four-seat majority the Republicans held in the Senate in 2017 when negotiations were delayed for months over the deficit number.)

Thus, one of the most difficult decisions must be made at the outset of the process in adopting a budget resolution. "This brings about an arguably backward process. The first thing House and Senate Republicans must agree on is how much their bill can add to deficits over 10 years. Then they spend that number. 'It's driven by your decision up front about what your budget number is.… You figure out what number you can live with, then you write policy that fits that number — not the other way around.'" Doug Sword, *TCJA's Extension Might Be a Short One*, 185 TAX NOTES FEDERAL 1471 (Nov. 18, 2024) (quoting Jonathan Traub of Deloitte Tax LLP).

The budget resolution can specify that a budget reconciliation bill will "reconcile" the work by various committees working on budget issues and comply with budget resolution targets. Like the budget resolution, it cannot be filibustered in the Senate and only requires a majority vote. The reconciliation directive directs committees to produce legislation by a certain date that meets specified spending or tax targets. The various bills are packaged into a single bill (only one reconciliation act is allowed in each Congressional session).

The single bill is voted on in the House and Senate. The Senate allows unlimited debate and amendments on reconciliation bills. The Senate majority members may end up having to

make embarrassing votes against amendments that on their own would be very appealing to their constituents (and which could be used against them in campaign ads in upcoming elections). Commentators have pointed to this factor as one reason that some members of Congress prefer one rather than two reconciliation bills in 2025 (see Item 2.c(11) below):

> The Senate has [the] preference [in 2025 for two reconciliation bills to address tax policy separately from other priorities including energy, immigration, and defense], even though doing two bills instead of one is against members' interests, because each reconciliation bill — including a budget resolution, followed by the bill itself — exposes Republican senators to two vote-a-ramas, [Rohit] Kumar [(with PwC)] said, referring to a series of votes on amendments that usually stretches for hours. For most bills, debate is limited, but for these two portions of the reconciliation process the price is high for the majority — debate is unlimited, and there is no limit on the number of difficult-to-vote-against amendments that the minority can force the majority to vote down.
>
> Kumar noted that Democrats had to take hard-to-defend positions in 2010, such as voting down an Affordable Care Act rider that would have prohibited qualified plans from providing an erectile dysfunction treatment to sex offenders.
>
> "Reconciliation bills in the Senate for the majority are no fun," Kumar said. "The minority comes up with its most conniving, politically sharp-edged amendment and makes the majority vote on it, and there's no way out of it."
>
> "No Senate majority is like, 'Oh, let's do this twice,'" he said.
>
> Senate Finance Committee member Bernie Sanders, I-Vt., chuckled when asked if he would have a creative vote-a-rama amendment. "You'll get it," he said, noting that he had "a little bit of time" to work on it.

Stanton & Sword, *Fast Budget Timeline Faces Reality of Small House GOP Margin*, 186 TAX NOTES FEDERAL 947 (Feb. 3, 2025).

The reconciliation bill, when ultimately approved by the House and Senate, goes to the President for approval or veto.

(b) **Byrd Rule.** While the reconciliation act is not subject to Senate filibuster, under the "Byrd rule" any single Senator can call a point of order against any provision or amendment that is "extraneous" to the reconciliation process for various prescribed reasons, including (1) provisions without fiscal impact or that are merely "incidental" to fiscal impact (the measure can only be for the purpose of implementing budget changes [spending and revenue provisions]; for example, a provision mandating an increase of the minimum wage would not be germane to fiscal matters), (2) provisions that impact Social Security, and (3) any provision that raises deficits beyond the budget window of the reconciliation bill unless other provisions in the bill fully offset these costs. *See The Budget Reconciliation Process: The Senate's "Byrd Rule,"* CONGRESSIONAL RESEARCH SERVICE (Sept. 28, 2022).

Despite the restrictions of the Byrd rule, nine Republicans on the Senate Finance Committee, led by Senators Crapo and Thune, sent a letter to President Trump on February 13, 2025, vowing they "would not support a tax package that only provides temporary relief from tax hikes." *See GOP Finance Committee Members Urge Trump to Make TCJA Permanent*, TAX NOTES TODAY FEDERAL (Feb. 13, 2025). They would use a "current policy" approach to achieve that result; under a current policy approach, a permanent extension of the TCJA would have zero revenue impact. Doug Sword & Cady Stanton, *What's in a Score? Maybe the Future of TCJA*, 186 TAX NOTES FEDERAL 1499 (Feb. 24, 2025).

(c) **Scoring Rules.** Scoring rules for determining the fiscal impact of the reconciliation act will become a central discussion point in 2025. One significant issue will be whether to use a "current law" baseline (under which tax cuts would expire) or a "current policy" baseline (the current law, assuming it is extended indefinitely).

i. **Current Law Is Typically Used.** Under the "current law" approach, the baseline assumes that revenue programs that expire within a specified time frame will operate as written. The Congressional Budget Act of 1974 directs the Congressional Budget Office (CBO) to provide Congress an annual report summarizing baseline projections of

spending, revenue, and resulting deficits (or surpluses). These estimates give Congress a policy-neutral baseline for analyzing the budgetary effects of proposed legislation. The CBO baseline is typically the starting point for the annual congressional budget resolution. The Balanced Budget and Emergency Deficit Control Act requires that a current law approach be used in developing the baseline. 2 U.S.C. 907. The Congressional Budget Act, which authorizes the reconciliation process, in §257 defines the baseline: "For any budget year, the baseline refers to a projection of current-year levels of new budget authority, outlays, revenues, and the surplus or deficit into the budget year and the outyears based on laws enacted through the applicable date."

ii. **Current Policy Approach Favored by Senate.** Senator Michael Crapo (R-ID), the Senate Finance Committee Chair, urges that the cost of tax legislation should be measured against "current policy": "If you're just extending current law, we're not raising taxes or lowering taxes, [to say] that is a $4 trillion deficit. That's ridiculous." Andrew Duehren, *Republicans Ponder: What if the Trump Tax Cuts Cost Nothing?*, NEW YORK TIMES (Nov. 25, 2024) (quoting Senator Crapo in an interview with Larry Kudlow).

   Sen. Ron Johnson (R-WI), who sits on both the Senate Budget and Senate Finance Committees, says the Senate will use a two-Act approach (addressing border security and defense in the first Act and tax issues in the second Act), and will use a current policy approach in the first Act to set precedent for the second Act. *See* Cady Stanton & Doug Sword, *Senate to Move on Budget Plan, But House Embraces the Challenge*, 186 TAX NOTES FEDERAL 1130 (Feb. 6, 2025).

   Indeed, Section 1101(2) of the Senate budget resolution lists "Federal Revenue Changes Relative to **Current Policy**." (emphasis added).

   Treasury Secretary Scott Bessent has stated that a current policy approach will be used for the reconciliation act (or acts). *Id*.

   As noted above, nine Senate Republican leaders sent a letter to President Trump on February 13, 2025, vowing they "would not support a tax package that only provides temporary relief from tax hikes." The current policy approach would produce no revenue impact even if the TCJA is extended permanently. *See* Doug Sword & Cady Stanton, *What's in a Score? Maybe the Future of TCJA*, 186 TAX NOTES FEDERAL 1499 (Feb. 24, 2025) ("Thune and Crapo have said the only path to permanency is a current-policy baseline and that the House approach won't deliver on that count."). Interestingly, Senate Finance Committee member Bill Cassidy, (R-LA) filed an amendment to the Senate's February 2025 budget resolution that would "strike references to current policy accounting, and Senator Cassidy was among five Finance Committee Republicans who did not sign the February 13, 2025 letter to the President vowing to support only a permanent extension of the TCJA. *Id.*

iii. **Current Policy Approach Prior Precedent.** The Obama administration promoted the current policy baseline rhetorically to defend extending the Bush tax cuts that were set to expire at the end of 2012, arguing that the extension should be measured against current policy, not the "current law" under which tax cuts would expire. The current policy approach in 2012 reflected that the legislation was deemed to *reduce* the deficit by $737 billion over ten years vs. the Congressional Budget Office estimate that it *increased* deficits by about $4 trillion over those ten years using a current law approach as the baseline. *See* Andrew Duehren, *Republicans Ponder: What if the Trump Tax Cuts Cost Nothing?*, NEW YORK TIMES (Nov. 25, 2024). However, the Congressional Budget Office and the Joint Committee on Taxation used the current law baseline for scoring the legislation, as required by congressional rules. The Obama administration and some lawmakers merely highlighted the current policy perspective to justify the compromise. The Obama administration did that to highlight that they were raising revenue compared to current policy by increasing income taxes on wealthy taxpayers by allowing certain tax cuts to expire.

Very significantly, the 2012 legislation was not a reconciliation act. Being able to continue indefinitely what Congress previously did temporarily (with limited budgetary impact), all with only a majority vote in the Senate using reconciliation, is a big additional precedential step. Congress has never used a current policy baseline for reconciliation.

A letter dated February 19, 2025, from five Democratic Senators to the Joint Committee on Taxation (JCT), asked if the JCT has "ever produced a score on a current policy baseline for official use on the Senate floor?" (The letter is discussed in Item 2.c(10)(c)iv below.)

iv. **Letter from Joint Committee on Taxation Addressing the Current Policy Baseline Approach for Projections.** A letter dated February 19, 2025, from five Democratic Senators to the Joint Committee on Taxation (JCT), posed various interesting questions, which Thomas A. Barthold, on behalf of the JCT, answered in a letter dated March 4, 2025. For a copy of the letter, see *GOP Approach to Scoring Tax Plans Unprecedented, Letter Says*, TAX NOTES TODAY FEDERAL (Mar. 4, 2025). Some of the answers are summarized below.

a. **JCT Uses a Current Policy Baseline.** The JCT has used a current law baseline as their default approach to scoring legislation since the 1970s. The reconciliation process is authorized in The Congressional Budget and Impoundment Control Act of 1974. That Act, as amended by the Omnibus Budget Reconciliation Act of 1990, defines the baseline "based on laws enacted through the applicable date." If asked to score the extension of the TCJA, the JCT would use a current law baseline unless directed to score the bill in another particular way.

b. **Approach When Requested to Provide Estimates Using a Current Policy Baseline.** When members of Congress request revenue estimates relative to an alternate baseline (including what members describe as their views of current policy), the JCT presents an estimate with two components, "the first of which is an estimate of the defined current policy relative to the present law baseline followed by the proposed modification as a modification to the defined current policy."

c. JCT Has Provided Estimates For Official Use on the Senate Floor Using a Current Policy Baseline Only For a Special Exception Involving Excise Taxes. When asked if the JCT has ever produced a score on a current policy baseline for official use on the Senate floor, the JCT responded that it has provided such estimates for certain excise taxes because §257(b)(ii)(C) of the Budget Act explicitly defines the baseline "[e]xcise taxes dedicated to a trust fund, if expiring" to be extended at current rates despite their planned expiration under current law. An example is the FAA Reauthorization Act of 2024, which extended taxes dedicated to the Airport and Airway Trust Fund. Implicit in that response is that the JCT has never provided a score for official Senate use under a current policy baseline other than for that specific excepted purpose involving excise taxes dedicated to a trust fund.

d. Scoring of Spending Increases Under a Current Policy Baseline. If the JCT were asked to score the impact of extending the expanded child credit under the American Rescue Plan of 2021 or an enhanced insurance premium tax credit under the Affordable Care Act, "relative to a baseline defined to assume that the enhanced premium tax credit was a permanent component of the Internal Revenue Code, legislation extending the enhanced premium tax credit would have no reportable budgetary effect." In effect, under a current policy approach, spending increases also would be scored as being costless to continue.

v. **Criticism of Current Policy Approach.** Rep. David Schweikert (R-AZ), chair of the House Ways and Means Oversight Subcommittee, has strongly criticized suggestions from Senate leaders to use a "current policy" approach:

> Current policy isn't the right way to score a tax bill, says Rep. David Schweikert, R-Ariz., who chairs the subcommittee overseeing the IRS and makes frequent after-votes speeches on the House floor about what he and others — including the CBO — consider to be the nation's unsustainable fiscal path.
>
> "It's intellectually a fraud," Schweikert said of the current-policy approach. "It is an intellectual fraud to say, 'Let's ignore the actual law and let's just keep doing what we're doing because it's convenient,'" he told reporters February 4.
>
> …
>
> "It's disingenuous because every projection of U.S. debt is based on the law. It is not based on our feelings that we like what we're getting today," Schweikert said. "If you're going to play honest economics, then try actually doing honest math."
>
> Schweikert also has a problem with Republicans bashing the scorekeeper, whether it's the CBO or the Joint Committee on Taxation, which scores tax provisions for both its own reports and the CBO's.

Doug Sword, *Top House Taxwriter Calls Current-Policy Approach 'a Fraud,'* 186 TAX NOTES FEDERAL 1129 (Feb. 10, 2025).

Rep. Chip Roy (R-TX) said of the current policy baseline approach, "This is fairy dust, and they're full of crap. And I'm gonna call them out on it" Benjamin Guggenheim, *'Full of crap': Deficit hawk Roy snipes at senators who say tax cut extensions are free*, POLITICO PRO (Mar. 4, 2025).

House Ways and Means Committee Chair Jason Smith has acknowledged that some members of the House Republican Caucus consider the current policy baseline approach to be a "budget gimmick just so they don't have to do spending cuts." *See* Doug Sword, *Smith Sets Memorial Day Deadline, Airs Additions for Tax Bill*, 186 TAX NOTES FEDERAL 1910 (Mar. 10, 2025).

The House Republican Study Committee, the largest caucus with the House Republican Conference, released an official position statement that reconciliation legislation must reduce the federal deficit. *RSC Adopts Reconciliation Goal*, Republican Study Committee website (Press Release dated Jan. 29, 2025).

Senator Elizabeth Warren, joined by four other Senators, on Feb. 19, 2025, sent a letter to the Chief of Staff of the Joint Committee on Taxation criticizing the current policy approach, asking whether there is any precedent for using a current policy baseline, and arguing that the Republican baseline maneuvering amounts to "magic math" and a "sleight-of-hand."

> Now, Republicans are seeking to extend their tax cuts, which would cost about $3.4 trillion over the next ten years, according to your estimates, or about $4.6 trillion, according to Congressional Budget Office (CBO) estimates once business provisions are extended and interest is included…. Some Republicans have claimed that a TCJA extension would not have any impact on the deficit and that Congress does not need to budget for that additional $4.6 trillion. This is magic math. The deficit cost of tax cuts is real, even for those who do not like the way the math works. After hardworking Americans paid their rent in December, they still had to budget for rent in January. Rent is not free because you paid last month's rent. Congress does not get to ignore that same basic math when it comes to funding more tax cuts for the wealthy.
>
> Measuring the cost of a tax bill requires a baseline to evaluate the bill against – and by law, that baseline has been "current law." A "current law" baseline means that if a tax cut is set to expire, as much of the TCJA will under law, extending the tax cut costs money. But Senate Republicans have suggested that this year's tax bill should be evaluated based on an assumption that existing cuts will be extended, known as the "current policy baseline." This sleight-of-hand would still drive up the deficit by $4.6 trillion – but would allow Republicans to claim that the price tag of extending TCJA is zero dollars.
>
> All costs must be counted at some point, and since the full cost of TCJA was not counted in 2017, it must be accounted for now if Republicans choose to extend the law. The $4.6 trillion addition to the deficit produced by extending the TCJA does not simply disappear.

Letter currently posted on Senator Warren's website. It is also available at **https://punchbowl.news/warren-letter-re-current-policy-baseline-2/**. Senator Warren has also analogized the current policy baseline to "free rent":

> Billionaire math: "You sign your yearlong lease and pay your rent each month for your apartment. When your landlord comes back at the end of the lease and says, 'How about signing for another year?' You say, 'Happy to sign. It won't cost anything since this is an extension, right?' Well, of course not."

Here's What They're Saying: Bipartisan Policymakers & Budget Policy Analysts Criticize Republicans' "Magic Math" That Will Explode the Deficit-Current Policy Baseline is a "Budget Gimmick," United State Senate Committee on the Budget Ranking Member's Newsroom (Mar. 5, 2025) (quotes from 13 individuals strongly criticizing use of the current policy baseline) available at **https://www.budget.senate.gov/ranking-member/newsroom/press/heres-what-theyre-saying-bipartisan-policymakers-and-budget-policy-analysts-criticize-republicans-magic-math-that-will-explode-the-deficit**.

Various commentators have strongly criticized the current policy approach. For critical comments from a wide variety of individuals about use the current policy baseline, see *Id*.

Jessica Riedl, senior fellow at the Manhattan Institute and former chief economist for former Senator Rob Ortman summarize that reconciliation cannot overrule the laws of economics and math:

> Congress can play whatever budget games it wants to evade its budget rules. But the deficit still skyrockets, the interest costs still bury taxpayers, and the bond market still eventually cries uncle. The laws of economics and math cannot be overruled in reconciliation.

Id.; Jessica Riedl, Post on X (Feb. 24, 2025).

The Tax Foundation summarizes:

> [F]uture deficits are higher under a current policy baseline because it includes lower revenues from extending the expiring parts of the TCJA. Because lower revenues from TCJA extension are baked into a current policy baseline, enacting legislation to continue the TCJA would score as having zero additional budget impact. Many lawmakers would likely appreciate the opportunity to extend the tax cuts in legislation that doesn't score as having any additional costs, but, really, that would just mean that higher deficits, interest costs, and long-term debt would already be baked into the projections for future years. Changing the baseline for scoring purposes doesn't change the actual trajectory of revenues, deficits, and debt under a continuation of the TCJA's expiring provisions.

Daniel Bunn, Garrett Watson, *All About That Bases(line)*, TAX FOUNDATION (Dec. 5, 2024) available at **https://taxfoundation.org/blog/extending-tax-cuts-budgetary-impact/**.

The Committee for a Responsible Federal Budget criticizes the current policy approach as a "dangerous precedent" and as "a dangerous and reckless move" that relies on "gimmicks and sleights of hand."

> Adopting a current policy baseline in reconciliation would be a dangerous and reckless move, especially given our near-record debt, exploding interest costs, and out-of-control borrowing trajectory. Our deficit is projected to total almost $2 trillion this year, and we're on course to borrow $22 trillion over the decade before any tax extensions. Any new legislation enacted by Congress should improve that trajectory, not make it worse.
>
> While employing a current policy baseline may be tempting to justify the current tax extensions, it would set a dangerous precedent for future actions. For example, if the temporary measures of the American Rescue Plan had been characterized as current policy, lawmakers could have extended them and added trillions of dollars to the debt with a $0 score.
>
> Adopting a current policy baseline for TCJA extension would allow lawmakers to borrow $4 trillion or more without ever recognizing the impact, and using it in reconciliation would be a clear accounting gimmick to end-run the choices required in budgeting. Remember, the original 2017 tax bill was made to be temporary to keep its reported deficit impact down. Since the impact of extension wasn't accounted for back in 2017, it needs to be accounted for now.

> Pretending the TCJA is permanent now wouldn't reduce its price tag; it would just hide it. The money still has to be borrowed.
>
> Showing a $0 impact on paper by changing the rules doesn't actually prevent the $4 to $5 trillion of additional borrowing from taking place. And it doesn't stop that borrowing from pushing up interest rates, slowing economic growth, and putting our debt sustainability at risk.
>
> Instead of relying on gimmicks and sleights of hand, Congress should ensure any tax extension is *truly* paid for and that overall we are reducing our debt, not adding to it. There are plenty of ways to improve the tax bill and incorporate that keep the important parts of the TCJA in place while reducing overall borrowing.

Current Policy Baseline Would Set Dangerous Precedent, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Jan. 27, 2025) (statement from Maya MacGuineas, president of the Committee for a Responsible Federal Budget).

The Center for American Progress, an independent (but left leaning) nonpartisan policy institute, strongly argues that a current law baseline should be used and that using a current policy baseline "is a gimmick."

> But the alternative current policy baseline that some Republicans have proposed—either for rhetorical purposes or for official CBO/JCT scoring and budget enforcement—would change the assumption that the Trump tax cuts that are set to expire under the law to instead assume that they will actually continue. Doing so would make it appear as if a bill extending them is free, despite the fact that an extension of the individual and estate tax cuts would cost taxpayers roughly $3.9 trillion over 10 years that has never been counted, increasing upward pressure on the debt-to-GDP ratio by 50 percent."

Republican Tax Legislators' Potential Framework for Extending Trump's Tax Cuts Is a Gimmick That Would Cost More Than Advertised, REPORT OF CENTER FOR AMERICAN PROGRESS (Dec. 7, 2024).

Arnold Ventures, a foundation that "advocates for public policies that maximize opportunity and minimize injustice for all" has blasted the reasons given by the U.S. Chamber of Commerce for supporting the current policy baseline approach, calling it a "fantasy," a "fiscally reckless precedent," and a "heads I win, tails you lose" approach. *Heads I Win, Tails You Lose: The Myths Behind "Current-Policy Baseline*,*"* ARNOLD VENTURES (Feb. 27, 2025) ("a current-policy baseline would allow Congress to claim TCJA permanence will have no impact on the national debt – which is more like a *fantasy*.") (A letter, dated Feb. 26, 2025, was sent to U.S. members of Congress urging the use of a current policy baseline to extend the TCJA. The letter was sent on behalf of 492 state and local chambers of commerce and national trade associations. *See* Doug Sword & Cady Stanton, *Policy Fights Await Rewrite of Tax and Budget Roadmap*, 186 TAX NOTES FEDERAL 1700 (Mar. 3, 2025).

Even if extending the TCJA is viewed for legislative purposes as having no budgetary impact, it still would increase deficits by $4.6 trillion over 10 years compared to not extending it, which could rattle financial markets. *See* Reshma Kapadia, *This Technical Accounting Debate Could Rattle Debt Markets. Here's Why.*, BARRONS (Mar. 28, 2025) ("'Once you do this, there is no turnoff of the spigot. Fiscal restraint is over,' [Henrietta Treyz, Veda Partners] says. That could rattle investors already worried about the deficit, potentially pushing investors to short the U.S. dollar and push bond yields higher, she adds.")

vi. **Some Procedural Effects of Scoring Rules in Reconciliation; Tax Cuts vs. Spending Allocations.** Scoring rules that apply in the reconciliation process can be surprising. For example, additional IRS funding for enforcement may increase revenues by up to 12:1 for auditing high-income earners. However, additional net revenue generated by additional IRS funding cannot be counted in reconciliation, but net revenue losses resulting from defunding the IRS are counted in reconciliation. Tax Analysts Tax Policy Webinar (Nov. 20,

2024) (statement by Chris Towner, policy director for the Committee for a Responsible Federal Budget).

Interesting differences apply to the treatment of expiring tax cuts vs. spending appropriations. When tax legislation is being scored, changes in tax law during the term being analyzed are considered, but §257 of the Balanced Budget and Emergency Deficit Control Act of 1985 (Public Law 99-177) requires that projections of funding for discretionary programs generally reflect the assumption that funding in years for which there is not yet an appropriation will be equal to the amounts provided for the current year with increases for inflation. However, the Fiscal Responsibility Act of 2023 established limits—also known as caps—on discretionary funding for 2024 and 2025. In the Congressional Budget Office's baseline, "those caps reduce most discretionary funding in 2025. Because CBO's projections of discretionary funding for years after 2025 are based on the amounts projected for 2025, those caps reduce funding through the end of the projection period." *Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues*, CONGRESSIONAL BUDGET OFFICE (May 2024), available at **https://www.cbo.gov/publication/60271**.

Sen. Crapo has lamented that "spending is under current policy baseline that's intended to protect the spending, so it goes on perpetually," but tax extensions are treated differently. *See* Maureen Leedy, *Tax Reform Scoring Tactic Risky, Say Experts*, RIA CHECKPOINT (Mar. 17, 2025). (The Wall Street Journal uses that same reasoning in supporting the use of a current policy baseline.) However, Bobby Kogan, director of the Center for American Progress, disagrees, saying, in effect, that the spending was scored when initially adopted, and the key point of scoring is that all costs are recognized at some point. "It's not the case that spending gets one treatment, and revenue gets a different treatment. I don't think anyone is trying to be misleading. I think it comes from lack of education in this area." *Id*.

An additional wrinkle is that executive orders restricting renewable energy development credits or a Congressional Review Act challenge that reverts a tax credit to a less generous form may mean that less revenue is gained in the scoring for the 2025 reconciliation act from repealing energy tax credits in the 2022 Inflation Reduction Act or clean energy provisions in the 2021 infrastructure law. If some of the anticipated revenue from repealing those provisions have already been clawed back by the executive orders or CRA challenges, less revenue savings may be scored as revenue offsets. *See* Cioffi, *Trump's Energy Credit Clawbacks Risk Undercutting GOP Tax Plans*, BLOOMBERG DAILY TAX REPORT (Feb. 4, 2025).

vii. **Senate Parliamentarian's Impact on Scoring Rules.** The Senate Parliamentarian gives advice about the interpretation of Senate rules and procedures, including guidance on compliance with requirements of reconciliations acts. The Parliamentarian clearly advises about what matters are "extraneous" under the Byrd rule, which includes whether a reconciliation bill extends deficits beyond the budget window, but the Parliamentarian's decision may not be decisive as to whether the budgetary impact is within the impact number specified in the budget resolution.

The Senate Parliamentarian, Elizabeth MacDonough, was also the parliamentarian when the 2017 TCJA was passed in 2017. She ruled in 2017 that the individual tax cuts that will expire at the end of 2025 were "explicitly temporary" since they were expiring and would therefore not violate the Byrd rule as having a budgetary impact after 10 years. She might view an approach treating an extension of those same cuts as having no cost in the 2025 act as being inconsistent. *See* Doug Sword, *Bye-Bye Round Numbers, Hello Rate Tweaks for Rescored TCJA Bill*, 186 TAX NOTES FEDERAL 1332 (Feb. 17, 2025). She also rejected requests to change scoring procedures by Republicans in 2017 and Democrats in 2021. *See* Zach Cohen, *Tax Bill's 'Magic Math' Approaches Inflection Point in Congress*, BLOOMBERG DAILY TAX REPORT (Mar. 18, 2025).

The Senate could overrule the parliamentarian's decision, or replace her with a more "sympathetic umpire," but that could set a bad precedent. Some commentators have suggested that effectively would emasculate the Byrd rule. Financial commentators have suggested that could "rattle debt markets." *See* Reshma Kapadia, *This Technical Accounting Debate Could Rattle Debt Markets. Here's Why.*, BARRONS (Mar. 28, 2025) ("What else could get investors' attention and create some volatility in bond markets: If there is a move to overrule the Senate parliamentarian or a growing view that the administration is 'monkeying around' with how the CBO scores legislation, says George Pearkes, macro strategist at Bespoke Investment.").

viii. **Budget Resolution Can Define Budget Impact Using Current Policy Baseline.** In setting the budget impact limit, the budget resolution can describe how to calculate the budget impact. Sen. Mike Crapo (R-ID), Senate Finance Committee chair, points out that the budget resolution can adopt a current policy baseline in defining the budget impact number. "While CBO and the Joint Committee on Taxation are required to build their estimates off of current law, the budget resolution adopted at the onset of the reconciliation process can include language requiring a different calculation." Cioffi, *Republican Scoring Plan Poses Pitfalls for Future Tax Bills*, BLOOMBERG DAILY TAX REPORT (Jan. 13, 2025). *See* Staff of Joint Committee on Taxation, *The Joint Committee on Taxation Revenue Estimating Process* (Jan. 28, 2025) ("JCT estimates provide comparisons against predictions of future revenue under present law, *not* current revenue levels"; "Each year the Congressional Budget Office produces a budget baseline that includes a forecast of present law receipts for the 10-year budget period").

ix. **Byrd Rule Impact on Current Policy Baseline Approach.** Any senator can raise a point of order for anything "extraneous" to reconciliation, which would require 60 votes for that provision. Any provision that does not change government outlays or revenues would be extraneous. Therefore, if the budget resolution uses a current policy approach, each of the 40 expiring provisions in the TCJA may need to be tweaked. For each provision, a change must be made that would have a scoring impact (i.e., so it would result in a change using a current policy baseline). For example, for some provisions that might involve a slight tweaking of rates or threshold numbers to qualify for deductions or credits, but the change must be more than "merely incidental," or else the Senate Parliamentarian may declare that the provisions do not have budgetary impact and therefore violate the Byrd rule. *See* Doug Sword, *Bye-Bye Round Numbers, Hello Rate Tweaks for Rescored TCJA Bill*, 186 TAX NOTES FEDERAL 1332 (Feb. 17, 2025); Cioffi, *Republican Scoring Plan Poses Pitfalls for Future Tax Bills*, BLOOMBERG DAILY TAX REPORT (Jan. 13, 2025).

Senate Republicans believe that the current policy approach would apply to the issue of whether additional deficits are produced outside the budget window, thus allowing a permanent extension of the TCJA. *See* Doug Sword & Cady Stanton, *What's in a Score? Maybe the Future of TCJA*, 186 TAX NOTES FEDERAL 1499 (Feb. 24, 2025). Some commentators suggest that is not clear. *See "Current Policy Baseline" Gimmick Could Explode the Debt*, Committee for a Responsible Federal Budget (Feb. 27, 2025) ("it is unclear that Senate rules allow the use of a current policy baseline for enforcing the Byrd Rule"), available at **https://www.crfb.org/blogs/current-policy-baseline-gimmick-could-explode-debt.** Even if a current policy baseline is used, House Budget Committee Chair Jodey Arrington (R-TX) has questioned whether it would also apply for purposes of determining if deficits would be increased outside the budget window under the Byrd rule. *See* Tobias Burns, *Tax, spending rankle Republicans despite momentum on reconciliation*, THE HILL (Mar. 27, 2025) ("Well, even though there's no impact to the budget, there is an increase to the deficit outside the 10-year window," quoting Rep. Arrington).

x. **Impact of Current Policy Approach on Pay-Fors.** Pay-fors that have been suggested include retiring some of the credits in the climate provision of the 2022 Inflation

Reduction Act. Like other reconciliation bills, those provisions slowly phase down to minimize the budgetary impact and avoid causing deficits outside the 10-year budget window. Using a current policy approach would assume the credits last indefinitely. Therefore, "[i]f you use a current policy baseline, the expiring provisions are going to look like they have a larger budgetary impact in the 10-year window," according to Kyle Pomerleau, a senior fellow at the American Enterprise Institute. *Id*. Another example is that Affordable Care Act premium subsidies that expire at the end of 2025 are part of current policy. They were scored as costing $20 billion a year; allowing them to expire could be counted as a large revenue raiser compared to current policy. *See* Doug Sword, *Bye-Bye Round Numbers, Hello Rate Tweaks for Rescored TCJA Bill*, 186 TAX NOTES FEDERAL 1332 (Feb. 17, 2025).

xi. **Precedent.** Even if the current policy baseline approach could be used in the budget resolution, Republicans may be concerned that the precedent could be used by Democrats in future reconciliation acts to extend their own preferred tax credits, deductions, spending, without registering a hit to the deficit.

> [Using a current policy baseline] threatens to open a Pandora's box of big government mischief. As recently as 2021, for example, Congress provided pandemic unemployment benefits far above historical levels, discouraging beneficiaries from working and costing taxpayers hundreds of billions of dollars, much of it in fraudulent claims, for a program scheduled to expire in *less than six months*. Imagine if Congress said, "We should ignore the CBO score of trillions of dollars to make these unemployment benefits permanent. These benefits are 'reality' for the people receiving them, and therefore making them permanent doesn't actually cost anything."
>
> That's exactly the standard the U.S. Chamber of Commerce is endorsing and the fiscally reckless precedent it is trying to set. **Congressional Republicans must recognize that a future Democratic Congress and President will use that precedent to enact Medicare for All, the Green New Deal, and Universal Basic Income for just one year, and then come back a year later and make it all permanent at "zero cost" because, "those programs are reality."**

Heads I Win, Tails You Lose: The Myths Behind "Current-policy Baseline,*"* ARNOLD VENTURES (Feb. 27, 2025) (bold emphasis added), available at **https://www.arnoldventures.org/stories/heads-i-win-tails-you-lose-the-myths-behind-current-policy-baseline**.

Similarly, the Committee for a Responsible Federal Budget argues that

> [f]uture lawmakers could simply pass a one-year policy of their choosing and then make it permanent "for free." In an extreme case, a future Congress and Administration could implement a Medicare for All plan at the single-year cost of less than $3 trillion and then make the Medicare for All plan permanent while treating the additional $30 trillion of nine-year costs as if they are costless.

"Current Policy Baseline" Gimmick Could Explode the Debt, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Feb. 27, 2025), available at **https://www.crfb.org/blogs/current-policy-baseline-gimmick-could-explode-debt.**

xii. **Tariffs.** Republican tax writers have observed that the scoring on the reconciliation bill will not acknowledge offsets from tariffs resulting from executive action because those measures are not part of the reconciliation process. *See* Stanton, *GOP Leaders Point to Impact of TCJA Expirations on Manufacturing*, 186 TAX NOTES FEDERAL 593 (Jan. 20, 2025). Republicans may make an argument that their plans for deregulation, tariffs, and economy-growing tax provisions mean the bill will pay for itself despite any CBO score (but deregulation and tariffs will not be a part of the reconciliation act). *See* Doug Sword, *House Leans Toward Two Bills With Tax Second, Budget Chair Says*, 185 TAX NOTES FEDERAL 2445 (Dec. 23, 2024).

(d) **Cumbersome Process.** The negotiation and implementation of a reconciliation act is a cumbersome time-consuming process. "You have to involve the [Congressional Budget Office], you have to involve the budget committees, you have to involve the [Joint Committee on Taxation] . . . they are the arbiters, and I think that's a process." Stanton &

Rifaat, *Reconciliation Discord Portends Slow Movement for Tax Extensions*, 186 TAX NOTES FEDERAL 379 (Jan. 13, 2025) (statement by Jorge Castro of Miller & Chevalier, Chtd.).

(10) **One or Two Reconciliation Acts in 2025?** One reconciliation act is allowed in each fiscal year (though two reconciliation bills have never been passed in a single calendar year). In 2017, a FY 2017 budget resolution was introduced on January 3, 2017, to repeal various mandates, taxes and penalties associated with the Affordable Care Act (Obamacare), with the hope of enacting legislation in April or May 2017. Negotiations stalled, and that attempt failed. The plan was then to introduce a separate FY 2018 budget resolution sometime in May or June 2017, with the goal of completing the reconciliation act by August 2017, that would deal with tax reform. Similarly, no reconciliation bill was introduced for FY 2025, so in 2025, two reconciliation acts would be possible (one for FY 2025 and one for FY 2026).

Republican leadership in the Senate and House have differed over whether to plan to pursue one or two reconciliation acts in 2025. The House Republican leadership prefers a single bill with border security, defense, and tax measures all together, thinking that packaging different priorities together will make it harder for Republican dissenters to defect. House Speaker Johnson acknowledges that the razor-thin Republican majority in the House means that only a few defections from "budget-hawks" would doom any bill. Having a single bill with matters such as border security and defense included would make it harder for bitterly divided House Republicans to defect. Johnson warns his Senate colleagues: "It's a very different chamber with very different dynamics and the House needs to lead this and we're going to have success," *See* Steven Dennis, *GOP Senators Break With House Over Trump's Budget Strategy*, BLOOMBERG DAILY TAX REPORT (Feb. 5, 2025).

President Trump has expressed his preference for a single-bill approach. The Senate originally preferred a two-bill approach, and the Senate budget resolution, passed on Feb. 21, 2025, addresses only border security and defense, leaving tax issues for a later bill. There are some reports that the Senate and House have resolved their differences over this issue, and the Senate will proceed with a single-bill approach as differences between the House and Senate budget resolutions are being negotiated, but that is not totally clear, especially if the tax negotiations break down. *See* Doug Sword, *Crapo Says Tax Package Will Be Bigger and Broader Than Expected*, TAX NOTES TODAY FEDERAL (Mar. 13, 2025).

(11) **Senate Budget Resolution.** Sen. Graham (R-SC) released the text of a budget resolution on February 7, 2025, that would address border security and defense, with a cost of $85.5 billion annually for 4 years (total of $342 billion), that would be paid for with a reduction in annual spending of up to $520 billion over four years. The bill would provide funding to finish building a border wall; increase the number of ICE officers, border patrol officers and prosecutors; strengthen the U.S. Navy; pay for "an integrated air and missile defense"; and increase domestic energy production through onshore and offshore lease sales and repealing the Biden administration's methane emissions fee. The Senate passed its budget resolution for fiscal year 2025 on Feb. 21, 2025. The resolution was approved by a vote of 52 to 48 and serves as a blueprint for reconciliation legislation focusing on border security, military spending, and energy production.

The Senate budget resolution uses a "current policy" baseline approach. See Item 2.c(10)(c)ii above. (The House uses a "current law" approach.) Leadership in the Senate has vowed not to vote for legislation that does not extend the TCJA permanently (which would require using a current policy baseline). This will lead to extensive negotiations, particularly with "budget hawks" in the House who are especially concerned with deficits and the national debt. House Budget Chairman Jodey Arrington (R-TX) has noted that "[t]here would need to be certain conditions if I even would consider [using a current policy baseline]…. But I'm certainly open." Jack Fitzpatrick & Ken Tran, *Senate, House GOP in for Fight to Make Trump Tax Cuts Permanent*, BLOOMBERG DAILY TAX REPORT (Feb. 26, 2025). Republican House taxwriters have said that much of the focus of meetings will be on maximizing the permanency of TCJA extensions. House Ways and Means Committee member Ron Estes (R-KN) seems open: "I think the big thing is we want to make as

much permanent as possible, so we don't have to have these battles every so often." *See* Cady Stanton, *House Taxwriters to Start Work Despite Stalemate With Senate*, 186 TAX NOTES FEDERAL 1912 (Mar. 10, 2025).

(12) **House Budget Resolution.** The House leadership issued the initial draft of its budget resolution on February 12, 2025, that deals with taxes as well as border security, immigration, and defense. Leadership has struggled with reaching measures that are acceptable to the both the "Freedom Caucus" members (budget hawks who want to reduce spending and reduce deficits) as well as more moderate members of the Republican party.

The House passed the budget resolution by a vote of 217-215 on Feb. 25, 2025. All Republicans except Rep. Thomas Massie (R-KY) voted for the resolution, and all Democrats other than one absent party voted against the resolution. There were a number of holdouts throughout that day, including a small band of conservatives who cited concerns over deficits and spending levels and more moderate Republicans who expressed concern over potential cuts to Medicaid. At one point, holdouts were brought into a private cloakroom for "further discussions." President Trump himself began calling the holdouts.

Holdouts included Rep. Warren Davidson (R-OH), who said he "finally received assurances I needed that there will be cuts to discretionary spending," Rep. Victoria Spatz (R-IN), who referred to her call with President Trump and his commitment "to save healthcare and make it better for physical and fiscal health for all Americans … I trust his word," and Rep. Tim Burchett ((R-TN), who said President Trump "committed to me that he is going to go after the spending in a lot of these big departments." Speaker John said the calls from President Trump were "a big help." *See* Katherine Tully-McManus & Meredith Lee Hill, *House Approves 'Big, Beautiful Bill' Budget After Wild Whip Effort*, POLITICO (Feb. 25, 2025), available at **https://www.politico.com/news/2025/02/25/house-budget-republican-agenda-00206125**.

Negotiations with the Senate over some of these issues could be difficult. Some Representatives who are aggressive about cutting spending have observed that some Senators may not be as committed to spending cuts. Rep. Chip Roy (R-TX) stated "[i]f they think they're going to meaningfully shrink the spending restraint and try to juice the tax side, then I don't think that's going to go so well." *See* Doug Sword & Keith Lobosco, *House Advances Budget Plan, Setting Up Cross-Chamber Conference*, 186 TAX NOTES FEDERAL 1698 (Feb. 26, 2025).

The lone Republican holdout from voting for the resolution was Rep. Thomas Massie (R-KY), who voiced opposition to the fact the resolution would add additional deficits. Massie said "If the Republican plan passes, under the rosiest assumptions, which aren't even true, we're going to add $328 billion to the deficit this year, we're going to add $295 billion to the deficit the year after that, $242 billion to the deficit after that. Why would I vote for that?" *See* Jennifer Shutt, *House Republicans Overcome Own Members' Doubts to Push Through Sweeping Budget*, GOVERNMENT EXECUTIVE (Feb. 25, 2025), available at available at **https://www.govexec.com/management/2025/02/house-republicans-overcome-own-members-doubts-push-through-sweeping-budget/403282/**. In a pithier statement, he said "[i]t's insane. We're going to increase the deficit with this. Why would I vote for that? You can't cut taxes without cutting spending, and they're not really cutting spending." *See* Catie Edmondson, Andrew Duehren, Maya C. Miller, & Robert Jimison, *House Passes G.O.P. Budget Teeing Up Enormous Tax and Spending Cuts*, NEW YORK TIMES, Section A, p.15 (Feb. 27, 2025).

Just because representatives voted for the budget resolution does not mean they would necessarily vote for the same provisions in a reconciliation act for several reasons. First, the House members felt pressure to adopt a resolution so the House resolution would drive the process rather than having the Senate drive the process (and some representatives view the Senate as "less fiscally responsible"). *See* Doug Sword & Keith Lobosco, *House Advances Budget Plan, Setting Up Cross-Chamber Conference*, 186 TAX NOTES FEDERAL 1698 (Feb. 26, 2025) (quoting Rep. Gregory Murphy (R-NC)). Second, they realize the passage of a budget resolution in the House is a necessary step to start the serious discussions. Representative Tim Burchette (R-TN) expressed this point of view colorfully: "It's not everything I wanted, but in this

game, you're either at the table or on the menu. It's time to get at the table." *See* Katherine Tully-McManus & Meredith Lee Hill, *House Approves 'Big, Beautiful Bill' Budget After Wild Whip Effort*, POLITICO (Feb. 25, 2025), available at **https://www.politico.com/news/2025/02/25/house-budget-republican-agenda-00206125**. House Budget Committee member Rep. Chip Roy (R-TX) has made clear that his vote for the budget resolution didn't mean that support would continue in subsequent votes and his vote will be "contingent on additional crucial actions in a final reconciliation bill." Doug Sword & Cady Stanton, *Policy Fights Await Rewrite of Tax and Budget Roadmap*, 186 TAX NOTES FEDERAL 1700 (Mar. 3, 2025).

Important provisions of the House budget resolution are briefly summarized.

- Budget window: 2025-2034
- Ways and Means Committee (tax cuts): $4.5 trillion (sliding scale; will go up or down to the extent spending cuts are more than or less than $2.0 trillion; so, if spending cuts are $1.5 trillion, the tax cuts number would be cut to $4 trillion, and if spending cuts are $2.5 trillion, the tax cuts number would be increased to $5 trillion)
- Additional allocation to Defense: $100 billion
- Additional allocation to Homeland Security and Judiciary Committees (border and immigration enforcement): $200 billion
- Spending cuts: $2.0 trillion (Those spending cuts may impact Medicaid, Medicare, and Affordable Care Act ($880 billion), food assistance programs ($230 billion), and student loan programs ($330 billion).)
- Total of tax cuts and spending increases: $4.8 trillion (because the tax cuts are not needed for 2025, this translates to $5.5 trillion to $6 trillion of ten-year increases, see *Taking a Closer Look at the House Budget's Reconciliation Instructions*, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Feb. 12, 2025))
- Uses current law approach
- Estimates the reconciliation bill will generate revenue of $2.6 trillion in macroeconomic impacts over 10 years, much larger than predicted by economists. (Economists' estimates range from $200 billion to about $400 billion, see Item 2.c(3) above; the House budget resolution estimate may include anticipated revenues from tariffs and economic growth from cutting regulations, *see* Doug Sword, *$4.5 Trillion Tax Cut Pays Largely for Itself, Budget Bill Asserts*, 186 TAX NOTES FEDERAL 1323 (Feb. 17, 2025).)
- Assumed net financial impact: $4.5 trillion for tax cuts and $300 billion for border security and defense total $4.8 trillion; to be offset by $2 trillion in spending cuts and $2.6 trillion in revenues coming from higher than projected economic growth; nets to $200 billion short of paying for itself; without the $2.6 trillion from projected economic growth, the plan results in **$2.8 trillion** added to the national debt over ten years. *See What's in the FY 2025 House Budget Resolution*, BIPARTISAN POLICY CENTER (Feb. 12, 2025), available at **https://bipartisanpolicy.org/explainer/whats-in-the-fy2025-house-budget-resolution/**. In addition, the Committee for a Responsible Budget estimates that the House bill would add **$3.4 to $4.6 trillion** of deficit increases through FY 2034 including additional interest costs. *"Current Policy Baseline" Gimmick Could Explode the Debt*, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Feb. 27, 2025) available at **https://www.crfb.org/blogs/current-policy-baseline-gimmick-could-explode-debt.**
- By comparison, the budget resolution for the 2017 TCJA allowed for a deficit increase of $1.5 trillion over the 10-year budget window.
- The $4.5 trillion for tax cuts may not include any amount for SALT relief or the Trump administration's other tax cut goals (no tax on tips, overtime pay, Social Security).

- The bill estimates $2.6 trillion of revenue from economic growth. The resolution assumes GDP growth would be 2.6 percent per year for the coming decade instead of the Congressional Budget Office's 1.8 percent estimate. *See* Doug Sword, *House Budget Headed for Vote on $4.5 Trillion Tax Package*, 186 TAX NOTES FEDERAL 1321 (Feb. 17, 2025); Benjamin Page, *Understanding House Republican Estimates on Macroeconomic Benefits of Tax Cuts*, URBAN INSTITUTE AND BROOKINGS INSTITUTION TAX POLICY CENTER (Feb. 19, 2025) (the $2.6 trillion estimate would require the economy to be about 4 percent larger, but that impact far exceeds advance projections of the effects of TCJA on GDP, which were under 1 percent). The Committee for a Responsible Federal Budget has referred to the House budget's resolution's $2.6 trillion estimate of revenue from economic growth as "fantasy math." *$3 Trillion of Dynamic Feedback is Fantasy Math*, Committee for a Responsible Federal Budget Blog (Feb. 7, 2025) available at **https://www.crfb.org/blogs/3-trillion-dynamic-feedback-fantasy-math**.
- $4 trillion increase in the debt ceiling (this could be controversial; a number of Republican House members oppose raising the debt limit for ideological reasons and dozens of them have never voted to increase the debt ceiling, and Democrats are unlikely to vote for the massive tax cuts bill just to avoid exceeding the debt ceiling). "The plan still faces the buzzsaw of a GOP conference that includes debt hawks who have never voted in favor of raising the debt limit." Chris Cioffi, *'Angst' for Tax Writers After House Budget Proposal*, BLOOMBERG DAILY TAX REPORT (Feb. 13, 2025).
- Mixed messages: Freedom Caucus members say they support the budget resolution despite the deficit increases. However, a statement from Republican Study Committee Steering Group stated, "Reconciliation legislation must reduce the federal budget deficit. Our national security depends on our ability to bring about meaningful fiscal reform." *RSC Adopts Reconciliation Goal*, Republican Study Committee website (Jan. 29, 2025), available at **https://rsc-pfluger.house.gov/media/press-releases/rsc-adopts-reconciliation-goal#:~:text=%E2%80%9CReconciliation%20legislation%20must%20reduce%20the,bring%20about%20meaningful%20fiscal%20reform.%E2%80%9D**. "Republicans are going to have to square the two arguments – that tax cuts pay for themselves and that the growing deficit is a concern – in order to succeed." Doug Sword, *What to Expect From Scoring the 2025 Tax Bill*, 186 TAX NOTES FEDERAL 35 (Jan. 6, 2025).
- Much negotiation lies ahead. For example, some Republicans say they will not vote for a plan that does not include SALT deduction relief; Rep. Murphy (R-NC) says some provisions are "sacrosanct," including the §199A deduction and the doubled estate tax exemption. *See* Doug Sword, *$4.5 Trillion Tax Cut Pays Largely for Itself, Budget Bill Asserts*, 186 TAX NOTES FEDERAL 1323 (Feb. 17, 2025). Budget hawks will be demanding in negotiations (and with a very slim Republican majority, any one, two, or three of them hold a veto power, depending on the exact margin at the time, see Item 2.c(7) above). Even so, the tide may be turning with some budget hawks:

  > On taxes, Congress is moving with much more rapidity to enact a plan than in 2017, giving businesses and individuals more lead time to adapt to looming changes.
  >
  > Trump's campaign proposals to expand breaks to end taxes on tips, overtime and Social Security, once considered wishful thinking, are even gaining momentum despite their costs.
  >
  > Last week's dramatic, down-to-the-wire vote on the $4.5 trillion House tax cut outline was a milestone in the GOP's evolution toward unity, with Trump quelling a rebellion from fiscal conservatives through a few last-minute phone conversations.
  >
  > The budget plan would add nearly $3 trillion in deficits over 10 years and raise the debt ceiling by $4 trillion. Nonetheless spending hardliners voted for the compromise.
  >
  > **"It's a new day,"** said conservative Ralph Norman [R] of South Carolina.

  Erik Wasson, Steven Dennis, *Trump Bends Congress to His Will on Spending, Tax Cut Agenda*, BLOOMBERG DAILY TAX REPORT (Mar. 3, 2025) (emphasis added).

The House budget resolution initial draft suggests it would support extension of much or all of TCJA for 10 years, but a lot of negotiation remains. The addition of other tax cuts supported by the Trump administration or the inability to cut spending by $2 trillion would mean that the TCJA cuts could only be extended for significantly less than the full 10 years (see immediately below).

(13) **Negotiations to Resolve Differences Between Senate and House Budget Resolutions.** As discussed above, there are some indications the Senate has agreed to negotiating under a one-bill approach that will address taxes as well as border security and defense. Additional tax provisions are being considered in addition to an extension of the TCJA. Senate Finance Committee Chair Mike Crapo (R-ID) has said "It's a bigger deal than everybody is focused on," itemizing between $800 billion and potentially several trillion dollars of tax provisions that might be added to extension of the TCJA. *See* Doug Sword, *Crapo Says Tax Package Will Be Bigger and Broader Than Expected*, TAX NOTES TODAY FEDERAL (Mar. 13, 2025). Some or all of the President's tax priorities will be included, adding $300-$500 billion or up to $3 or $4 trillion of cost, depending on specific features. *Id*. In addition, Senate Republicans have suggested nearly 200 tax proposals that will be considered. Crapo named only three of them, (1) "repeal or at least reduction of the estate tax, as 'rather prominent senators' want," (2) increases to the low-income housing credit, and (3) changes to tax-favored Opportunity Zones. *Id*.

The current policy baseline issue will have an important impact on what additional items might be added: "Just how jarring the eventual price tag will be depends on whether Crapo and Senate leadership can win approval from the Senate parliamentarian – or proceed without that approval – for the reconciliation bill to be scored on a current-policy basis. *Id*.

Like the House budget resolution, the Senate is also looking at the argument that $2.6 trillion of additional revenue would be produced from economic growth spurred by the package. *Id*.

(14) **Shortened Extension to Reduce Deficit Impact.** One way of dealing with the deficit impact of tax cuts is to reduce the period of the extension. The 2017 TCJA reduced its deficit impact (to $1.5 trillion) by shortening the extension to eight years rather than the full ten years of the budget window. Three ways of reducing the bill's deficit impact are to (i) make it shorter, (ii) make it skinnier by reducing the tax cuts, and (iii) include pay-fors. The two likely approaches in 2025 will be making it shorter and adding some pay-fors (new revenue sources, such as a state and local tax deduction limitation for corporations or an attempt to count tariffs toward a reconciliation score). *See* Doug Sword, *TCJA's Extension Might Be a Short One*, 185 TAX NOTES FEDERAL 1471 (Nov. 18, 2024). (This is, of course, if the current law approach is used; as explained above, under a current policy approach, the deficit impact of extending TCJA tax cuts as they currently exist would be zero, with some tweaks as required by the Byrd rule).

House Ways and Means Committee Chair Rep. Jason Smith has acknowledged that even with the $4.5 trillion set aside for tax relief in the House budget resolution, that may just permit extending the TCJA and enacting other tax provisions for just eight or nine years. *See* Doug Sword, *Smith Sets Memorial Day Deadline, Airs Additions for Tax Bill*, 186 TAX NOTES FEDERAL 1910 (Mar. 10, 2025); Doug Sword, *Crapo Says Tax Package Will Be Bigger and Broader Than Expected*, TAX NOTES TODAY FEDERAL (Mar. 13, 2025).

Another factor is the political reality of the upcoming 2026 mid-term elections, when the party out of power historically has more success. In 2026, 20 Republicans but only 13 Democratic senators are up for reelection. The political reality, then, is that the cuts must last longer than two years, "but a four-year bill might not be prohibitively expensive. 'I'm thinking this is maximum like a four-year extension.'" *Id*. (quoting Marc Gerson of Miller & Chevalier Chtd.). Another prediction: "Three to five years is more likely than eight years," [referring to the eight-year extension of the 2017 TCJA]. *Id*. (quoting Jonathan Traub of Deloitte Tax LLP).

(15) **Estate and Gift Tax Measures; Repeal Bills; Impact of Potential 2025 Legislation on Planning.** The estate and gift tax provisions do not have a big revenue impact in relation to the overall TCJA changes. Extending the estate tax measure would increase the deficit by $189

billion over ten years vs. $4.6 trillion for extending all of the TCJA. But the estate tax provisions are highly charged political issues and are likely to be included in the tax cut extensions. Because of the Byrd Rule, the extension of the $10 million (indexed) exclusion amount will probably last for only 10 years (or less). It will automatically revert to a lower exclusion amount at the end of that time—whether it will be further extended may depend on how the political winds are blowing at that time.

Not only is it likely that the $10 million (indexed) exclusion amount will be extended, but the Republican sweep also raises the specter of possible *repeal* of the estate tax. Indeed, Senator John Thune (R-SD), the Senate majority leader, has repeatedly introduced estate tax repeal bills and initially won his Senate seat in part by running against the "death tax." He again introduced the Death Tax Repeal Act of 2025 bill on February 13, 2025. (A companion bill was also introduced as H.R. 1301 in the House.) For a summary of these bills, see Gassman, Crotty, Ketron & Farrell, *Breaking Up with the Death Tax, A Valentine's Day Update on Estate and GST Tax Repeal*, LEIMBERG ESTATE PLANNING NEWSLETTER, Archive #3182 (February 14, 2025). A difference between the Senate and House versions is the inclusion of a new §2511(c) in the Senate bill, which provides: "Notwithstanding any other provision of this section and except as provided in regulations, a transfer in trust shall be treated as a taxable gift under section 2503, unless the trust is treated as wholly owned by the donor or the donor's spouse under subpart E of part I of subchapter J of chapter 1." This rather curious provision was enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 and repealed in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. It has been included in various other estate tax repeal bills filed beginning in 2011. For a discussion of this enigmatic provision and its inclusion in various estate tax repeal bills, see Item 16.a(1)(c) of Aucutt, Washington Update: Estate Tax Changes Past, Present, and Future (Mar. 12, 2024) (search for the words "Section 2511(c)" for other discussions of this provision in various repeal bills) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

The greatly increased likelihood that the $10 million (indexed) exclusion amount will be extended has reduced the perceived pressure on clients to take advantage of the large exclusion amount before it may be slashed in half. Clients who were not totally comfortable making large gifts will likely wait before making gifts to see when Congress will ultimately decide whether the larger exclusion amount will be extended (but they should consider engaging in planning, structuring trusts, etc. currently so the planning will be in place when they decide to make large gifts). Clients who were not totally comfortable making large gifts are probably the clients most interested in implementing transfer planning with SLATs, so we may see less emphasis on SLATs going forward. Clients who have enough wealth that they are comfortable making gifts are best advised to make the gifts currently, so that future appreciation can be removed from the estate.

(16) **Conclusion.** It is very likely that a tax reconciliation act will be passed extending the expiring individual tax cuts (including the $10 million indexed estate and gift tax exclusion amount), possibly limited to say 4-5 years. But that is not a given; significant hurdles exist, and the legislation may not be passed until late in the year (or even into early 2026). The budget impact number that is agreed to in the budget resolution will be telling as to how comprehensive and how long the extension may be.

3. Miscellaneous Guidance From IRS; Overview of Treasury-IRS Priority Guidance Plan Projects

In the first Trump term, the administration placed a temporary freeze on regulation projects in an executive order signed January 20 (which is typical for a new administration). The administration on January 30, 2017, also signed an executive order establishing a "one-in, two-out" system for regulations, requiring that for each new regulation, agencies must find at least two to repeal in order to reduce the net regulatory costs. President Trump issued an Executive Order on April 21, 2017, directing Treasury to review all "significant tax regulations" issued on or after January 1, 2016, and identify those that impose undue financial burden or complexity or that exceed statutory authority of the IRS. An April 11, 2018

memorandum required review of IRS regulations by the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA).

The Biden administration, in a memorandum dated June 9, 2023, ended the OIRA review of IRS regulations. For a history of the review of tax regulations by the OIRA, see Marie Sapirie, *News Analysis: A Finale for OIRA Tax Review*, 180 TAX NOTES FEDERAL 349 (July 17, 2023).

A January 31, 2025, executive order revives the OIRA review of tax regulations, reinstating the April 11, 2018 memorandum of agreement between the Treasury and OMB to allow OIRA to review proposed regulations. The order also says "[u]nless prohibited by law, whenever an executive department or agency … publicly proposes for notice and comment or otherwise promulgates a new regulation, it shall identify at least 10 existing regulations to be repealed." However, perhaps the concern is primarily with incurring no net incremental costs rather than necessarily repealing 10 existing regulations. The order adds that in connection with the direction to repeal 10 regulations for every new regulation: "any new incremental costs associated with new regulations shall, to the extent permitted by law, be offset by the elimination of existing costs associated with at least 10 prior regulations." *See* Slowey, *Tax Rules to Undergo White House Review After Trump Revives Order*, BLOOMBERG DAILY TAX REPORT (Feb. 3, 2025).

An executive order dated Feb. 19, 2025, titled "Ensuring Lawful Governance and Implementing the President's 'Department of Government Efficiency' Regulatory Initiative," charges agency heads to identify the following types of regulations:

(i) unconstitutional regulations and regulations that raise serious constitutional difficulties, such as exceeding the scope of the power vested in the Federal Government by the Constitution;

(ii) regulations that are based on unlawful delegations of legislative power;

(iii) regulations that are based on anything other than the best reading of the underlying statutory authority or prohibition;

(iv) regulations that implicate matters of social, political, or economic significance that are not authorized by clear statutory authority;

(v) regulations that impose significant costs upon private parties that are not outweighed by public benefits;

(vi) regulations that harm the national interest by significantly and unjustifiably impeding technological innovation, infrastructure development, disaster response, inflation reduction, research and development, economic development, energy production, land use, and foreign policy objectives; and

(vii) regulations that impose undue burdens on small business and impede private enterprise and entrepreneurship.

The first three of those items seem directly related to the *Loper Bright* Supreme Court decision overruling the *Chevron* doctrine, discussed in Item 18 below. With another nod to *Loper Bright*, section 3 of the executive order also directs that "agencies shall preserve their limited enforcement resources by generally de-prioritizing actions to enforce regulations that are based on anything other than the best reading of a statute and de-prioritizing actions to enforce regulations that go beyond the powers vested in the Federal Government by the Constitution."

These changes by the Trump administration have led one commentor to suggest that the IRS-Treasury priority guidance business plan process should be shelved, at least while these restrictions are in effect. Monte Jackel, *Does the IRS Still Need a Priority Guidance Plan?*, 186 TAX NOTES FEDERAL 1875 (Mar. 10, 2025).

a. **2024-2025, 2023-2024, 2022-2023 and 2021-2022 Treasury-IRS Priority Guidance Plans.** The 2024-2025 Treasury-IRS Priority Guidance Plan (dated October 3, 2024) sets the priority for guidance projects during the Plan year (from July 1, 2024, to June 30, 2025), but no deadline is provided for completing the projects. The 2024-2025 Plan adds three new projects in the "Gifts and Estates and Trusts" section.

(1) Guidance regarding amounts qualifying as distributions of income exempt from estate tax under §2056A (Number 6).

(2) Regulations under §2642 regarding the redetermination of the inclusion ratio on the sale of an interest in a trust for GST exemption purposes (Number 9). (For example, if G1 creates a trust for G2 and G2 sells its beneficial interest to G3, are trust distributions to G3 taxable distributions? Are they indirect distributions to G2? If G2 sold the interest for fair value, there is no gift so no change of transferor occurs for GST purposes. The New York State Bar Association Tax Section has submitted detailed comments to the IRS regarding this project. *Report on the GST Tax Effect of Assignments of Beneficial Interests*, NEW YORK STATE BAR ASSOCIATION TAX SECTION (Nov. 19, 2024). *See* Bramwell & Weisbart, *The Dueling Transferors Problem in Generation-Skipping Transfer Taxation*, 41 ACTEC L.J. 95 (Spring 2015).)

(3) Guidance updating the user fee for estate tax closing letters (Number 12). (The project about establishing a user fee for estate tax closing letters (Reg. §300.13 (T.D. 9957)) was finalized on September 27, 2021, effective October 28, 2021. Charging a user fee for closing letters was apparently viewed by some in the IRS as the only way to keep issuing them at all. Informal indications are that the price will be going down; the IRS has corrected a lot of issues with the closing letter system. Closing letters are obtained through pay.gov.)

The 2024-2025 Plan deletes one project in the "Gifts and Estates and Trusts" section that was finalized in the last Plan year, extensions to allocate GST exemption (final regulations (RIN 1545-BH63) were published on May 6, 2024, discussed in Item 6 below. In addition, Item 7 on the 2024-2025 Plan says that references in Reg. §20.2056A-2 regarding qualified domestic trust elections on estate tax returns were updated in proposed regulations filed August 20, 2024 (Number 6 in the 2023-2024 Plan).

For a general discussion of and commentary about the 2023-2024 Priority Guidance Plan and various items that have been on the Plan in prior years see Item 5 of Aucutt, *Washington Update: Pending and Potential Administrative and Legislative Changes* (Mar. 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

The following are items regarding gifts and estates in the 2024-2025 Plan.

GIFTS AND ESTATES AND TRUSTS

1. Regulations under §645 pertaining to the duration of an election to treat certain revocable trusts as part of an estate.

2. Final regulations under §§1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016.

3. Regulations under §2010 addressing whether gifts that are includible in the gross estate should be excepted from the special rule of §20.2010-1(c). Proposed regulations were published on April 27, 2022.

4. Regulations under §2032(a) regarding imposition of restrictions on estate assets during the six-month alternate valuation period. Proposed regulations were published on November 18, 2011.

5. Final regulations under §2053 regarding the deductibility of certain interest expenses and amounts paid under a personal guarantee, certain substantiation requirements, and the applicability of present value concepts in determining the amount deductible. Proposed regulations were published on June 28, 2022.

6. Guidance regarding amounts qualifying as distributions of income exempt from estate tax under §2056A.

7. Regulations under §20.2056A-2 for qualified domestic trust elections on estate tax returns, updating obsolete references.

- PUBLISHED 08/21/24 in FR as REG-119683-24 (FILED 08/20/24).

8. 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.

9. Regulations under §2642 regarding the redetermination of the inclusion ratio on the sale of an interest in a trust for GST exemption purposes.

10. Final regulations under §2801 regarding the tax imposed on U.S. citizens and residents who receive gifts or bequests from certain expatriates. Proposed regulations were published on September 10, 2015.

11. Final regulations under §6011 identifying a transaction involving certain uses of charitable remainder annuity trusts as a listed transaction. Proposed regulations were published on March 25, 2024.

12. Guidance updating the user fee for estate tax closing letters.

Several of the items on the Plan (and on Plans from the last several years) are discussed in more detail below.

Proposed regulations were issued in 2022 with respect to two of the items on the Plan (Numbers 3 [abuse exception to the anti-clawback regulation], and 5 [§2053]). Final regulations were issued for the GST exemption allocation extensions project (Number 8 on the 2023-2024 Plan and deleted in the 2024-2025 Plan) on May 3, 2024. See Item 6 below.

Cathy Hughes, Treasury Department Office of Tax Policy, at the ABA Tax Section meeting in May 2024, listed four sets of final regulations that were expected by the end of the summer of 2024: (1) basis consistency (Number 2 on the 2023-2024 Plan, final regulations were issued September 17, 2024, discussed in Item 4 below); (2) imposition of restrictions on estate assets during the six-month alternate valuation period under §2032(a) (Number 4 on the 2023-2024 Plan); (3) final regulations under §2801 regarding taxation of gifts or bequests from "covered expatriates" (Number 9 on the 2023-2024 Plan, final regulations were issued January 10, 2025, discussed in Item 7); and (4) updating obsolete references (presumably Number 6 on the 2023-2024 Plan). *See* Erin Schilling, *Finalized Estate Tax Regulations Expected This Summer,* BLOOMBERG DAILY TAX REPORT (May 3, 2024). The basis consistency final regulations, proposed regulations updating obsolete QDOT references, and §2801 final regulations regarding gifts or bequests from covered expatriates have been completed. Apparently, the alternate valuation date final regulations will come later.

b. **Basis Consistency (Number 2).** The basis consistency provisions of §1014(f) and §6035 were enacted as part of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, enacted July 31, 2015, applicable to estates for which estate tax returns are filed after the date of enactment (i.e., after July 31, 2015). Form 8971 and its instructions were released on January 29, 2016, and revised draft instructions were released in June and in October 2016, with a September 2016 date. Final regulations were issued on September 16, 2024, and published in the Federal Register on September 17, 2024. (T.D. 9991, 89 FED. REG. 76356, Sept. 17, 2024). For a detailed discussion of the final regulations, see Item 4 below.

c. **Anti-Abuse Exceptions to Anti-Clawback (Number 3).** Number 3 addresses the anti-abuse exception to the clawback regulation. The IRS released proposed regulations on April 26, 2022, discussed in Item 5 below.

d. **Alternate Valuation Period (Number 4).** This project has been on the Plan for a number of years. For further discussion of this project see Item 6.d of Estate Planning Current Developments and Hot Topics (December 2019) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** These final regulations may be among the next projects that will be completed in the gifts and estates area, but their issuance is not imminent.

e. **Section 2053 Proposed Regulations (Number 5).** Proposed regulations were released on June 24, 2022, and published in the Federal Register on June 28, 2022 (REG-130975-08). These regulations eventually could have a profound impact on planning and the deductibility of certain administrative expenses for estate tax purposes.

The proposed regulations address four general topics about deductions for claims and administration expenses under §2053: (1) applying present value concepts, (2) deductibility of interest, (3) deductibility of amounts paid under a decedent's personal guarantee, and (4) curing technical problems of references in existing regulations to a "qualified appraisal" for valuing claims by instead describing requirements for a "written appraisal document." For a detailed discussion of the proposed regulations, see Item 7 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-**

partners/advisor-insights. For a summary of the especially important provisions about applying present value concepts and the deductibility of post-death interest, see Item 6 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

f. **Qualified Domestic Trust Elections (Number 6).** The IRS released proposed regulations on August 20, 2024, which were published in the Federal Register on August 21, 2024, updating various outdated references regarding qualified domestic trusts (QDOTs). No substantive changes to the rules for QDOTs are included.

g. **GST Exemption Allocation (Number 8).** Proposed regulations regarding §2642(g) were published on April 17, 2008 (REG-147775-06). Final regulations were published on May 6, 2024 (89 Fed. Reg. 37116-37127), discussed in Item 6 below.

h. **Post-AJCA Reportable and Listed Transaction Notices Will Not Be Enforced; Proposed and Final Regulations Being Promulgated.** The American Jobs Creation Act of 2004 (AJCA) added and amended various Code sections providing penalties for failing to disclose "reportable transactions" and a sub-category of reportable transactions called "listed transactions," as described in Reg. §1.6011-4. The IRS has issued various Notices identifying certain transactions as listed and other reportable transactions. The Tax Court, Sixth Circuit, and Eleventh Circuit have all held that Notices identifying particular transactions as reportable or listed transactions did not comply with the notice-and-comment rulemaking procedures under the Administrative Procedure Act. *Green Rock LLC v. Internal Revenue Serv.*, 104 F.4th 220 (11th Cir. 2024) (issuance of Notice 2017-10 labeling certain syndicated conservation easement deals as listed transactions was in violation of the APA; ruling does not address validity of listed transaction designations other than Notice 2017-10), *acq*. AOD 2024-10, 2024-52 IRB 1354; *Mann Construction, Inc. v. United States*, 27 F.4th 1138 (6th Cir. 2022); *Green Valley Investors, LLC v. Commissioner*, 159 T.C. 80 (2022). *Green Rock LLC* reasoned that statutory penalties imposed under the AJCA revisions are what render a listing notice as a legislative rule subject to notice-and-comment rulemaking procedures. For a more detailed discussion of those developments, see Item 21.c of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

The IRS issued an acquiescence in *Green Rock LLC*. AOD 2024-01, 2024-52 IRB 1354. The acquiescence states that the IRS will not enforce disclosure and reporting requirements and will not assert penalties regarding post-AJCA reportable transactions identified in Notices that did not comply with notice-and-comment procedures.

> Despite our disagreement with the Eleventh Circuit's ruling, we recognize that there is controlling adverse precedent in both the Sixth Circuit and the Eleventh Circuit, as well as in the Tax Court. The reasoning of this precedent applies to all existing post-AJCA listing notices, which are not distinguishable with respect to the application of notice-and-comment rulemaking procedures. The Sixth Circuit, Eleventh Circuit, and Tax Court have all held that the post-AJCA notices create new substantive duties, the violations of which can lead to financial penalties and criminal sanctions. The Eleventh Circuit explicitly noted that 28 of the 34 existing listed transactions, issued pre-AJCA, were not backed by statutory penalties at the time of their issuance, and held that "penalties and criminal sanctions" are what render a listing notice a "legislative" rule subject to notice-and-comment rulemaking procedures. *Green Rock*, 104 F.4th at 229. Therefore, the reasoning of this adverse precedent applies to all existing post-AJCA reportable transaction notices.
>
> The Service will follow the Sixth and Eleventh Circuit and the Tax Court decisions in all circuits and will no longer defend post-AJCA reportable transaction notices.… The Service will not take these steps in cases where there is a court-approved settlement or closing agreement relating to the aforementioned penalties, there is an existing final court decision, or the applicable statutes of limitations have expired. This AOD does not apply to pre-AJCA notices.

AOD 2024-01, 2024-52 IRB 1354.

The IRS is in the process of issuing proposed and final regulations regarding various "listed transactions" considering those cases.

Final regulations were released October 7, 2024, (TD 10007, RIN 1545-BQ39) treating conservation easements as listed transactions.

Proposed regulations were released March 22, 2024 (scheduled to be published in the Federal Register on March 25, 2024), identifying as a listed transaction the use of abusive charitable remainder annuity trusts that purchase a single premium immediate annuity (SPIA) to permanently avoid recognition of ordinary income and/or capital gain. Prop. Reg. §1.6011-15. The beneficiary would treat "the annuity amount payable from the trust as if it were, in whole or in part, an annuity subject to section 72, instead of carrying out to the beneficiary amounts in the ordinary income and capital gain tiers of the trust in accordance with section 664(b)." REG-108761-22, preamble at 13-14.

i. **Foreign Trusts and Foreign Gifts to U.S. Persons.** Extensive proposed regulations (153 pages) were released on May 7, 2024, dealing with foreign trusts and foreign gifts. REG-124850-08. The proposed regulations revise the standards for U.S. taxpayers to report large foreign gifts and transactions with foreign trusts (including loans and distributions from and the use of property of foreign trusts). For a brief overview of the proposed regulations, see Andrew Velarde, *Detailed Foreign Trust, Gift Regs Address Reporting Penalties*, 183 TAX NOTES 1261 (May 13, 2024).

j. **Inflation Adjustments.** Inflation adjustments using the C-CPI-U numbers published by the Bureau of Labor Statistics and based on information through August 31 (typically available in mid-September of each year) for 2021, 2022, 2023, 2024, and 2025 were announced in Rev. Proc. 2020-45, Rev. Proc. 2021-45, Rev. Proc. 2022-38, Rev. Proc. 2023-34, and Rev. Proc. 2024-40 respectively. Some of the adjusted amounts are as follows:

- Basic exclusion amount and GST exemption – $13,990,000 in 2025, $13,610,000 in 2024, $12,920,000 in 2023, $12,060,000 in 2022, $11,700,000 in 2021;
- Gift tax annual exclusion – $19,000 in 2025, $18,000 in 2024, $17,000 in 2023, $16,000 in 2022, $15,000 in 2018-2021 (observe that the annual exclusion was $15,000 for four years [2018-2021], but it has increased by $1,000 in each of 2022-2025;
- Estates and trusts taxable income for top (37%) income tax bracket – $15,650 in 2025, $15,200 in 2024, $14,450 in 2023, $13,450 in 2022, $13,050 in 2021;
- Top income tax bracket for individuals – $751,600/$626,350 (married filing jointly/single) in 2025, $731,200/$609,350 in 2024, $693,750/$578,125 in 2023, $647,850/$539,900 in 2022, $628,300/$523,600 in 2021;
- Taxable income threshold for §199A qualified business income – $394,600/$197,300 (married filing jointly/single) in 2025, $383,900/$191,950 in 2024, $364,200/$182,100 in 2023, $340,100/$170,050 in 2022, $329,800/$164,900 in 2021;
- Standard deduction – $30,000/$15,000 (married filing jointly/single) in 2025, $29,200/$14,600 in 2024, $27,700/$13,850 in 2023, $25,900/$12,950 in 2022, $25,100/$12,550 in 2021;
- Non-citizen spouse annual gift tax exclusion – $190,000 in 2025, $185,000 in 2024, $175,000 in 2023, $164,000 in 2022, $159,000 in 2021;
- Section 6166 "two percent amount" – $1,900,000 in 2025, $1,850,000 in 2024, $1,750,000 in 2023, $1,640,000 in 2022, $1,590,000 in 2021; and
- Special use valuation reduction limitation – $1,420,000 in 2025, $1,390,000 in 2024, $1,310,000 in 2023, $1,230,000 in 2022, $1,190,000 in 2021.

The increase of the basic exclusion amount to almost $14 million in 2025 suggests that if the estate and gift exclusion amount decreases from $10 million (indexed) to $5 million (indexed) in 2026, it would be some amount over $7 million in 2026.

k. **IRS Tweaking Estate and Gift Tax Returns for e-Filing; Revised Gift Tax Return for Reporting 2024 Gifts.** The IRS is in the process of making some changes to estate and gift tax returns as it plans for allowing e-filing of estate and gift tax returns. This is part of the IRS's goal to go paperless by the 2025 filing season. Some estate tax returns span thousands of pages and are shipped in

boxes to the IRS. "The bevy of exhibits and attachments that often accompanies estate and gift tax returns makes the transition from paper to electronic filing of those returns a challenge." Attachments often have "unstructured data" that is not easily converted to a digital format. *See* Jonathan Curry, *ABA Section of Taxation Meeting: E-Filing Could Prompt Tweaks to Estate and Gift Tax Returns*, 182 TAX NOTES FEDERAL 961 (Jan. 29, 2024).

The Form 709 was changed for reporting 2024 gifts. A brief summary of changes in the 2024 Form 709 is in Item 9 below.

l. **Legal Effect of Proposed Regulations.** This item mentions various proposed regulations that have been issued in response to items that have appeared on Priority Guidance Plans. Bear in mind that proposed regulations do not become effective until final regulations are issued, and typically they take effect as to transactions occurring after that time. (On rare occasions, proposed regulations state they will apply, once the regulations are finalized, as to transactions after the date the proposed regulations are released. The anti-abuse proposed regulation regarding the anti-clawback rule takes that approach, as described in Item 5 below.) While planners may be concerned about provisions in proposed regulations, bear in mind that "proposed regulations, … unlike final regulations, absolutely don't have the force of law. Thus, taxpayers can't be penalized in any way for failing to follow them …." Redd, *What Basis Consistency Regulations?*, TRUSTS & ESTATES 8, at 10 (May 2022). The article by Clary Redd cites very interesting comments in several cases about proposed regulations:

> *Zinniel v. Commissioner*, 883 F.2d 1350 (7th Cir. 1989), *aff'g* 89 T.C. 357, at 369 (proposed regulations "carry no more weight than a position advanced on brief" (quoting *F.W. Woolworth Co. v. Comm'r*, 54 T.C. 1233, 1265 (1970)); *see also LeCroy Research Sys. Corp. v. Comm'r*, 751 F.2d 123, 127 (2d Cir. 1984) ("Proposed regulations are suggestions made for comment; they modify nothing.")

Id. at n.15.

4. Basis Consistency Final Regulations

a. **Historical Background.** The basis consistency provisions of §1014(f) and §6035 were enacted as part of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, enacted July 31, 2015. Section 1014(f) provides that for federal income tax purposes the basis of property to which §1014(a) applies (*i.e.*, property acquired from a decedent but with various exceptions) shall not exceed the final value determined for estate tax purposes, or if the final value has not been determined, the value provided in a statement to the decedent's recipients. Section 6035 provides that if the estate is required to file an estate tax return under §6018(a), the executor is required to submit valuation information reports to recipients and to the IRS. Penalties apply (potentially very substantial penalties) if the required reports are not given. These statutory provisions apply to estates for which estate tax returns are filed after the date of enactment (i.e., after July 31, 2015).

Form 8971 and its Instructions were released on January 29, 2016, and revised draft instructions were released in June and in October 2016, with a September 2016 date. No later versions of the Form or Instructions have been issued. Updated information about Form 8971 is posted at **https://www.irs.gov/forms-pubs/about-form-8971**. (It was last updated August 6, 2024, to update where to file Form 8971—at Internal Revenue Service, Stop 824G, 7940 Kentucky Drive, Florence, KY 41042.)

Temporary and proposed regulations regarding §1014(f) and §6035 were published in the Federal Register on March 4, 2016. Various provisions in the proposed regulations were very controversial. The IRS received over thirty written comments about the proposed regulations. ACTEC filed very detailed comments on May 27, 2016, and ACTEC representatives testified at the hearing with the IRS about the proposed regulations.

For a detailed discussion about the legislative history behind the basis consistency provisions, the Form 8971, and the proposed regulations, see Item 5.b of Aucutt, *Washington Update: Pending and Potential Administrative and Legislative Changes* (Mar. 2024) found **here** and Akers**,** *Basis Consistency Temporary and Proposed Regulations* (Mar. 25, 2016) found **here**, both available at

www.bessemertrust.com/for-professional-partners/advisor-insights and Akers, *The Executor's Job Gets Tougher: Basis Consistency and Selected Other Income Tax Issues Facing Executors*, 51st ANN. HECKERLING INST. ON EST. PL. ¶1803.1 (2017).

b. **Due Date for Statements to Beneficiaries Reporting Property the Beneficiaries Have Not Yet Acquired.** One of the most controversial provisions of the proposed regulations (that would have been problematic for many if not most estates required to file basis consistency reports) was that "Statements" (Schedules A to Form 8971) had to be provided to all beneficiaries by the earlier of 30 days after the due date of the estate tax return or the date that is 30 days after the date the estate tax return is filed with the IRS. If the executor had not determined what property would be distributed to each beneficiary by that time, the executor had to report on the Statement for each beneficiary *all* the property that the executor could use to satisfy the beneficiary's interest. Commenters complained that this requirement would cause duplicate reporting, may confuse beneficiaries by leading them to expect to receive all the property reported to them, and would require disclosure of private information about many if not most estate assets to all potential beneficiaries (which might result in conflicts and litigation among beneficiaries with competing interests).

Commenters noted that §6035(a)(1) requires the executor to furnish Statements "to each person *acquiring* any interest in property included in the decedent's gross estate," and the common meaning of "acquiring" and the way it is used in other Code sections refers to something already received.

The IRS adopted that interpretation of the term "acquiring," and adjusted the due date of Statements for property that beneficiaries have not received by 30 days after the estate tax return is due or is filed before the due date. The final regulations continue to require that for each beneficiary who acquired property on or before the due date or earlier filing of the estate tax return, the due date of Statements is 30 days after the due date or earlier filing of the return. But the due date for furnishing a Statement to a beneficiary who acquires property at a later date is January 31 of the calendar year following the year of acquisition. (That will give the beneficiary plenty of time to properly report tax information after the beneficiary received the property, for example, reporting income from the beneficiary's sale of the property.) A beneficiary is treated as "acquiring" property when title vests in the beneficiary or the beneficiary has sufficient control or connection with the property that the beneficiary can take action related to the property for which basis of the property is important (such as selling or depreciating the property). That usually occurs when the property is distributed but may occur upon the death of the decedent for property passing by contract or operation of law. Reg. §1.6035-1(c)(4).

If the executor anticipates that a beneficiary will receive certain property, the executor has the option to furnish Statement(s) to any such beneficiaries within 30 days of filing the estate tax return. That could reduce the burden associated with these filing requirements if the executor believes certain beneficiaries will receive particular property. If a different beneficiary ends up receiving that property, the executor must file a supplemental Information Return with the IRS and a revised Statement to the beneficiary. Reg. §1.6035-1(c)(5), §1.6035-(d)(2)(iv). (Such supplemental returns are required within 30 days after information becomes available to conclude that supplemental reporting is required. Reg. §1.6035-1(d)(4).)

Coordinating changes are made to the information that must be included in the initial and supplemental Information Returns (Form 8971). Statements are attached (as Schedules A) for property distributed before the due date or earlier filing date of the estate tax return and Statements that the executor elects to furnish by that date as to property the executor anticipates distributing to particular beneficiaries. Reg. §1.6035-1(c)(1). The Information Return must be filed by the due date even if no Statements are attached. Preamble to Final Regulation, T.D. 9991, 89 FED. REG. 76356, at 76365 (Sept. 17, 2024).

The final regulations do not address or authorize the executor to give a Schedule A to all beneficiaries listing all assets that could be distributed to them (as was required in the proposed regulations). An executor who does not have privacy concerns about giving information to all beneficiaries about all

undistributed assets of the estate may wish to do that when the initial Form 8971 is filed so the executor would not have to submit multiple Schedules A in subsequent years as assets are distributed.

c. **Removal of Zero Basis Rule for Unreported Property.** The proposed regulations surprisingly took the position that after-discovered or omitted property gets a basis of zero if the property is not reported on an estate tax return before the period of limitations on assessments has expired. Prop. Reg. §1.1014-10(c)(3)(i)(B).

Comments to the IRS argued that the zero basis rule was not authorized by the statute (§1014(f), which applies only to property reported on an estate tax return, the IRS's regulatory authority was to provide exceptions to the basis consistency requirement not to expand basis consistency, and the Code does not support denying at least allowing a carryover basis for an inherited asset). The IRS rejected those arguments.

Comments also urged that the practical effects of the zero basis rule are onerous, unduly harsh, and unfair (beneficiaries do not control reporting on estate tax returns by executors and unreported property is more likely to arise by an inadvertent omission or as a result of being undiscovered, rather than willful omission). The preamble to the final regulations recognizes those practical effects and also observes that existing Federal tax enforcement mechanisms (including criminal liability) serve to deter willful nonreporting on the estate tax return.

The final regulations delete the zero basis provisions in proposed regulation §1.1014-10(c)(3)(i)(B). The final regulations do not specifically address after-discovered or omitted property, but the preamble to the final regulations addresses the comments about the zero basis rule and concludes with this summary.

> The rule identifying property subject to the consistent basis requirement in §1.1014-10(c)(1)(i) of the final regulations, together with the definition of the term *included property* in §1.1014-10(d)(4) of the final regulations, is sufficient to clarify the scope of the consistent basis requirement, and therefore these final regulations do not include a specific rule on the basis of unreported property.

Preamble to Final Regulations, T.D. 9991, 89 FED. REG. 76356 at 76361 (Sept. 17, 2024) (emphasis included in original).

d. **Eliminating the Subsequent Transfer Reporting Requirement for All Beneficiaries Other Than Trustees.** The proposed regulations also surprisingly included a subsequent transfer reporting requirement. If a recipient of an asset in the gross estate makes a subsequent gift or distribution to a "related transferee" (which, for some strange reason, included a grantor trust but not a non-grantor trust for a related party), the recipient must file a Schedule A (beneficiary Statements are Schedules A attached to the Form 8971) with the IRS and transferee reporting the change in ownership and final estate tax value of the property. Prop. Reg. §1.6035-1(f).

Comments to the IRS about this requirement included that the IRS lacks authority to require reporting of subsequent transfers, the reporting requirement could continue for generations, the requirement would be impossible for the IRS to monitor and enforce, and the requirement would be particularly unfair to unsophisticated individual recipients who would likely be unaware of the reporting requirement and would be more likely to become subject to noncompliance penalties. The IRS and Treasury reconsidered the benefits and burdens of the proposed subsequent transfer reporting requirement and concluded that the burden of the requirement, including penalties for noncompliance, is too heavy to impose on individual beneficiaries. However, the IRS and Treasury concluded that for trustees of trusts the subsequent transfer reporting requirement would not be sufficiently burdensome to outweigh the needs of and benefits to the IRS and trust beneficiaries. Preamble to Final Regulations, T.D. 9991, 89 FED. REG. 76356, at 76372 (Sept. 17, 2024).

The final regulations omit the subsequent transfer reporting requirement for individual recipients of property that was in Prop. Reg. §1.6035-1(f), but the requirement continues to apply to trustees of beneficiary trusts when they make distributions, including direct distributions to trust beneficiaries and distributions pursuant to the exercise or lapse of a power of appointment (whether general or limited). The subsequent transfer reporting requirement would apply to trustees of trusts that receive

property from beneficiary trusts (so the reporting obligation continues until property is distributed to an individual not in trust). But the reporting requirement does not apply to a sale or other transaction that is a recognition event for income tax purposes (whether or not resulting in a gain or loss) if the property's basis is no longer determined by reference to the estate tax value of the property. Reg.§1.6035-1(h)(1), (3).

The subsequent transfer report by trustees is due by January 31 of the calendar year following the year of distribution. Reg. §1.6035-1(h)(2).

Some commenters have noted that the subsequent transfer reporting requirement for trustees will be a burden for individual trustees, many of whom will be unaware of the requirement. See Wallace, *Estate Tax Basis Consistency Regs to Reduce Compliance Burden*, 184 TAX NOTES FEDERAL 2552 (Sept. 23, 2024).

e. **Ability of Beneficiaries to Challenge Value.** Several commenters requested that a procedure be added under which a beneficiary could challenge the determination of final value since the beneficiary has no control over the executor's reporting on the estate tax return or involvement in any redetermination of value in an examination or court proceeding. The IRS rejected that request because of "[a]dministrability and other concerns," including that it would leave the IRS in the same position of litigating valuation issues with a beneficiary, the same as before the enactment of §1014(f). However, the IRS and Treasury are considering future guidance that may allow a beneficiary to produce "certain credible evidence of value" during some limited period of time "if the credible evidence of value indicates the reported value represents a substantial understatement of value." Preamble to Final Regulations, T.D. 9991, 89 FED. REG. 76356, at 76362 (Sept. 17, 2024).

f. **Excepting Certain Types of Property From Consistent Basis and/or Reporting Requirements.**

(1) **Estate Tax Returns Filed On or Before July 31, 2015.** The consistent basis provisions of §1014(f) and the reporting requirements under §6035 apply to estates for which estate tax returns are filed after July 31, 2015. The final regulations clarify that the basis consistency and reporting requirements do not apply to estates for which the estate tax return was filed on or before July 31, 2015, even if the due date of the return is after July 31, 2015, or if one or more supplements to the return are filed after July 31, 2015. Reg. §1.1014-10(c)(1)(ii); §1.6035-1(b)(1).

(2) **Overview of Types of Excepted Property.** The proposed regulations provide as exceptions to the consistent basis requirement only property that qualifies for the marital or charitable deduction and tangible personal property for which an appraisal is not required under §20.2031-6(b). Prop. Reg. §1.1014-10(b)(2). The proposed regulations provided four exceptions of types of property that do not have to be reported under §6035: (i) cash (other than a coin collection or other coins or bills with numismatic value); (ii) income in respect of a decedent; (iii) tangible personal property for which an appraisal is not required; and (iv) property sold or disposed of in a transaction in which capital gain or loss is recognized. Prop. Reg. §1.6035-1(b)(1). The final regulations add clarifications and add some types of excepted property.

(3) **Property *Wholly* Deductible Under Marital or Charitable Deductions.** Property qualifying for the estate tax marital or charitable deduction is not subject to the consistent basis provisions of §1014(f) (but generally is subject to the reporting requirements under §6035). The final regulations clarify that property qualifying for only a *partial* marital or charitable deduction is not excepted from the consistent basis requirement. The preamble to the final regulations lists several examples:

> (1) a charitable remainder trust, a charitable lead trust, or a pooled income fund; (2) a trust subject only to a partial QTIP election under section 2056(b)(7); and (3) property divided between the decedent's surviving spouse and a charity if the sum of the deductions for the two interests given to those recipients is less than the value of the property included in the value of the gross estate.

Preamble to Final Regulation, T.D. 9991, 89 FED. REG. 76356, at 76358-59 (Sept. 17, 2024). As to that third example, the actual language of the final regulation is broad enough to include property divided between two charities if the sum of the deductions is less than the gross estate value, as occurred in *Estate of Warne v. Commissioner*, T.C. Memo. 2021-17. Reg. §1.1014-10(c)(2)(xi).

(4) **Taxable Termination Property Subject to GST Tax and Surviving Spouse's One-Half Community Property Interest.** The consistent basis and reporting requirements apply only to property included in the decedent's gross estate. The proposed regulations provided a long list of items not included in the gross estate and therefore not subject to the requirements. The final regulations add several additional exceptions.

(a) **Taxable Termination Property Not Subject to Consistent Basis.** The final regulations add that property subject to a taxable termination for GST tax purposes is not in the gross estate and therefore is not subject to the consistent basis requirement. Reg. §1014-10(c)(2)(xiii).

(b) **Spouse's One-Half Community Property Interest Not Subject to Consistent Basis and Reporting Requirements.** The surviving spouse's one-half of community property is not in the decedent's gross estate for estate tax purposes and therefore is not subject to the consistent basis and reporting requirements. Reg. §1014-10(c)(2)(xii); §1.6035-1(e)(1). If the executor makes a non pro rata division and distribution of community property under applicable state law, property included in the decedent's gross estate that is distributed to the surviving spouse in lieu of the spouse's interest in community property pursuant to state law must be reported on the Information Return and on a Statement to the spouse. Reg. §1.6035-1(e)(1).

(5) **Cash**. The proposed regulations did not include cash as property not subject to the consistent basis requirement and described cash that is not subject to the reporting requirement fairly generically. Prop. Reg. §1.6035-1(b)(1). The final regulations add more guidance for cash-type assets that are not subject to the consistent basis or reporting requirements. The following are not subject to either the consistent basis or reporting requirements: U.S. dollars (defined to include physical bills and coins with values equal to their face values, Reg. §1.1014-10(d)(6)), U.S. dollar-denominated demand deposits, certificates of deposit denominated in U.S. dollars, cash collateral denominated in U.S. dollars held by a third party to secure a liability, money market funds, life insurance proceeds payable in a lump sum in U.S. dollars, and tax refunds (Federal, state, or local) payable in U.S. dollars. Reg. §1014-10(c)(2); §1.6035-1(f)(2).

The preamble to the final regulations lists as examples the following items that do not fall within the list of excepted property in §1.6035-1(f)(2) of the final regulations:

> (1) currency other than in United States dollars; (2) any payments not made in United States dollars; (3) life insurance policies not paid in United States dollars, and life insurance policies payable to a beneficiary in United States dollars annually or at some other interval for a period of time after the decedent's death; (4) notes (other than an installment obligation subject to section 453) that the decedent did not forgive in full upon the decedent's death, whether or not expressed in United States dollars; (5) U.S. Savings bonds; and (6) accounts receivable (unless such property consists entirely of the right to receive an item of income in respect of a decedent as defined in section 691 (IRD)). This property generally has basis, its value generally may not equal its face value and, accordingly, this property is not excepted from the reporting requirements in the final regulations. For the same reasons, digital assets as defined in section 6045(g)(3)(D), including virtual currency or cryptocurrency, do not fall within the list of excepted property set forth in § 1.6035-1(f)(2) of the final regulations.

Preamble to Final Regulations, T.D. 9991, 89 FED. REG. 76356, at 76368 (Sept. 17, 2024).

(6) **Household and Personal Effects.** In the exception for "tangible personal property for which an appraisal is not required under §20.2031-6(b)," the final regulations change "tangible personal property" to "household and personal effects" to conform more closely to §20.2031-6(b). This refers to household and personal effects that do not have a marked artistic or intrinsic value over $3,000.

(7) **Notes Forgiven by Decedent.** The final regulations add as an exception to the consistent basis and reporting requirements for notes that are forgiven in full by the decedent, whether or not denominated in U.S. dollars. Reg. §1014-10(c)(2)(viii); §1.6035-1(f)(2)(viii).

(8) **Property Whose Basis is Unrelated to the Federal Estate Tax Value of the Property.** The proposed regulations except income in respect of decedent property from the consistent basis and reporting requirements. The final regulations add to the consistent basis and reporting

exceptions several other types of assets whose basis is unrelated to the estate tax value of the property:

- Annuity contracts subject to §72 and amounts received as an annuity under §72;
- Income in respect of a decedent property described in §691;
- Amounts received under installment obligations subject to the §453 installment method;
- Stock of a passive foreign investment company (§1296(i)) if the basis is the decedent's basis immediately before death;
- Retirement plans, deferred compensation plans and IRAs expressed entirely in U.S. dollars;
- Bonds to the extent redeemed by the issuer for U.S. dollars prior to being distributed to a beneficiary;
- Property included in the gross estate of a beneficiary who died before the due date of the Information Report (the Form 8971); and
- Any other property that may subsequently be identified by the IRS as excepted property.

Reg. §1.1014-10(c)(2)(x); §§1.6035-1(f)(2)(xi).

(9) **Property Sold or Disposed of in Recognition Events.** Assets sold or disposed of in recognition events (whether or not resulting in gain or loss and whether any gain is capital or ordinary) are not subject to the reporting requirements under §6035. The final regulations add examples of such property.

> In addition, in response to requests for additional clarification, §1.6035-1(f)(2)(x)(A) through (E) of the final regulations include examples of excepted property pursuant to this rule as follows: (1) property distributed in satisfaction of a pecuniary bequest on which the estate recognizes any gain or loss pursuant to §1.661(a)-2(f); (2) property for which an election under section 643(e)(3) has been made for the estate to recognize any gain or loss; (3) interests in business entities that are redeemed for United States dollars prior to distribution to a beneficiary; (4) property disposed of in a transaction described in section 267(a) and (b)(13), which disallows a loss from the sale or exchange of property, directly or indirectly, between the executor and the beneficiary of the estate, except in a sale or exchange in satisfaction of a pecuniary bequest; and (5) property subject to the mark to market accounting method at the time of distribution from the estate or from the decedent's revocable trust.

Preamble to Final Regulations, T.D. 9991, 89 FED. REG. 76356, at 76369-70 (Sept. 17, 2024).

g. **Information Returns and Supplemental Information Returns.** The final regulations add various clarifications regarding information to be reported on initial and supplemental Information Returns (Form 8971), including the situations for which supplemental Information Returns must be filed.

One of the clarifications is that an Information Return must be filed even if all distributions from the estate are of property excepted from the reporting requirements. If excepted property exists, the executor must disclose on the Information Return that some or all of the property included in the gross estate is excepted from the full reporting requirements, but the executor is not required to identify the excepted property or provide a Statement to a beneficiary with regard to excepted property. Reg. §1.6035-1(f)(1).

Several clarifications are made regarding reporting to beneficiary trusts. The beneficiary Statement is generally given to the trustee of the trust, but the final regulations allow the executor to furnish the Statement directly to trust beneficiaries, with a copy to the trustee, "if the executor reasonably believes that it is unlikely that the beneficiary trust will depreciate, sell, or otherwise dispose of the property subject to reporting in a recognition event for income tax purposes but instead will distribute the property in kind to the trust beneficiaries." Reg. §1.6035-1(g)(2)(i). If a beneficiary trust does not have at least one trustee and a tax ID number by the due date for filing the Information Return, the executor "must report on the Information Return that the beneficiary trust has not yet been established." Once the beneficiary trust has been established and the trust information becomes

available to the executor, a supplemental Information Return and Statement must be filed within 30 days. Reg. §1.6035-1(g)(2)(ii).

h. **Penalties.** The regulations to §6721 (failure to file correct information returns) and §6722 (failure to furnish correct payee statements) are modified in the final regulations to clarify that those sections apply to Information Returns and Statements, respectively, under §6035 as to Information Returns and Statements required to be filed on or after January 1, 2024. The preamble further clarifies the penalty provisions.

> A penalty applies separately to each initial or supplemental Information Return that the executor is required to file with the IRS, and to each initial or supplemental Statement that the executor is required to furnish to a beneficiary. Accordingly, only one penalty under section 6721 may be imposed for filing an incorrect Information Return, even if copies of multiple required Statements are not attached to the Information Return, but multiple penalties under section 6722 may be imposed for furnishing multiple incorrect Statements, even if the Statements were filed with the IRS as attachments to a single Information Return.

Preamble to Final Regulations, T.D. 9991, 89 FED. REG. 76356, at 76372 (Sept. 17, 2024). The final regulations also refer to §6724 and applicable regulations relating to waivers of the penalties if it is shown that the failure was due to reasonable cause and not to willful neglect. Reg. §1.6035-1(i).

i. **Property Subject to Debt.** The final regulations keep the helpful provision that the value of property for basis purposes is the gross value undiminished by recourse or non-recourse debt, regardless of whether the estate tax return reports the net value or separately reports the gross value and the outstanding debt. Reg. §1.1014-10(b)(3)(i).

j. **Effective Date of Regulations.** Consistent with §7805(b)(1), the §1.1014-10 consistent basis final regulations apply to estates of decedents if the estate tax return is filed after the date of publication in the Federal Register, and the §1.6035-1 reporting final regulations apply to estates required to file an estate tax return if the return is filed after the date of publication in the Federal Register (i.e., after September 17, 2024). Reg. §1.1014-10(f); §1.6035-1(j). However, the consistent basis and reporting requirements in general continue to apply to estates for which estate tax returns are filed after July 31, 2015.

5. Limitation on Anti-Clawback Special Rule, Proposed Regulations

a. **Background.** The IRS published proposed regulations in the Federal Register on April 27, 2022. REG-118913-21. The preamble to the anti-clawback final regulations, published on November 26, 2019, stated that further consideration would be given to the issue of whether gifts that are not "true inter vivos transfers," but rather are includible in the gross estate would be excepted from the anti-clawback relief provisions. Two and a half years later, these proposed regulations answer that question affirmatively.

b. **General Anti-Clawback Rule.** If a client made a $12 million gift in 2022 (when the gift exclusion amount was $12.06 million) but dies in 2026 after the basic exclusion amount has sunsetted to $5 million indexed (say $7 million), the $12 million is added into the estate tax calculation as an adjusted taxable gift, but the estate exclusion amount is only $7 million. So, will estate tax be owed on the difference? The special anti-clawback rule in Reg. §20.2010-1(c)(1) allows the estate to compute its estate tax credit using the higher of the BEA applied to gifts made during life or the BEA applicable on the date of death. Therefore, in the example above, if the donor dies when the BEA is $7 million, the $12 million gift would be included in the estate tax calculation as an adjusted taxable gift, but the available exclusion amount would be the larger of the $7 million BEA at the date of death or the $12 million of BEA applied to gifts made during life, the larger of those being $12 million. For a detailed discussion of the estate tax calculation process and the operation of the anti-clawback special rule, see Item 4 of Estate Planning Current Developments and Hot Topics (December 2019) found **here**, and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

c. **General Anti-Abuse Exception.** Proposed Reg. §20.2010-1(c)(3) provides that the special anti-clawback rule (which allows applying a BEA equal to the greater of the BEA at death or the BEA allowed against taxable gifts) does not apply to "transfers includible in the gross estate, or treated as includible in the gross estate for purposes of section 2001(b)" including, without limitation:

- Transfers includible in the gross estate under §2035, 2036, 2037, 2038, or 2042 (whether or not any part of the transfer was allowed a gift tax marital or charitable deduction);
- Transfers made by enforceable promise to the extent they remain unsatisfied at death;
- Transfers described in Reg. §25.2701-5(a)(4) and §25.2702-6(a)(1); and
- Transfers that would have been those types of transfers but for the elimination by any person of the interest, power, or property within 18 months of the decedent's death.

Exceptions to the Exception. The anti-clawback special rule continues to apply, however, to: (i) includible gifts in which the value of the taxable portion of the transfer, at the date of the transfer, was 5% or less of the total value of the transfer (observe that this would protect most GRAT transactions); and (ii) eliminations occurring within 18 months of death that were effectuated by termination of the period described in the original instrument by the mere passage of time or the death of any person.

d. **Examples.** Examples of transfers includible in the gross estate, gifts of promissory notes, gifts subject to §2701, gifts to a GRAT, gifts of DSUE amounts, and deathbed planning alternatives, as well as comments by the New York State Bar Association Tax Section to the proposed regulations are discussed in Item 6 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

e. **Effective Date.** Once the regulations have been published as final regulations, they are proposed to apply to estates of decedents dying on or after April 27, 2022 (the date of publication of the proposed regulations in the Federal Register). The rationale of this special effective date provision is that it is "the best way to ensure that all estates will be subject to the same rules" in case the BEA should be reduced before the regulations are finalized. Preamble of Reg. §20.2010-1. Accordingly, the proposed regulation would apply to gifts made at any time by a decedent who dies on or after April 27, 2022.

f. **Planning Implications.** For a discussion of ways in which the proposed regulations could impact various planning alternatives, see Martin Shenkman & Jonathan Blattmachr, *Proposed Clawback Regs May Undermine Some Estate-Planning Strategies*, TRUSTS & ESTATES 30 (July/Aug. 2022).

6. GST Exemption Allocations Final Regulations

a. **Overview.** Number 8 on the 2024-2025 Priority Guidance Plan estate tax provisions first appeared in the 2021-2022 Plan, but it is related to the final regulations regarding §2642(g) (Number 8 on the 2023-2024 Plan and deleted in the 2024-2025 Plan), first appearing in the 2007-2008 Plan. For a discussion of these projects, see Item 5.g of Aucutt, *Washington Update: Pending and Potential Administrative and Legislative Changes* (Mar. 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

Proposed regulations regarding §2642(g) were published on April 17, 2008 (REG-147775-06). Now, sixteen years later, final regulations have been issued. Reg. §26.2642-7, §301.9100-2(f), §301.9100-3(g). The final regulations (RIN 1545-BH63) were approved March 12, 2024, were released on May 3, 2024, and were published on May 6, 2024 (89 Fed. Reg. 37116-37127). A variety of changes (mostly rather minor) have been made between the proposed and final regulations. Some of the major changes are briefly summarized below.

b. **Section 2642(g)(1) Added in 2001.** The Economic Growth and Tax Relief Reconciliation Act of 2001(the "2001 Tax Act") added subsection (g)(1) to §2642, directing Treasury to publish regulations regarding circumstances in which extensions would be granted (1) to allocate GST exemption, (2) to elect out of automatic allocations of GST exemption to lifetime direct skips under §2632(b)(3) or to elect out of lifetime allocations to "GST trusts" under §2632(c)(5)(B)(i), or (3) to treat a trust as a GST trust as to any or all transfers made by such individual to such trust pursuant to §2632(c)(5)(A)(ii).

Before the addition of §2642(g)(1) in the 2001 Tax Act, such extensions of time were not available under Reg. §301.9100-3 ("9100 relief") because the deadlines for those actions were prescribed by

the Code, not by regulations. Shortly after the enactment of the 2001 Tax Act, Notice 2001-50 stated that taxpayers could seek extensions in those situations using 9100 relief. In addition, Rev. Proc. 2004-46, provides a simplified method for dealing with pre-2001 annual exclusion gifts that did not meet the special "vesting" requirements in §2642(c)(2).

c. **New Procedures Under Reg. §26.2642-7 Must be Used in Lieu of "9100 Relief."** The procedures under Reg. §26.2642-7 now must be used to obtain such extensions (including the automatic six-month extension under Reg. §301.9100-2(b), *see* Reg. §26.2642-7(i)(1)), and 9100 relief is no longer available for extensions regarding GST exemption allocations or elections. Reg. §301.9100-2(f) & §301.9100-3(g). Notice 2001-50 is obsolete. Cathy Hughes, Treasury Office of Tax Legislative Counsel, explained at the American Bar Association Tax Section 2024 Spring Meeting why the new procedures were needed. She explained that the procedures for 9100 relief

> don't mesh well or apply well in the context of the GST tax…. The purpose of this whole project was to tailor the standards for relief to the GST tax, which differs in many significant ways from income taxes.

Brett Ferguson & Chandra Wallace, *After 16 Years, Treasury Finalizes Rules for GSTT Extensions*, 183 TAX NOTES FEDERAL 1267 (May 13, 2024) (hereinafter "Treasury Finalizes Rules").

The regulations apply to requests for relief made on or after May 6, 2024. Pending extension requests filed before that date will continue to be processed under the 9100 relief provisions unless the taxpayer opts to withdraw the prior request and refile for relief under the new regulations.

Extension requests under the new regulations will be administered under the procedures for obtaining IRS letter rulings. Reg. §26.2642-7(i)(2). Cathy Hughes anticipates that the user fees applicable for 9100 relief will also apply to extension requests under Reg. §26.2642-7. *See* Treasury Finalizes Rules. User fees are discussed further in Item 6.k below.

d. **Simplified Procedures.** The simplified procedures under Rev. Proc. 2004-46 for certain pre-2001 annual exclusion gifts may still be used, and the IRS may in the future consider other situations in which simplified relief may be made available.

e. **Additional Proposed Regulations Coming.** The preamble to the final regulations explains that additional proposed regulations will be forthcoming to address the practical effect of a grant of an extension of time for making elections and the interplay between affirmative and automatic allocations. *See* Reg. §26.2642-7(b)(2) & §26.2642-7(f) ("[Reserved]" sections). The upcoming proposed regulations will include examples applicable to this new regulation and the newly proposed regulations. (These forthcoming proposed regulations apparently are related to Item 7 of the "Gifts Estates and Trusts" section of the 2023-2024 Priority Guidance Plan.)

f. **Provisions Regarding Basis for Determination.** The proposed and final regulations list various factors that are considered in determining whether relief will be granted. That depends on whether evidence is produced (including affidavits, as discussed below) establishing to the IRS's satisfaction that the transferor "acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the government." Reg. §26.2642-7(d)(1). The IRS will consider the nonexclusive list of factors contained in the regulations as well as other factors relevant to the particular situation. *Id*.

(1) **Reasonableness and Good Faith.** The final regulations add a paragraph making clear that this is a facts and circumstances test, and "as a general rule, no single factor (whether listed or not) will be determinative in all cases." All the listed factors may not be relevant in a particular situation. While no particular factor is necessarily determinative, evidence relating to a single factor may be sufficient in a particular situation to persuade the IRS to grant extension relief. Reg. §26.2642-7(d)(2). Factors described in the proposed regulations (and continued in the final regulations with minor revisions) include (i) intent of the transferor, (ii) intervening events, (iii) lack of awareness ("despite the exercise of reasonable diligence" as added by the final regulations) of the need to allocate GST exemption, (iv) consistency of the transferor including a pattern of electing (although the final regulations add that relief "will not be denied merely because a pattern of allocation or election does not exist or because the existing pattern changed at some point"), and (v) reasonable reliance on a qualified tax professional.

(2) **Prejudice to the Interests of the Government.** The proposed regulations describe a nonexclusive list of factors that are continued in the final regulations with some clarifications. An important factor emphasized in the regulations is that "[a]n attempt to benefit from hindsight will be deemed to prejudice the interests of the government." The final regulations add an example of when the use of hindsight will constitute prejudice:

> Prejudice also would exist if the transferor failed to make the allocation or election in order to wait to see (thus, with the benefit of hindsight) whether making an allocation of exemption or election would be more beneficial than not making the allocation or election. For instance, assume that a transferor funds several trusts with different property interests on the same date, and does not allocate GST exemption to any trust. Several years later, the transferor seeks relief to allocate GST exemption to the trust that enjoyed the greatest asset appreciation and thus constitutes the most effective use of the transferor's GST exemption. Relief will not be granted because the transferor attempted to benefit from hindsight and thereby acquire an economic advantage.

Reg. §26.2642-7(d)(3)(i). The hindsight factor is reiterated in a later section of the regulations and the "greatest appreciation" situation was repeated:

> Relief under this section will not be granted if the IRS determines that the requested relief is an attempt to benefit from hindsight by waiting to see which of multiple transfers, made at substantially the same time but consisting of different property interests, enjoyed the greatest appreciation and thus would constitute the most effective use of the transferor's GST exemption.

Reg. §26.2642-7(e)(5).

Other factors related to prejudice to the interests of the government include timing of the requested relief and intervening taxable events. The final regulations also add a paragraph addressing closed years stating that, subject to the considerations in the "timing of requested relief" section, the expiration of limitations of the assessment or collection of transfer taxes generally is not relevant to whether relief will be granted, but if the value reported on a gift or estate tax return likely constituted a gross valuation misstatement, the purported undervaluation will be considered as to whether the relief would prejudice the interests of the government.

g. **Relief From Affirmative Elections Is Permitted Under Final Regulations.** The proposed regulations provided that relief would not be granted from affirmative elections (1) to elect out of automatic allocations of GST exemption to lifetime direct skips under §2632(b)(3), (2) to elect out of lifetime allocations to "GST trusts" under §2632(c)(5)(B)(i), or (3) to treat a trust as a GST trust as to any or all transfers made by such individual to such trust pursuant to §2632(c)(5)(A)(ii). The preamble to the final regulations acknowledges, though, that no statute "provides that an election made under section 2632(b)(3) or (c)(5) is irrevocable." Therefore, the final regulations delete the statement in the proposed regulations that relief is not available to revoke an election under §2032(b)(3) or (c)(5) made on a timely filed gift or estate tax return.

h. **Relief From Affirmative Allocations of GST Exemption.** Section 2631(b) provides that an allocation of GST exemption under §2631(a), once made, is irrevocable. The final regulations make clear that relief generally will not be granted to revoke an affirmative allocation (as opposed to an automatic allocation) of GST exemption, for both lifetime allocations and allocations upon a transferor's death. Reg. §26.2642-7(e)(2)(i). However, the final regulations add three exceptions to the general rule (and the first two exceptions are automatic – no request for relief is required).

(1) **Excess Exemption Allocation.** Exemption allocation is **void** to the extent it exceeds the amount necessary to result in a zero inclusion ratio, but this exception does not apply to charitable lead annuity trusts or trusts subject to an estate tax inclusion period (such as a GRAT). Reg. §26.2642-7(e)(2)(ii)(A).

(2) **No GST Potential.** Exemption allocation is **void** for a transfer to a trust that, at the time of the allocation, has no GST potential with respect to the transferor making the allocation. For purposes of this exception, a trust has GST potential even if the possibility of a GST is so remote as to be negligible. Reg. §26.2642-7(e)(2)(ii)(B).

(3) **Late Allocations Made When Extensions Not Available Prior to Enactment of §2642(g).** The preamble to the final regulations summarizes this third exception, for which relief is not automatic but must be requested, as follows.

> The third exception is that a late allocation (as defined in section 2642(b)(3)) will be deemed to be void as part of the relief granted under section 2642(g) if the late allocation was made in an effort to mitigate the tax consequences of the missed allocation that is the subject of the grant of relief and that was not eligible for relief prior to the enactment of section 2642(g)(1). Specifically, such a late allocation is deemed to be void if (1) prior to December 31, 2000, a transfer was made to a trust with GST potential with respect to the transferor; (2) a timely allocation of GST exemption to the trust was not made; (3) prior to December 31, 2000, a late allocation of GST exemption was made to the trust; (4) the late allocation is disclosed as part of the request for relief or during the IRS's consideration of that request; and (5) relief under section 2642(g)(1) is granted to make a timely allocation to the transfer made prior to December 31, 2000.

i. **Affidavits.** The final regulations continue the requirements in proposed regulations (with modifications) that affidavits be supplied from advisors connected with the GST exemption allocation or election decision. The proposed and final regulations list four categories of persons who must provide affidavits: (a) agents or legal representatives of the transferor who participated in certain activities, (b) preparers of gift or estate tax returns, (c) individuals (including employees of the transferor) who participated in certain activities, and (d) tax professionals who participated in certain activities. In particular, the final regulations narrow the list of persons who must provide affidavits. For example, the proposed regulations required affidavits from each tax professional who was consulted by the transferor or executor of the transferor's estate about "**any aspect of the transfer, the trust,** the allocation of GST exemption, and/or the election under section 2632(b)(3) or (c)(5)." (Emphasis added). That could include any number of advisors over decades who may have given advice about some aspect of the trust, having nothing to do with GST exemption allocations or elections. The final regulations narrow the list of tax professionals who must give affidavits by omitting the words "any aspect of the transfer, the trust."

j. **Ability to Revoke GST Exemption Allocation to a Trust Subject to an Estate Tax Inclusion Period (ETIP)?** The preamble to the final regulations says: "The allocation of exemption to a trust subject to an ETIP does not become irrevocable until the termination of an ETIP." There is no similar provision in the substantive provisions of the new regulations. A pre-existing regulation states the opposite. Reg. §26.2632-1(c)(1)(ii) ("An affirmative allocation of GST exemption cannot be revoked but becomes effective as of (and no earlier than) the date of the close of the ETIP with respect to the trust"). Section 2642(f)(1) provides that an allocation of GST exemption to property involving an ETIP cannot be made before the end of the ETIP, which suggests that an affirmative allocation to a trust subject to an ETIP could be modified or revoked prior to the close of the ETIP.

k. **User Fee.** The user fee for obtaining letter rulings is generally $43,700 ($3,450 for taxpayers with gross income less than $400,000 and $9,775 for taxpayers with gross income between $400,000 and $1 million), but the user fee for "9100 relief" is only $14,500. Rev. Rul. 2025-1, Appendix A. Which will apply going forward for GST rulings? The preamble to the final regulations says, "[t]he user fee would follow the same schedule and amount as rulings under §301.9100-1." Hopefully, the IRS will follow through with a revenue procedure making that clear.

7. Final Regulations Regarding Tax Under §2801 on Gifts from Covered Expatriates

a. **Brief History.** Section 2801 was enacted as part of the Heroes Earnings Assistance and Relief Tax Act of 2008 (the HEART Act). In addition, §877A was passed as part of that same act, providing for a "mark-to-market" tax to certain U.S. persons and long-term resident individuals ("covered expatriates") who expatriate on or after June 17, 2008 (treating all property of the person as sold for its fair market value on the day before their expatriation date.) Before that time, U.S. citizens and long-term residents who expatriated to avoid U.S. taxes were subject to an alternative tax regime under §877 and §2105 for 10 years following expatriation.

b. **New Chapter 15.** The estate and gift tax provisions of the Code are in chapters 11-14. New chapter 15 consists solely of §2801. Section 2801 very generally imposes a tax on certain transfers of

property by gift (covered gifts) and on certain transfers of property by bequest (covered bequests) from certain individuals who expatriate on or after June 17, 2008 (covered expatriates).

c. **Section 2801 General Rule.** The §2801 tax is imposed on each U.S. citizen or resident receiving (directly or indirectly) a covered gift or covered bequest on or after June 17, 2008. (This is very different from the gift and estate tax, which imposes the tax on the donor or the decedent's estate. This tax is imposed on the recipient (who may not even be aware of the gift or bequest).) The general theory of §2801 is to remove transfer tax advantages to expatriating, but there are various ways in which the tax paid is different (including that the $10 million (indexed) gift and estate tax basic exclusion is not allowed in calculating the tax).

(1) **Domestic Trusts and Electing Foreign Trusts.** For this purpose, domestic trusts and foreign trusts that elect to be treated as domestic trusts solely for purposes of §2801 (electing foreign trusts) are included in the definition of a U.S. citizen (and therefore are subject to §2801 upon receipt of covered gifts or covered bequests).

(2) **Non-Electing Foreign Trusts.** Foreign trusts that do not elect to be treated as domestic trusts for purposes of §2801 (non-electing foreign trusts) are not U.S. citizens or residents and, therefore, do not become subject to the §2801 tax upon receipt of covered gifts and covered bequests. Instead, the beneficiaries of non-electing foreign trusts who are U.S. citizens or residents (U.S. citizen or resident beneficiaries) become subject to the §2801 tax upon their receipt of a distribution from a non-electing foreign trust that is attributable to covered gifts and covered bequests made to that non-electing foreign trust.

(3) **General Tax Calculation.** If the aggregate value of the covered gifts and covered bequests received by the U.S. recipient during the calendar year exceeds the amount of the inflation-adjusted annual exclusion under §2503(b) ($19,000 for 2025), the §2801 tax is computed by multiplying the excess by the highest estate tax rate specified in §2001(c) in effect on the date of receipt (currently 40%), and then reducing the product by any gift or estate taxes paid to a foreign country with respect to the covered gifts and covered bequests. The value of each covered gift and covered bequest is its fair market value as of the date of its receipt.

Limited exemptions apply (for example, for transfers to U.S. spouses or to a charity, or for a gift or bequest that is reported on a timely filed gift or estate tax return).

(4) **Covered Gifts and Bequests and Covered Expatriates.** Covered gifts and bequests are gifts and bequests received from a "covered expatriate" or from a trust funded by a covered expatriate.

A "covered expatriate" (as defined in §877A(g)(1)) is an expatriate, i.e., any U.S. citizen who relinquishes citizenship or any green card holder whose status is revoked or abandoned at a time when the person was a lawful permanent resident of the United States in at least 8 of the past 15 years, who expatriates on or after June 17, 2008 and who meets at least one of the following criteria: (i) net income test--average annual U.S. income tax liability over the five years preceding expatriation exceeds a certain threshold ($206,000 for 2025); (ii) net worth test-- had a worldwide net worth of $2 million or more at the time of expatriation; or (iii) certification test–failed to certify under penalties of perjury that she or he was in compliance with all U.S. federal tax obligations for the preceding five years. Certain individuals are exempt from being classified as covered expatriates (persons who have not lived in the U.S. for specified periods of time and who are born as dual citizens or persons who relinquish U.S. citizenship before reaching age 18 ½. (In addition to the special tax imposed on recipients of gifts or bequests from covered expatriates, covered expatriates are also subject to an "exit tax" under §877A when they expatriate. The overall goal of these provisions in the HEART Act is to remove tax incentives from expatriating.)

(5) **Notice 2009-85.** Notice 2009-85, 2009-45 IRB 598 reiterated that gifts or bequests from a covered expatriate on or after June 17, 2008, are subject to transfer tax under §2801 and very importantly, stated that satisfaction of the reporting and tax obligations was deferred pending the issuance of separate guidance by the IRS.

(6) **Effective Date.** Section 2801 applies to gifts or bequests made on or after June 17, 2008.

d. **Final Regulations.** The final regulations generally adopt the approach of the proposed regulations. Extensive comments to the proposed regulations filed by ACTEC on March 10, 2016, provide insight into issues addressed in the final regulations. A few highlights about the final regulations are briefly summarized.

(1) **General Overview.** In very general terms, the final regulations include important definitions, guidance on computing the §2801 tax, the effective tax rate, the treatment of foreign gift or estate taxes, the value of covered gifts or covered bequests, the date of receipt, non-electing foreign trusts, treatment of distributions from non-electing foreign trusts as subject to the §2801 tax (but without applying the deemed distribution rules of §643(i)), the election by a foreign trust to be treated as a domestic trust, income tax effects of the §2801 tax, information reporting and §6039F and §6048(c), recordkeeping requirements, powers of appointment not in trust, the effect of estate and gift tax treaties, the ability to file a protective claim for refund of the §2801 tax in case foreign gift or estate tax is paid after payment of the §2801 tax, and a reminder that the filing of Form 708 to report a distribution from a non-electing foreign trust is in addition to and not a substitute for filing Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*. (Form 708 has not yet been issued.)

(2) **Effective Date.** The final regulations apply to covered gifts and bequests received on or after January 1, 2025. They are silent as to transfers in the 16 years from June 17, 2008 to January 1, 2025. The proposed regulations had noted the deferral under Notice 2009-85 without further explanation. Clearly, covered gifts or covered bequests received by U.S. recipients on or after January 1, 2025, must be reported on Form 708.

(3) **Treatment of Covered Gifts or Bequests Received Between June 17, 2008 and December 31, 2024?** Significant uncertainty exists about the obligation to report and pay tax, and the procedures for doing so, for gifts or bequests received between June 17, 2008, and December 31, 2024. The recipient has a statutory obligation under §2801 to report and pay the tax, but that obligation was deferred until final regulations were issued. The final regulations are now issued but make no provisions regarding covered gifts made before January 1, 2025. One commentator concludes that "the final regulations' deafening silence on this topic seems to indicate that it is at least possible that recipients of covered gifts or bequests between June 17, 2008, and January 1, 2025, may be off the hook entirely from a tax and reporting standpoint." Ian Weinstock & Heather Fincher, *Treasury Finalizes Regulations Taxing Gifts and Bequests from Covered Expatriates*, Kostelanetz News (January 16, 2025(available at **https://kostelanetz.com/treasury-finalizes-inheritance-regulations-taxing-gifts-and-bequests-from-covered-expatriates/?utm_medium=email&_hsenc=p2ANqtz-8ntbHi-JNFzrNYymV04FReH7C_ADN48AP_BeDaK-r-vBc99YP74qxJ8dHG7LM3qvIY312eeOoDgaK_sqhrXlgKyAqsfw&_hsmi=342824446&utm_content=342824446&utm_source=hs_email**.

(4) **Definitions.** The final regulations include definitions of important terms, including expatriate and covered expatriate, foreign trust and domestic trust, covered bequest, and indirect acquisition of property.

(5) **Timely Filed Gift or Estate Tax Returns.** The §2801 tax does not apply to gifts or bequests reported on timely filed gift or estate tax returns. A requirement in the proposed regulations that the tax shown on the return be timely paid as well was dropped in the final regulations.

(6) **Avoiding Duplicate Liability for Covered Bequests That Were Also Covered Gifts.** Property that was subject to §2801 tax as a covered gift might theoretically also be subject to §2801 tax as a covered bequest**.** (For example, if a covered expatriate transfers a remainder interest in property while retaining a life estate, the value of the remainder interest is a covered gift and the value of the entire property at death is a covered bequest.) The final regulations clarify that the value of a covered gift under §2801 is subtracted from a covered bequest of the same property.

(7) **No Annual Filing for Electing Foreign Trusts.** The final regulations clarify that a foreign trust that elects to be treated as a domestic trust does not have file a Form 708 each year, but only in years in which the foreign trust receives covered gifts or bequests.

e. **Uncompensated Use of Trust Property.** Section 643(i) was amended in 2010 to treat the uncompensated use of trust property by a U.S. person who is a grantor or beneficiary of a foreign trust as a distribution from the foreign trust to the grantor or beneficiary (unless the trust is paid the fair market value for the use of the trust property within a reasonable period of time or unless the use is treated as a de minimis use of trust property). Treating the uncompensated use of property as a distribution entitles the foreign trust to a distribution deduction and can have income tax effects for the recipient under complicated rules that may treat the distribution as an accumulation distribution of the foreign trust's undistributed income.

Distributions from a non-electing foreign trust are subject to the §2801 tax. The final regulations address whether the uncompensated use of property in foreign trusts, which is treated as a deemed distribution under §643(i) for purposes of that section, is also treated as a distribution from a non-electing foreign trust for purposes of the §2801 tax. The final regulations provide that the deemed distribution rules under §643(i) do not apply for purposes of §2801, and the uncompensated use of trust property is not automatically treated as a distribution for purposes of the §2801 tax. However, the preamble to the final regulations clarifies that "[t]o the extent that a loan from, or the use of property of, a non-electing foreign trust constitutes a gift under chapter 12 of the Code, then the portion of that loan or use received by a U.S. recipient constitutes a distribution and thus a covered gift to the extent of the trust's section 2801 ratio." Reg. §28.2801-5(b).

8. Planning for IRA and Retirement Plan Distributions Under the SECURE Act; New Life Expectancy Tables for Calculating Required Minimum Distributions; SECURE 2.0; New Final and Proposed Regulations

a. **Overview.** The SECURE Act made various changes regarding retirement benefits, including (i) changing the required beginning date (RBD) for required minimum distributions (RMDs) (April 1 of the following year) from age 70½ to 72 (and SECURE 2.0 changes it to age 73 beginning in 2023 and to age 75 beginning in 2033), (ii) eliminating the prohibition on contributions to an IRA after age 70½ (but if an individual both contributes to an IRA and arranges for a qualified charitable distribution (QCD) between ages 70½ and 72, the IRA contribution will reduce the portion of the QCD that would otherwise be treated as tax-free), and (most important) (iii) substantially limiting "stretch" planning for distributions from defined contribution plans and IRAs over a "designated beneficiary's" (DB's) lifetime (with several exceptions). (A DB is an individual; for example, an estate or a charity would be a non-designated beneficiary (non-DB).) Generally, much more favorable rules (allowing slower payouts) apply if a plan has DBs than if it doesn't. The SECURE Act mandates that distributions to a DB be made within 10 years following the death of the participant, with exceptions for five categories of "eligible designated beneficiaries" (EDBs). The anti-stretch provisions of the SECURE Act generally apply to owners who die after 2019.

These rules apply to qualified retirement plans that are defined contribution plans as well as to IRAs. This summary refers to any of these as a "plan."

b. **ACTEC Comments; Proposed Regulations; Extension Notices.** These provisions of the SECURE Act create many uncertainties, and ACTEC has filed various comments with the IRS with detailed observations and recommendations for guidance regarding the implementation of the statutory provisions. See Item 6.e of Estate Planning Current Developments (December 2021) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

The IRS issued proposed regulations to update the minimum distribution rules, including guidance regarding the SECURE Act, on February 23, 2022. REG-105954-20 (published in the Federal Register on February 24, 2022, correction published March 14, 2022, in 2022-11 I.R.B. 828). The proposed regulations reflected statutory amendments since the required minimum distribution regulations were last issued, clarified issues that had been raised in public comments and private ruling requests, and replaced the question-and-answer format of the existing regulations. Among other

clarifications, the regulations "clarify and simplify" the minimum distribution rules where trusts are beneficiaries. ACTEC filed extensive comments with the IRS regarding the proposed regulations on May 24, 2022 (available at **https://www.actec.org/legislative-comments/actec-submits-comments-on-proposed-regulations-irs-reg-105954-20-the-proposed-regulations-address-the-required-minimum-distribution-requirements-for-plans-qualified-under-code-section-401a-and-are/**).

The proposed regulations regarding required minimum distributions were proposed to apply for calendar years beginning in 2022, and for 2021 "taxpayers must apply the existing regulations, but taking into account a reasonable, good faith interpretation of the amendments made by sections 114 and 401 of the SECURE Act. Compliance with these proposed regulations will satisfy that requirement." Preamble to REG-105954-20 at 77-78.

The IRS delayed the issuance of final RMD regulations until the provisions impacted by SECURE 2.0 could be revised. Notice 2023-54, issued in July 2023, provided transition relief related to the RMD age increases in SECURE 2.0 and waived excise taxes for the failure to make certain required minimum distributions. It also announced that the final RMD regulations would not apply until 2024. Notice 2024-35 extends the waiver of excise taxes for the failure to make "specified RMDs" in 2024 and states that the final RMD regulations will not apply until 2025. Guidance in the form of questions and answers regarding certain provisions in SECURE 2.0 was released December 20, 2023, in Notice 2024-2, 2024-2 I.R.B. 316 (dated January 8, 2024).

For a detailed summary of planning issues under the SECURE Act for trusts as beneficiaries, including Natalie Choate's analysis for testing a trust beneficiary, see Item 4.d.-e. of Estate Planning Current Developments and Hot Topics (December 2023) found **here**. For a fairly detailed summary of highlights of the proposed regulations, see Item 4.d of Estate Planning Current Developments and Hot Topics 2022 (December 2022) found **here**. For a much more detailed discussion of planning issues in light of the SECURE Act, see Item 3 of Estate Planning Current Developments and Hot Topics (December 2020) found **here**. All those documents are available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

c. **Final Regulations Regarding Distribution Rules.** The long-awaited final regulations for distributions from retirement plans and IRAs, including implementation of changes made by the SECURE Act (and some changes by the SECURE 2.0 Act) were released July 18, 2024, and published in the Federal Register on July 19, 2024. The final regulations largely follow the 2022 proposed regulations but include various clarifications and some significant changes. Some of the changes reflected in the final regulations are briefly summarized below.

(1) **Effective Date.** The required minimum distribution rules in the final regulations apply generally (at least with respect to the distribution discussed in this summary) for distributions in calendar years beginning in 2025. For earlier years, the preexisting final regulations apply, as adjusted for a "reasonable, good faith interpretation" of changes made in the SECURE Act, and for 2023 and 2024, changes in certain sections of the SECURE 2.0 Act.

(2) **Retention of Requirement That Life Expectancy Payments Must be Made During the 10-Year Period for Making Distributions to Designated Beneficiaries If the Owner Dies On or After the RBD.** This was a rather shocking change made in the proposed regulations. Planners (and the IRS in a position taken at one point in IRS Publication 590-B) had believed that if the 10-year rule applied (i.e., for DBs who are not EBDs), no distributions were required until the end of the 10-year period. Indeed, the IRS had taken that position in official IRS publications, but the IRS took a different position in the proposed and final regulations. The final regulations retain the provisions in the proposed regulations, providing that if the decedent dies after the RBD naming a DB, distributions must continue to be made over the greater of the life expectancy of the participant or of the DB during the 10-year period (Reg. §1.401(a)(9)-5(d)(1)), and the full account must be distributed by December 31 of the tenth year after the year of death (Reg. §1.401(a)(9)-5(e)(2)). If the decedent dies before the RBD naming a DB, no distributions are required annually, but the full account must be distributed by December 31 of the tenth year. Regs. §1.401(a)(9)-3(c)(3) & §1.401(a)(9)-3(c)(5)(i)(B).

Thus, whether the owner dies before the RBD or on or after the RBD is critically important under the regulations as to whether distributions must be made during the 10-year period following the owner's death. (For a Roth IRA, the owner is deemed to have died before the RBD, so no annual payments are required during the 10-year period even if the owner died on or after the RBD. Reg. §1.408-8(b)(1)(ii).)

If the owner dies after the RBD and distributions must continue to be made annually, for the annual distribution in the calendar year after the year of the owner's death, the life expectancy of the DB would typically be used (assuming the beneficiary is younger than the deceased owner), and the life expectancy is determined initially using the beneficiary's age as of the birthday in the calendar year following the calendar year of the owner's death. Reg. §1.401(a)(9)-5(d)(3)(iii). (For example, if the beneficiary has a life expectancy of 30 years, 1/30th would be distributed in that first year, 1/29th in the next year, etc.)

As discussed above, the final regulations apply to distributions in years beginning in 2025. Therefore, the annual distribution requirement if the owner dies after the RBD does not apply until 2025. The anti-stretch provisions of the SECURE Act apply to owners who die in 2020 or later. IRS Notices have made clear that the failure to make such annual distributions in 2021-2024 will not cause the plan to fail to be a qualified plan, and the beneficiary who failed to take the distribution will not be liable for an excise tax. Notice 2022-53, 2022-45 IRB 437, Notice 2023-54, 2023-31 IRB 382, Notice 2024-35, 2024-19 IRB 1051. (The 2022 Notice (but not the 2023 and 2024 Notices) stated that if the taxpayer had already paid an excise tax for a missed distribution, the taxpayer may request a refund.) Footnote 11 of the preamble to the final regulations clarifies that make-up distributions are not required in 2025 for any such annual distributions that were not made in 2021-2024, but the 10-year deadline is still determined from the date of the participant's death. "For example, if an employee died in 2020, then in 2025, there are six years remaining in the 10-year period without regard to whether the designated beneficiary took distributions in 2021, 2022, 2023, or 2024. In 2030, the designated beneficiary must take a distribution of the remaining account balance." Preamble to Final Regulations, n.11. The annual payments for the remaining years are determined using the relevant life expectancy at participant's death and subtracting by one for each subsequent year in the "applicable denominator" (even though no distributions were required in those years between 2021-2024).

The IRS's rationale for the changed position requiring annual distributions during the 10-year term if the owner dies on or after the RBD was explained in the preamble to the proposed regulations. While the 10-year rule is based on a 5-year rule (that applies if a participant dies before the RBD with a non-DB), which does not require annual distributions, the SECURE Act did not repeal §401(a)(9)(B)(i), which requires that distributions be made "at least as rapidly" as of the date of death. (That is interpreted to require that distributions be made over the longer of the "ghost life expectancy" of the participant – as if she had not died – or of the DB.)

The effect of the annual distribution requirement if the owner dies on or after the RBD with a DB as beneficiary is that two distribution rules apply, and **both** must be satisfied:

- certain **annual distributions** are required (generally based on the life expectancy of the beneficiary); and
- an **outer limit** on distributions applies (the 10-year rule, but if an EDB is named as beneficiary, the outer limit is generally 10 years after the EDB dies or ceases to be an EDB).

The preamble to the proposed regulations gave this example:

> For example, if an employee died after the required beginning date with a designated beneficiary who is not an eligible designated beneficiary, then the designated beneficiary would continue to have required minimum distributions calculated using the beneficiary's life expectancy as under the existing regulations for up to nine calendar years after the employee's death. In the tenth year following the calendar year of the employee's death, a full distribution of the employee's remaining interest would be required. Proposed Regulations Preamble at 46-47.

(3) **Increased Ages for RBD of Owners.** The increased ages that were enacted in SECURE 2.0 for the RBD of an owner (discussed in Item 8.d below) are reflected in Reg. §1.401(a)(9)-2(b)(2).

(4) **Definition of "Child" Expanded.** The definition of "child" (for purposes of the minority EDB provision) is expanded to include "a stepchild, an adopted child, and an eligible foster child" (as explained in the preamble) by referencing §157(f)(1) in the definition. Reg. §1.401(a)(9)-4(e)(1)(ii).

(5) **Documentation Requirements for See-Through Trusts.** Certain documentation requirements apply for a see-through trust if the plan is to be treated as having DBs. The final regulations add that the plan administrator may determine which of two alternatives (providing a copy of the trust instrument or providing a list of beneficiaries) is available to an owner.

(6) **Charity as Remainder Beneficiary of Special Needs Trust.** The proposed regulations provided detailed provisions for "applicable multi-beneficiary trusts" that include a disabled or chronically ill individual as a beneficiary (thus qualifying as an EDB). Trusts for disabled persons are often drafted to include "special needs trust" provisions, and some people want to design special needs trusts to have a charity as the remainder beneficiary following the disabled person's death. The SECURE 2.0 Act amended §401(a)(9)(H)(v) to permit a charitable remainder beneficiary of a Type II applicable multi-beneficiary trust (AMBT). The final regulations reflect that change, but the final regulations delete the concept of "Type I" and "Type II" AMBTs. Reg. §1.401(a)(9)-4(g)(3).

(7) **Multiple Minor Beneficiaries of a Trust.** The proposed regulations provided that if a trust has multiple minor beneficiaries (i.e., have not reached age 21), the plan can be treated as having an EDB, and the final required distribution would not be until ten years after the *oldest* minor beneficiary reached age 21. The final regulations change this to provide that the final distribution would not be required until ten years after the *youngest* beneficiary reached age 21, or ten years after the last of the minor children dies. Reg. §1.401(a)(9)-5(f)(2)(ii)(C).

(8) **Separate Account Provision Applied to Trusts.** If the beneficiary designation provides that interests in a plan will pass to separate DBs, each of them are treated separately to determine the payout provisions to each. Under the proposed regulations, the separate account rule did not apply for a plan interest that passed to a trust, under which the plan interest would be allocated to separate trusts for specific individuals or would be distributed to specific individuals at the owner's death. Instead, all the trust beneficiaries were generally counted for purposes of determining if the plan had a DB, and the oldest DB's life expectancy was used to determine the minimum annual distributions.

An important change in the final regulations is to apply the separate account rule to plan interests passing to a trust if the terms of that trust provide that it is to be divided immediately upon the death of the owner into separate shares for one or more trust beneficiaries, and the regulation provides details as to what "immediately divided" means:

> *Immediately divided defined.* For purposes of paragraph (a)(1)(iii)(B) of this section, a trust is immediately divided upon the death of the employee only if, as of the date of death, the trust is **terminated** and there is **no discretion** as to the extent to which of the separate trusts post-death distributions attributable to the employee's interest in the plan are allocated. A trust does not fail to be immediately divided upon the death of the employee merely because there are **administrative delays** between the date of the employee's death and the date on which the trust is divided and terminated, provided that any amounts received by the trust during this period are allocated as if the trust had been **divided** on the date of the employee's death.

Reg. §1.401(a)(9)-8(a)(iii)(C) (emphasis added).

A significant problem under this provision is that it applies "only if the separate interests are held in separate see-through trusts." Reg. §1.401(a)(9)-8(a)(iii)(B). If the trust named as the beneficiary of the plan divides in a manner that at least some of the interests pass directly to individuals rather than remaining in further trusts, the provision would not apply. There is no policy reason for this distinction, but that is literally what the regulation requires. Conservative planners will not leave a plan interest outright to a single trust that divides at the owner's death unless it splits in its entirety into separate see-through trusts. Also, the trustee cannot be given discretion as to

where the plan interests pass; they *must* pass into the designated sub-trusts in the proportions indicated.

(9) **Required Distribution In Year of Owner's Death May be Made to "Any" Beneficiary.** If the owner had reached the RBD before the date of death, distributions must be made each year, including in the year of death. If the required minimum distribution for that year has not been made to the owner before his or her death, the distribution must made at some point during that year after his death, and the final regulations clarify that the required distribution for that year may be made to "any" beneficiary ("as opposed to each of the beneficiaries being required to take a proportional share of the unpaid amount," as clarified in the preamble). Reg. §1.401(a)(9)-5(d)(1).

(10) **Beneficiary Younger Than Deceased Owner.** The distributions can be made over the greater of the life expectancy of the owner or the life expectancy of the DB (with the requirement that the full amount be distributed within ten years unless the beneficiary is an EDB). Reg. §1.401(a)(9)-5(d)(1)(ii). However, the proposed regulations had a provision stating that if the DB was younger than the owner, the entire plan interest would have to be distributed no later than when the owner would have reached his life expectancy (even though, up until that time, annual payments were being made over the life expectancy of the younger beneficiary). Prop. Reg. §1.401(a)(9)-5(e)(5). That provision was deleted from the final regulations, so the distributions can be made over the DB's full life expectancy (subject to the 10-year rule if the beneficiary is not an EDB).

d. **SECURE 2.0.** The House of Representatives passed H.R. 2954, the Securing a Strong Retirement Act of 2022 (commonly referred to as "SECURE 2.0") on March 29, 2022, by an overwhelming bipartisan vote of 414 to 5. Several similar versions were considered in the Senate, and an agreed version titled "SECURE 2.0 Act of 2022" was included in Division T of the FY 2023 omnibus spending bill, the Consolidated Appropriations Act, 2023, which was signed by the President on December 29, 2022 (i.e., the date of enactment). SECURE 2.0 is an expansive (130 pages of legislative text!) addition of a wide variety of retirement savings enhancement provisions. A very helpful Committee section by section summary of SECURE 2.0 is available at **https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf.** A few of the added provisions are briefly summarized. More of the provisions are summarized in Item 4.i of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

(1) **Some Topics Included.** A few of the topics include: (1) increased age for required beginning date for mandatory distributions (age 73 for those reaching age 72 after 2022 and age 74 for those reaching age 74 after 2032); (2) rollovers from 529 plans to Roth IRAs; (3) reduction in excise tax and statute of limitations for failure to take required minimum distributions; (4) IRA charitable rollovers (indexing of the $100,000 limit and allowing a rollover of up to $50,000 to a charitable remainder trust); (5) surviving spouse election for certain matters; (6) special needs trusts; and (7) conservation easements.

(2) **Notice 2024-2.** Guidance in the form of questions and answers regarding certain provisions in SECURE 2.0 was released December 20, 2023, in Notice 2024-2, 2024-2 I.R.B. 316 (dated January 8, 2024).

(3) **SECURE 2.0 Technical Corrections Act.** A draft of bipartisan legislation, titled the SECURE 2.0 Technical Corrections Act, was released December 6, 2023. It makes various technical corrections to SECURE 2.0.

Proposed Regulations. Proposed regulations regarding various provisions of SECURE 2.0 were issued on July 18, 2024 (and published in the Federal Register on July 19, 2024). In particular, detailed provisions are included regarding elections by a surviving spouse-beneficiary under §327 of SECURE 2.0.

9. Form 709 Changes for 2024

The Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return for 2024, released on January 3, 2025, was changed in various important ways. Some of them are summarized.

a. **General Information (Part I).** Part I has been reorganized. Address entries include foreign address options.

Line 15 has been added to check whether the return is an amended return, rather than writing "Supplemental Information" across the top of the return. (As before, the amended return must also include a statement of what changed, with supporting information, and a copy of the original return.).

Lines 12-18, regarding gift splitting, have been replaced by a single Line 19, and gift splitting information has been moved to a new Part III (discussed immediately below).

b. **Gift Splitting.**

(1) **Part I, Line 19.** Line 19 of Part I asks the following very confusing question: "Did you **and** your spouse make gifts to third parties? See Instructions. (If the answer is 'Yes,' complete Part III on page 2)." (emphasis added). In the typical situation where one spouse makes gifts and the other spouse consents to gift splitting, this question literally would be answered "No" because both spouses (note the word "and" in the question) did not make gifts to third parties. Furthermore, if both spouses do make gifts to third parties, very often they would not intend to elect gift splitting, but the literal answer to the question would be "Yes."

However, the updated instructions for Form 709 say: "If you and your spouse want your gifts to be considered made one-half by you and one-half by your spouse, check the 'Yes' box and complete Part III. If you are not married or do not wish to split gifts, skip to line 20." Therefore, in many cases, when both spouses do not make gifts to third parties, the question should nevertheless be answered "Yes," and in many cases when both spouses do make gifts to third parties the question should nevertheless be answered "No." (Do you think that may cause some confusion?)

When Line 19 is answered "Yes" (meaning that the spouses want to elect gift splitting according to the instructions), the donor is to complete new Part III.

(2) **New Part III, Spouse's Consent on Gifts to Third Parties.** Part III asks general questions about the spouses. Line 1 asks if the donor consents to gift-splitting. Lines 2-6 ask the same questions that were in Part I, Line 12-17 of the prior form. Part I, Line 18 of the prior form required that the consenting spouse sign the donor's form to elect gift splitting. In the 2024 Form, the consenting spouse no longer signs the donor's Form 709 but must sign and date an attached separate "Notice of Consent." (No form "Notice of Consent" is provided.) The instructions provide the same guidance as in prior versions regarding when the Notice may be signed and when both spouses must file separate returns. If both spouses must file separate returns (generally when all gifts are not covered by the annual exclusion or the political organization, education, or medical exclusions), each spouse must sign and date a Notice of Consent attached to the other spouse's return if the split-gift election is being made.

c. **Schedule A.** Schedule A (and Schedules B, C, and D) are now in landscape format.

Schedule A (Parts I, II, and III) has additional columns for information about the donees and the gifted assets, as well as additional columns with new checkboxes to make elections for the charitable deduction, marital deduction, or to make the "reverse QTIP" election under §2652(a)(3). Return preparers will need to make sure that these appropriate boxes are checked in order to qualify for these deductions or to make the reverse QTIP election.

The columns for entering information are very small and may be too small to enter relevant information. In that case, the instructions say to use continuation statements.

The reverse QTIP election checkbox may be particularly confusing (meaning that it may often inadvertently not be checked) because it has a GST election being made under a very small column

on the gift schedule rather than in Schedule D that deals with generation-skipping transfer taxes. (That election was previously made in Schedule D, Part 2, GST Exemption Reconciliation (Section 2631) and Section 2652(a)(3) Election.)

d. **Software Platforms.** The Form 709 software platforms may not be suited to completing information in the small columns provided on Schedule A. Continuation statements should be used as needed.

10. Corporate Transparency Act Overview; BOI Reporting Applies Only to Foreign Reporting Companies

a. **Major Reversal of Course by FinCEN: BOI Reporting Will Apply Only to Foreign Reporting Companies.** FinCEN posted a press release on March 2, 2025, stating that it will not enforce any penalties or fines on U.S. citizens or domestic reporting companies or their beneficial owners. FinCEN followed by issuing an interim final rule on March 23, 2025. The interim final rule:

- Changes the definition of a reporting company to mean only entities that are formed under foreign law and have registered to do business in any U.S. state or Tribal jurisdiction.
- If a foreign entity creates a U.S. subsidiary to do domestic business, there would be no requirement to report beneficial ownership information (BOI).
- Foreign companies owned by U.S. citizens do not have to report.
- U.S. persons (as defined in the Code) would not have to be reported as beneficial owners. In addition, they would not be required to give beneficial ownership information to foreign companies subject to the reporting requirement.
- New BOI reporting deadlines for foreign companies are specified. Reporting companies registered to do business in the U.S. before the date of publication of the interim final rules in the Federal Register will have to report the information within 30 days of that date. Foreign reporting companies qualifying to do business in the U.S. after that date must file an initial BOI report 30 days after receiving notice that their registration is effective.
- FinCEN invites public comments and plans to finalize the rule in 2025.
- The limited scope of the interim final rule means that a little under 12,000 companies must comply on average per year, compared with about 32 million first estimated to be impacted by the reporting requirements.

The President has confirmed suspension of the enforcement of the CTA, citing it as an "economic menace" to U.S. citizens.

b. **Very Brief Summary.** The Corporate Transparency Act ("CTA") was enacted on January 1, 2021, effectively creating a national beneficial ownership registry for law enforcement purposes. This is an outgrowth of the efforts of the international community, through the Financial Action Task Force ("FATF"), to combat the use of anonymous entities for money laundering, tax evasion, and the financing of terrorism. The U.S. has been viewed internationally as being vulnerable to money laundering and tax evasion because of a perceived lack of corporate transparency and reporting of beneficial ownership.

The CTA requires that certain entities must disclose to the Financial Crimes Enforcement Network ("FinCEN") identifying information about the entity, individual owners and those who control the entity ("Beneficial Owners"), and "Applicants" applying to form an entity. "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).

c. **Resources.** For a much more detailed overview of highlights of the beneficial ownership reporting requirements (including the general reporting requirements and penalties for failure to comply, BOI issues for trusts, FinCEN frequently asked questions, options when owners refuse to provide information, and legislative proposals to extend the reporting dates) see Item 8 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and

Item 3 of Estate Planning Current Developments and Hot Topics 2022 (December 2022) found **here**, both available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

d. **Constitutionality of CTA.**

(1) ***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 case is on appeal to the Eleventh Circuit Court of Appeals. A number of amicus briefs were filed with the Eleventh Circuit, arguing both for and against the CTA's constitutionality. In response to a case decided by the Supreme Court in July 2024, addressing facial challenges to statutes on constitutional grounds (*Moody v. NetChoice LLC*, 144 S. Ct. 2383 (2024)), the Eleventh Circuit requested the parties to submit supplemental briefs arguing whether the district court erred "in not holding the plaintiffs to their burden of showing that there are no constitutional applications of the Corporate Transparency Act." Oral arguments before the Eleventh Circuit were heard on September 27, 2024. For a summary of issues raised in the oral arguments, see Nana Sarfo, *Eleventh Circuit Weighs the Corporate Transparency Act*, 185 TAX NOTES FEDERAL 206 (Oct. 14, 2024).

(2) ***Texas Top Cop Shop, Inc. v. Garland*, No. 4: 24-CV-478 (E.D. Texas May 28, 2024).** The federal district court in the Eastern District of Texas on February 3, 2024, granted the plaintiffs' motion for a preliminary injunction from enforcing the Corporate Transparency Act and its implementing regulations, and the court did so with a *nationwide* injunction. *Texas Top Cop Shop, Inc. v. Garland*, No. 4: 24-CV-478 (E.D. Texas Dec. 3, 2024). The court determined that the plaintiffs carried their burden to prove:

> (1) that the CTA and Reporting Rule substantially threaten Plaintiffs with irreparable harm; (2) a substantial likelihood of success on the merits of any of their challenges; (3) that the threatened harm outweighs any damage the injunction might have on the Government; and (4) that preliminary injunctive relief will not harm the public.

As to the threat of irreparable harm, the court refused to set a bright line rule in the context of this case as to what a de minimis harm to the Plaintiffs would be, observing that "deprivations of constitutional rights come a few dollars at a time" and that FinCEN acknowledges that companies throughout the country will incur substantial compliance costs in complying with the CTA. Perhaps more importantly, once the plaintiffs "must comply with an unconstitutional law, the bell has been rung"; they would have disclosed information they seek to keep private and surrendered to a law they contend exceeds Congress's powers. "That damage 'cannot be undone by monetary relief.'"

As to the likelihood of success, the plaintiffs had alleged that the CTA is beyond Congress's constitutional powers and violates their rights under the First, Fourth, Ninth, and Tenth

Amendments. The court concluded that the CTA is beyond Congress's enumerated powers, is not justified by the Commerce Clause or the Necessary and Proper Clause, and the plaintiffs showed a substantial likelihood of success. (The court did not address the claims under the First and Fourth Amendments.)

The court addressed the third and fourth factors with an analysis of balancing the equities and concluded that the CTA is likely unconstitutional, and the court could not render a meaningful decision on the merits before the reporting deadline which would cause the plaintiffs to "suffer the very harm they seek to avoid. A preliminary injunction will preserve the constitutional status quo. Thus, the balance of equities favors the issuance of an injunction."

In addressing the scope of the preliminary injunction, the court observed that the government noted that granting a preliminary injunction against enforcement of the CTA as to the 300,000 members the National Federation of Independent Businesses (one of the plaintiffs) would effectively be a nationwide injunction. The court acknowledged the controversy regarding nationwide injunctions but concluded that a nationwide injunction is appropriate in this case.

> The Court determines that the injunction should apply nationwide. Both the CTA and the Reporting Rule apply nationwide, to "approximately 32.6 million existing reporting companies." …. NFIB's membership extends across the country. And, as the Government states, the Court cannot provide Plaintiffs with meaningful relief without, in effect, enjoining the CTA and Reporting Rule nationwide. The extent of the constitutional violation Plaintiffs have shown is best served through a nationwide injunction. *See Califano*, 442 U.S. at 705; *Career Colls. & Schs. of Tex.*, 98 F.4th at 256. Given the extent of the violation, the injunction should apply nationwide.

The government filed a Notice of Appeal (with the Fifth Circuit Court of Appeals) on December 5, 2024, and filed a Motion to Stay Preliminary Injunction Pending Appeal on December 11, 2024.

On December 17, 2024, the district court denied the government's motion to stay the injunction pending appeal, concluding that the Government does not have a "substantial case on the merits" and even if it did, "the equities here do not 'weigh heavily' in favor of granting a stay."

On December 23, 2024, a panel hearing motions for the U.S. Court of Appeals for the Fifth Circuit granted a stay of the district court's preliminary injunction pending the outcome of the Department of the Treasury's ongoing appeal of the district court's order. The Fifth Circuit was of the view that "the government has made a strong showing that it is likely to succeed on the merits in defending CTA's constitutionality." The order expressed little sympathy for the plaintiff's position that lifting the stay days before the compliance deadline would be unduly burdensome because the reporting deadlines under the CTA have been in effect for almost a year while the injunction was only in place for approximately three weeks. The order also expedited the appeal to the next available oral argument panel.

On December 24, 2024, the plaintiffs filed a motion for rehearing and also filed an emergency petition for an en banc hearing.

The order from the panel hearing motions was vacated on December 26, 2024, by a different panel addressing the merits of the case. The order concluded that "in order to preserve the constitutional status quo while the merits panel considers the parties' weighty substantive arguments, that part of the motions-panel order granting the Government's motion to stay the district court's preliminary injunction enjoining enforcement of the CTA and the Reporting Rule is VACATED."

On December 31, 2024, the government asked the Supreme Court to stay the nationwide injunction. Justice Alito requested briefs be filed by January 10, 2025. The plaintiff's brief and 13 amicus briefs (reflecting a broad coalition opposing the CTA) were filed with the Court. On January 23, 2025, the Supreme Court entered an order staying the grant of the preliminary injunction – so filings of beneficial ownership reports under the CTA were back in place. Justice Gorsuch filed a concurring opinion taking the position that the Court should take the case currently "to resolve definitively the question whether a district court may issue universal injunctive relief." Justice Jackson dissented from the grant of the stay, reasoning that the

government has “failed to demonstrate sufficient exigency to justify our intervention” (observing that the Fifth Circuit has expedited its consideration of the government’s appeal, and the government delayed implementation of the statute nearly four years after Congress enacted the law). *McHenry v. Texas Top Cop Shop, Inc.*, 604 U.S. __ (2025) (Docket No. 24A653 Jan. 23, 2025).

The government’s reply brief to the Supreme Court represented that “FinCEN has informed this Office that, if this Court grants a stay, FinCEN would again briefly extend the deadline in light of the injunction’s having been in effect.” A number of amicus briefs have been filed with the Fifth Circuit.

Oral arguments before the Fifth Circuit were scheduled for April 1, 2025, but that court has delayed the oral argument (without providing a new date) and has asked the parties to submit simultaneous letter briefs by April 8, 2025, addressing the March 21 interim final rule. (Plaintiffs in *Taylor v. Yellen*, No. 2:24-cv-00527 (D.C. Utah), have withdrawn their second motion for a preliminary injunction, pending the issuance of a final rule about how the scope of the CTA will be narrowed.)

For a discussion of the controversy regarding nationwide injunctions under district court orders, see *District Court Reform: Nationwide Injunctions*, 137 HARV. L. REV. 1701 (2024).

(3) ***Smith v. U.S. Department of the Treasury.*** The U.S. District Court for the Eastern District of Texas on January 7, 2025, in a lengthy Memorandum Opinion addressed plaintiff’s motion for a preliminary injunction against enforcement of the CTA. It considered the likelihood of success on the merits, the risk of irreparable harm, and the balance of the equities and the public interest. The court granted a preliminary injunction against enforcement of the CTA, but it applied the injunction as to enforcement of the statute (31 U.S.C. §5336) only as to the named plaintiffs in the case. However, it granted a nationwide injunction against enforcement of the BOI Reporting Rule in the final regulations. *Smith v. U.S. Department of the Treasury*, Memorandum Opinion and Order Granting Motion for Preliminary Relief, No. 6:24-cv-336 (E.D. Texas Jan. 7, 2025). About a month later, the district court stayed its nationwide injunction in an order signed Feb. 17, 2025, and entered on Feb. 18, 2025, in light of the Supreme Court’s order in the *Texas Top Cop Shop, Inc*. case.

(4) **Small Business Association of Michigan v. Yellen.** The U.S. District Court for the Western District of Michigan on March 3 granted plaintiffs’’ motion of summary, enjoining enforcement of the CTA’s reporting requirements against the plaintiffs, two organizations, three individual companies, and two individual beneficial owners. Unlike prior cases that have found the CTA to be unconstitutional under the Commerce Clause or because it exceeded Congress’s power, the court found that the CTA violated the plaintiffs’ Fourth Amendment rights against unreasonable search. The court noted that

> [t]he CTA may have good intentions but the road it chooses to pursue them paves over all reasonable limits. The CTA’s reporting requirements reach indiscriminately across the smallest players in the economy to extract and archive a trove of personal data explicitly for future law enforcement purposes at an expected cost to the reporting players of almost $22 billion in the first year alone. The Fourth Amendment prohibits such an unreasonable search,

The court called the CTA’s reporting rule a step toward "'Big Brother' . . . omnipresent telescreens everywhere…. The mere designation of ‘beneficial owner’ reveals a closely guarded fact that private companies keep from competitors and within company walls.”

The court noted the FinCEN announcement on March 2, 2025, that it would not enforce the CTA against domestic companies, but reasoned that did not moot the plaintiffs’ case because that announcement did not carry the force of law. *Small Business Association of Michigan v. Yellen*, No. 1:24-cv-00314 (W.D. Mich Mar. 3, 2025).

(5) **FinCEN Alerts.** FinCEN posted Alerts at various times following these events.

FinCEN posted a statement on December 6, 2024, acknowledging that it will comply with the court's order "for as long as it remains in effect" and that the nationwide preliminary injunction "stays all deadlines to comply with the CTA's reporting requirements."

After the Fifth Circuit motions panel granted a stay of the injunction, FinCEN issued an Alert on December 23 noting the stay of the nationwide preliminary injunction but agreeing to an extension of filing deadlines for various situations. Reporting companies created before 2024 would have had until January 13, 2025, to file their initial beneficial ownership information reports.

After the Fifth Circuit panel addressing the merits reinstated the nationwide preliminary injunction, FinCEN issued an Alert on December 27, 2024, noting the Fifth Circuit's action and that "the injunction issued by the district court in *Texas Top Cop Shop, Inc. v. Garland* is in effect and reporting companies are not currently required to file beneficial ownership information with FinCEN."

FinCEN posted a statement on January 24, 2025, observing that the Supreme Court granted the government's motion to stay a nationwide injunction in *Texas Top Cop Shop*, but noted that a separate nationwide injunction issued in *Smith v. U.S. Department of the Treasury* still remains in place.

A posting on February 6, 2025, noted that because of the injunction in effect under *Smith,* reporting companies are "not currently required to file beneficial ownership information with FinCEN" but may voluntarily submit reports. However, the posting indicated that Treasury had filed a notice of appeal in the *Smith* case. The posting also clarified that if the *Smith* district court order is stayed and the reporting rule comes back into effect, FinCEN would extend the reporting deadlines by 30 days and would consider further appropriate deadline modifications:

> If the district court's order is stayed, thereby allowing FinCEN's Reporting Rule to come back into effect, FinCEN intends to extend the reporting deadline for all reporting companies by 30 days. Further, in keeping with Treasury's commitment to reducing regulatory burden on businesses, FinCEN, during that 30-day period, will assess its options to modify further deadlines or reporting requirements for lower-risk entities, including many U.S. small businesses, while prioritizing reporting for those entities that pose the most significant national security risks.

A notice posted February 18, 2025, observed that the *Smith* district court entered an order staying its injunction in light of the Supreme Court's action in the *Texas Top Cop Shop, Inc.* case. FinCEN extended the BOI filing deadlines by 30 days from February 19, 2025, to March 21, 2025, for most reporting companies. The notice stated that during this 30-day period, FinCEN is assessing its option to further modify deadlines, while prioritizing reporting for entities that pose the most significant national security risks. The notice added this statement that had not been in prior notices: " FinCEN also intends to initiate a process this year to revise the BOI reporting rule to reduce burden [sic] for lower-risk entities, including many U.S. small businesses."

FinCEN followed up on that statement on Feb. 27, 2025, stating that no enforcement actions will be taken and no fines or penalties will be issued until new relevant due dates have been announced in a forthcoming interim final rule. The statement also indicates that FinCEN anticipates issuing a notice of proposed rulemaking later this year "to minimize burden [sic] on small businesses while ensuring that BOI is highly useful to important national security, intelligence, and law enforcement activities, as well to determine what, if any, modifications to the deadlines referenced here should be considered."

In a major reversal of course, FinCEN posted a press release on March 2, 2025, that it will not enforce any penalties or fines on U.S. citizens or domestic reporting companies or their beneficial owners. It will narrow the scope of the rule to the BOI rule to foreign reporting companies only.

> Treasury takes this step in the interest of supporting hard-working American taxpayers and small businesses and ensuring that the rule is appropriately tailored to advance the public interest. "This is a victory for common sense," said U.S. Secretary of the Treasury Scott Bessent. "Today's action is part of President

Trump's bold agenda to unleash American prosperity by reining in burdensome regulations, in particular for small businesses that are the backbone of the American economy."

President Trump confirmed suspension of the enforcement of the Corporate Transparency Act as well, calling the reporting requirements an "economic menace" against U.S. citizens, **https://www.newsweek.com/donald-trump-corporate-transparency-act-boi-treasury-2038564**.

Planners are faced with many uncertainties until further guidance is provided. Foreign companies typically form U.S. subsidiaries to do business domestically. Will anything have to be reported about the domestic or foreign parent company in that situation? What will happen to the information beneficial ownership information that has already been provided by the millions of domestic companies that have already filed reports? Should reports for domestic companies still be filed to comply with statutory requirements? *See* John Wooley & Tristan Navera, *Trump's Latest Corporate Transparency Act Move Ignites Questions*, BLOOMBERG DAILY TAX REPORT (Mar. 3, 2025).

Few if any of those cases that have been brought questioning the constitutionality of the CTA involve foreign reporting companies. Query whether the plaintiffs will drop the cases to avoid further attorney fees? The Fifth Circuit in the *Texas Top Cop Shop, Inc.* case is still scheduled to hear oral arguments on April 1, 2025, regarding the validity of the preliminary injunction that was imposed by the district court and stayed by the Supreme Court. However, plaintiffs in *Taylor v. Yellen*, No. 2:24-cv-00527 (D. Utah), secured an order on March 3, 2025, the day after FinCEN's announcement that it would not enforce the CTA against domestic companies, granting the withdrawal of plaintiffs' motion for a preliminary injunction and to stay the case until the issuance of rules "from the Treasury Department and/or FinCEN so that the parties can then meet and confer and reassess what may be left to address with the case, or whether the case should then be dismissed if all constitutional issues have been resolved with the new rules."

(6) **Cases Refusing To Grant Preliminary Injunctions.** Three cases have refused to grant preliminary injunctions against the CTA.

(a) ***Firestone v. Yellen.*** A federal district court in Oregon on September 20, 2024, refused to grant a preliminary injunction against the enforcement of the CTA, finding that the plaintiffs failed to demonstrate a likelihood of success on the merits (that the Act is unconstitutional), irreparable injury, or that the balance of hardships tipped in their favor. *Firestone v. Yellen*, No. 3:24-cv-1034-SI (D. Ore. Sept. 20, 2024). The court addressed claims that the Act exceeded Congress's constitutional authority and claims of unconstitutionality under the First, Fourth, Fifth, Eighth, Ninth, and Tenth Amendments, and that the statute is unconstitutionally vague.

(b) ***Community Associations Inst. v. Yellen.*** A preliminary injunction was also denied on October 24, 2024, by a federal district court in Virginia. The court concluded that the plaintiffs were unlikely to prevail in contesting the constitutionality of the CTA under the Commerce Clause and under the First Amendment or that the FinCEN rules implementing the CTA failed to comply with the Administrative Procedure Act's notice-and-comment requirements. *Community Associations Inst. v. Yellen*, No. 24-cv-1597 (E.D. Va., Oct. 24, 2024).

(c) ***Boyle v. Bessent.*** The U.S. District Court for the District of Maine on February 14, 2025, granted the government's motion for summary judgement, finding that the CTA was constitutionally valid under the Commerce Clause. The court expressed skepticism, however, about the position of the regulations imposing penalties on persons who cause failures to report or are senior officers in a reporting entity that fails to report. The court observed that the statute imposes penalties on reporting companies that do not file beneficial ownership reports, but "the same cannot be said of individuals… A plain reading of the statute, therefore, demonstrates that an individual person cannot be liable under the penalty provision because an individual person is not duty-bound to file a report." *Boyle v. Bessent*, No. 2:24-cv-00081 (D. Me. Feb. 14, 2025).

(7) **Other Cases.** At least three additional cases have been filed in federal courts challenging the constitutionality of the CTA. *Gargasz v. Yellen*, No. 23-cv-02468 (N.D. Ohio Dec. 29, 2023) (arguing invalidity of CTA and its regulations under the Constitution, the Paperwork Reduction Act, and the Administrative Procedure Act and seeking a nationwide injunction); *Black Economic Council of Massachusetts, Inc. v. Yellen*, No. 1:24-cv-11411 (D. Mass. May 29, 2024) (Fourth Amendment rights of beneficial owners and applicants; outside of enumerated powers; First Amendment right to associate; Fifth and Ninth Amendment claims; seeks nationwide injunctive relief);*Taylor v. Yellen*, No. 2:24-cv-00527 (D.C. Utah July 29, 2024) (First Amendment, Fourth Amendment, Due Process, Congress exceeded authority, right to associate; plaintiffs withdrew motion for preliminary injunction following FinCEN announcement that it would not enforce the CTA against domestic companies).

Disclosure provisions in the Bank Secrecy Act were held to be constitutional in *California Bankers Ass'n v. Shultz*, 416 U.S. 21 (1974). S*ee also United States v. Miller*, 425 U.S. 435 (1976).

e. **CPAs Request Suspension of Enforcement of BOI Reporting Until After Constitutionality Cases Are Resolved.** The AICPA, joined by all state CPA societies, sent a letter to Treasury Secretary Yellen and the FinCEN Director on April 2, 2024, asking that all enforcement of BOI reporting be suspended until one year after all court cases related to *NSBA v. Yellen* are resolved.

f. **Legislative Proposal to Repeal CTA.** S.100/H.R. 425, filed January 15, 2025, would repeal the CTA. (The Trump administration has been supportive of the CTA.)

g. **Residential Real Estate Non-Financed Transfers.** Real estate "all-cash" sales in certain geographic areas must currently be reported under the existing Real Estate Geographic Targeting Order program (GTO) under the Bank Secrecy Act. Regulated lenders are excluded because banks already have anti-money laundering (AML) programs and requirements of filing suspicious activity reports (SARs) under the Bank Secrecy Act.

FinCEN on February 7, 2024, filed a Notice of Proposed Rulemaking (RIN: 1506-AB54) generally requiring that non-financed residential real estate transfers to trusts or entities be reported to FinCEN. Final rules were issued on August 28, 2024 (and published in the Federal Register on August 29, 2024) (RIN: 1506-AB58). FinCEN received 621 comments, and the preamble to the final rules responds to those comments. The rules are effective December 1, 2025.

(1) **Purpose.** The purpose of these reporting requirements is to combat and deter money laundering through non-financed residential real estate transfers, because non-financed transfers of residential real estate are subject to less oversight from financial institutions than financed transfers.

(2) **General Reporting Requirement.** The rules impose requirements on "Reporting Persons" (professionals involved in closing residential real estate transfers, including settlement agents, title insurance agents, escrow agents, and attorneys) to report certain information about "beneficial owners" (like the description of beneficial owners under the CTA) for non-financed transfers of residential real estate to a "transferee entity" (such as LLCs, corporations, or partnerships) or "transferee trust." Only one report is required for each reportable transfer, and rules provide which of the professionals would be required to file the report for particular situations.

The reporting requirement applies regardless of the size of the sales transaction (including for gift transactions) as long as the transaction is a non-financed transfer. The preamble to the final rules reasons that "[l]ow value non-financed transfers to legal entities and trusts, including gratuitous ones for no consideration, can present illicit finance risks and are therefore of interest to law enforcement." As discussed below, however, the final rules add an exception for gift transfers by an individual to a trust of which the individual is the settlor of the trust.

(3) **Exceptions (Including Gift Transfers to Certain Trusts).** Various exceptions were included in the proposed rules, including certain transfers involving an easement, transfers that occur as the result of the death of the property's owner, transfers that are the result of a divorce, and

transfers that are made to a bankruptcy estate. The final rules retain those exceptions, with clarifications, and add some additional exceptions.

The transfer resulting from death exception is clarified to include a broad range of transfers occurring because of the death of an individual.

The divorce transfer exception is clarified to include the dissolution of civil unions.

Exceptions are added for court supervised transfers and for transfers to an intermediary as part of a like-kind exchange transaction.

FinCEN refused to grant a broad estate planning transfer exception but provided a broad exception for (i) gift transfers (ii) by an individual (or an individual and his or her spouse) (iii) to a trust of which the same individual(s) are the settlor or grantor.

Sales to trusts would not be excepted from the reporting requirements under this exception for gifts to trusts.

More Detailed Discussion. For a more detailed discussion about the reporting requirements for residential real estate non-financed transfers see Item 10.f of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

h. **Proposed ENABLERS Act.** The required reporting under the CTA may just be the beginning. For example, the rules may be expanded at some point to treat trusts as Reporting Companies (private trusts are viewed very suspiciously throughout much of the world, and FATF may put pressure on the U.S. to require reporting about private trusts).

Over the last decade, bar groups and ACTEC have fought against a requirement that attorneys must file "suspicious activity reports" on their clients (without notice to their clients), **but that may come at some point.** The "Establishing New Authorities for Business Laundering and Enabling Risks to Security Act," or ENABLERS Act, would expand the list of "gatekeepers" who are required under the Bank Secrecy Act to conduct due diligence on clients and file suspicious activity reports, and the expanded list would include attorneys who assist in the following transactions: "the formation or registration of a corporation, limited liability company, trust, foundation, limited liability partnership, or other similar entity" or the "acquisition or disposition of an interest" in one of those entities.

The ENABLERS Act passed the House of Representatives as part of the National Defense Authorization Act of 2023 on July 14, 2022, with broad bipartisan support, but the U.S. Senate voted against including the Act in the 2023 defense budget on December 7, 2022. Similar legislation was not introduced in 2023 or 2024.

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

a. **Background.** A recent case involving the gift tax valuation of life insurance policies raises a thorny issue that has been percolating for years about life insurance policy valuations.

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.)

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.

b. **Basic Facts.** In *DeMatteo v. Commissioner*, Tax Court Docket No. 3634-21 (Petition filed April 9, 2021), 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.

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."

c. **Settlement.** 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.

From a planner's perspective, the settlement is disappointing. If the court in this case had ultimately decided on an appropriate approach for valuing the policies, the case could have been quite instructive regarding the valuation of life insurance policies for transfer tax purposes.

d. **Valuation of Life Insurance Policies.** The terminal reserve guidance was developed in the 1960s when the two types of policies were annual renewable term and whole life. Term insurance has no reserves; a whole life policy provides permanent protection and the insurer must maintain reserves each year to reflect future death benefit claims. The terminal reserve value at any time during a year can be interpolated.

Many new types of policies are now available (e.g., variable universal life, guaranteed no lapse universal life, etc.) Applying the original interpolated terminal reserve guidance to the newer policies often is not helpful and may seem irrelevant to the true value. In some cases, as in *DeMatteo*, the interpolated terminal reserve value plus unexpired term may be above the actual fair market value of the policy. For these new policies, terminal reserve value is not known until the end of the year, so it cannot be interpolated during the year. Several different reserve values now apply – tax reserve values (reflecting the insurer's income tax liability), statutory reserve values (reported on the insurer's annual financial statement), AG38 reserves (used for universal life policies with no lapse secondary guarantees), and deficiency reserves (used with policies with secondary guarantees).

In addition, the creation of a strong secondary market for life insurance policies may be much more relevant in determining the real-world value of policies than reserve values. But there is no ready source of quotations for the secondary market sales. Quotes from different buyers could be widely different from each other. And the secondary market is primarily for older insureds, and obtaining secondary market quotes for young healthy insureds can be more difficult.

Valuation risks include gift tax risks when existing policies are transferred, estate tax risks when a decedent owns a policy on the life of a third person, and fiduciary risks if a policy is sold at too low a value (particularly suspect would be a sale at a price below the interpolated terminal reserve).

While not perfect protection (as evidenced in *DeMatteo*), obtaining an appraisal of a policy may be the best planning approach if terminal reserve values are not available or are not representative of the real-world value of the policy.

12. 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); Invalidity under APA of Notice 2017-10, *Green Rock, LLC v. Internal Revenue Service et al*, 133 AFTR 2d 2024-1630 (11th Cir. June 4, 2024)

a. **Brief Background; *Hewitt* and *Oakbrook Land Holdings*.** 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 "protected in perpetuity" requirement in the conservation easement extinguishment proceeds regulations is invalid to the extent that it disallows the subtraction of the value of post-donation improvements in determining the portion of extinguishment proceeds attributable to the easement, 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 concerning the extinguishment proceeds regulations." *Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 2021). 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.

Hewitt was reversed by the Eleventh Circuit in 2021. *Hewitt v. Commissioner*, 21 F.4th 1336, (11th Cir. Dec. 29, 2021). *Oakbrook Land Holdings* was affirmed about two and a half months later by the Sixth Circuit. *Oakbrook Land Holdings, LLC. v. Commissioner*, 28 F.4th 700 (6th Cir. Mar. 14, 2022), *cert. denied*, 143 S. Ct. 626 (2023).

b. **Synopsis of *Valley Park Ranch*.** The Tax Court, in a reviewed opinion, reversed course from its prior positions in *Hewitt* and *Oakbrook Land Holdings*, concluding that the extinguishment proceeds provision in the regulations was invalid. *Valley Park Ranch, LLC et al. v. Commissioner*, 162 T.C. No. 6 (Mar. 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 *Valley Park Ranch* opinion generally follows the reasoning of the Eleventh Circuit's opinion in *Hewitt*.

c. **Effect on Subsequent Cases.** The *Valley Park* opinion specifically noted that an appeal of the case would lie in the U.S. Court of Appeals for the Tenth Circuit, so the court is "not bound to follow either the decision of the Sixth Circuit in *Oakbrook II* (upholding the regulation) or that of the Eleventh Circuit in *Hewitt* (invalidating the regulation). *See Golsen*, 54 T.C. at 757." In future cases regarding the validity of the extinguishment proceeds regulation regarding post-donation improvements, the Tax Court will follow *Oakbrook Land Holdings* in cases appealable to the Sixth Circuit, but otherwise will find that the regulation is invalid.

d. **Invalidity of Notice 2017-10, *Green Rock, LLC vs. Internal Revenue Service*. The** Tax Court held in *Green Valley Investors, LLC v. Commissioner*, 159 T.C. 80 (2022) (reviewed by the court) that prior Notices describing listed transactions did not comply with the Administrative Procedure Act. The Eleventh Circuit has ruled similarly in affirming an Alabama district court decision. *Green Rock, LLC v. Internal Revenue Service et al*, No. 23-11041 (11th Cir. June 4, 2024) (issuance of Notice 2017-10 labeling certain syndicated conservation easement deals as listed transactions was in violation of the APA; ruling does not address validity of listed transaction designations other than Notice 2017-10), *aff'g* 131 AFTR 2d 2023-562 (N.D. Ala. Feb. 2, 2023). (Final regulations were released October 7, 2024 (TD 10007, RIN 1545-BQ39) treating conservation easements as listed transactions.)

e. **Effect on Analysis of Validity under the APA of Other Regulations.** 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.

f. **Further Discussion.** For further discussion of cases addressing the validity of regulations under the APA, see Item 27 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and Item 17 of Estate Planning Current Developments and Hot Topics for 2022 (December 2022) found **here**, both available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. See Item 18 below for a summary of *Loper Bright Enterprises v. Raimondo*, the 2024 Supreme Court decision rejecting the *Chevron* doctrine regarding the validity of regulations addressing ambiguous statutory provisions.

13. Treatment of Advances to Son as Legitimate Loans vs. Gifts, *Estate of Bolles v. Commissioner*, 133 AFTR 2d 2024-1235 (9th Cir. April 1, 2024) (unpublished opinion), *aff'g per curiam*, T.C. Memo. 2020-71.

a. **Synopsis.** The Tax Court 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). The Ninth Circuit Court of Appeals affirmed in an unpublished per curiam opinion. *Estate of Bolles v. Commissioner*, 133 AFTR 2d 2024-1235 (9th Cir. April 1, 2024) (unpublished opinion).

b. **Basic Facts.** A mother generally wanted to treat her five children equally. She made advances to her children, keeping records of the advances and "occasional repayments for each child," but there were no notes, no collateral, and no attempts to force repayment. She treated the advances as loans, but she "forgave the 'debt' account of each child every year based on the gift tax exemption amount." The court observed that "[h]er practice would have been noncontroversial but for the substantial funds she advanced to Peter."

Peter was the oldest of the children. He took over his father's architecture practice. He experienced success in attracting clients but had financial difficulties largely because his expectations exceeded realistic results. A family trust became liable for $600,000 of his bank loans. Because of his financial difficulties, the mother advanced substantial funds ($1,063,333) to Peter from 1985 through 2007.

The mother prepared a revocable trust dated October 27, 1989, that "specifically excluded Peter from any distributions of her estate upon her death." She subsequently amended the revocable trust to permit Peter to share in her estate but only after accounting for "loans" made to him plus accrued interest. Peter signed an acknowledgement that $771,628 plus accrued interest using the AFR for short-term debt determined at the end of each calendar year, would be subtracted from Peter's share of the estate at the mother's death.

Presumably, the mother forgave some of the advanced amounts to Peter under her annual gift plan, and Peter apparently made some repayments on the loans through 1988, but the IRS asserted that the entire $1,063,333 amount, plus $1,165,778 of accrued interest, was an asset of the mother's gross estate or that $1,063,333 was an adjusted taxable gift to be included in computing her estate tax liability.

c. **Tax Court Analysis.** The court observed the nine factors listed in *Miller v. Commissioner*, T.C. Memo. 1996-3, *aff'd*, 113 F.3d 1241 (9th Cir. 1997) as traditional factors for determining whether an advance is a loan or a gift. The court observed that the mother had recorded the advances and kept track of interest, but there were no loan agreements, collateral, or attempts to force repayment. A critical factor to the court was "that the reasonable possibility of repayment is an objective measure of [the mother's] intent." Peter's creative ability as an architect and ability to attract clients likely convinced the mother that he would be successful and "she was slow to lose that expectation." But she must have realized he would be unable to repay her loans by October 27, 1989, when her revocable trust blocked Peter from receiving additional assets from her at her death.

The court concluded that advances to Peter were loans through 1989 but after that were gifts. Also, the court "considered whether she forgave any of the prior loans in 1989 but [found] that she did not forgive the loans but rather accepted they could not be repaid on the basis of Peter's financial distress."

d. **Court of Appeals Analysis.** The Ninth Circuit Court of Appeals affirmed in a short per curiam opinion (unpublished). The court reasoned that the mother had made loans to her husband over the years for his architecture practice, and they were always repaid. The mother could reasonably assume that loans made to Peter for the business would similarly be repaid, and the advances from 1985 through 1989 were loans. However, the advances after 1989 were gifts. The court reasoned–

> Unlike the payments from 1985 through 1989, the payments after 1990 were made under different circumstances. First, unlike the early years of Mary's payments to Peter, there is no evidence that Peter made any repayments during this period. Second, in late 1989, Peter was specifically excluded from Mary's personal trust. And third, Peter signed an agreement acknowledging that "he has neither the assets, nor the earning capacity" to make repayments. It was reasonable for the Tax Court to conclude that there was no bona fide

creditor-debtor relationship between Mary and Peter during this period, and accordingly that the payments from 1990 through 2007 were gifts.

e. **Planning Observations.** For a discussion of planning observations, including the general analysis of when advances are treated as resulting in bona fide loans and a discussion of various transfer tax related contexts in which the loan issue may arise, see Item 25 of Estate Planning Current Developments and Hot Topics (December 2020) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

14. QTIP Trust Planning; Unanimous Reviewed Tax Court Opinion Rejecting a §2519 Argument the IRS Has Been Making With Increasing Frequency, *Estate of Anenberg v. Commissioner*, 162 T.C. No. 9 (May 20, 2024)

a. **Synopsis.** The Tax Court, in a unanimous reviewed opinion, rejected an attack on Qualified Terminable Interest Property (QTIP) trust planning that the IRS has been making with increasing intensity in recent years. Assets in QTIP trusts (including their future appreciation) will eventually be subject to transfer tax. One planning approach is to move trust assets into the hands of the spouse-beneficiary by distributions to the spouse or by the exercise of a power of appointment in favor of the spouse (see Reg. §25.2519-1(e)), who can then engage in traditional transfer planning alternatives. If the distribution standards are not broad enough to allow direct distributions of assets to the spouse by the trustee or if the trust does not give someone the power to appoint assets to the spouse, an approach that has been used by some planners is to obtain a judicial termination of the trust, resulting in all the trust assets being distributed to the spouse (with the consent of trust remainder beneficiaries). That is the situation addressed by the Tax Court in *Anenberg v. Commissioner*, 162 T.C. No. 6 (May 20, 2024).

QTIP trusts created for the surviving wife (W) by her deceased husband (H) at his death in 2008 were terminated by a state court and all trust assets were distributed to W (with the consent of the remainder beneficiaries, H's sons by a prior marriage) in March 2012. The assets included almost half the stock of a closely held company (Company). In August 2012, W gave about 6.4% of the stock she received from the QTIP trusts to trusts for H's sons. In September 2012, W sold almost all the remaining stock of the Company to trusts for H's sons and grandchildren in return for nine-year secured and partially guaranteed promissory notes bearing interest at the applicable federal rate.

W timely filed a gift tax return for 2012 reporting the August 2012 gifts to the sons and reporting the September 2012 sales as non-gift transactions. W died before the IRS's examination of the 2012 return was completed, and the IRS proceeded with its gift tax claims against W's estate.

The IRS claimed that W owed more than $9 million of gift tax (and a penalty of $1.8 million) under two theories: (i) the termination of the QTIP trusts was a disposition of W's qualifying income interest resulting in a gift under §2519; or (ii) the termination of the QTIP trusts and W's subsequent sale of the stock received from the QTIP trusts resulted in a deemed transfer under §2519. Section 2519 provides generally that a disposition of any portion of the spouse's "qualifying income interest for life" is treated as a transfer of all the remainder interest in the trust.

The Tax Court unanimously rejected both positions (granting W's estate's motion for partial summary judgment and rejecting the IRS's motion for partial summary judgment). The court's analysis was grounded in its view of the "QTIP Regime" to defer transfer taxation for assets passing to a QTIP trust until the death of or gift by the surviving spouse," which is effectively "a legal fiction under which the surviving spouse is treated as receiving all of the QTIP passing from the deceased spouse." Opinion at 4. With this backdrop, the court reasoned: (i) no gift occurred at the termination of the QTIP trusts when the assets were distributed to W, because even if a "transfer" occurred under §2519, no gift resulted because W ended up owning all of the trust assets; and (ii) no deemed transfer under §2519 applied upon the sale of the assets because following the termination of the QTIP trusts, the qualifying income interest for life terminated, and there could be no disposition of something that did not exist.

The court distinguished cases, regulation examples, and rulings cited by the IRS, because they involved situations in which the spouse received nothing in return for the disposition of the income interest or received only the value of the income interest. The result in those cited situations "resulted in one-time taxation of the value of the remainder interests." In contrast, under the *Anenberg* facts, the spouse received all of the trust assets outright, which would subsequently be subject to transfer tax, resulting in double-taxation if a current gift tax on the value of the remainder interest was also imposed under §2519.

The court did not address whether a different result would occur if the trust termination and sale were part of an integrated transaction (the court noted that the IRS did not argue that the "substance over form" doctrine applied) (see Opinion at 25). Also, in footnote 18 the court expresses no view on whether H's sons made a gift by consenting to the termination and distribution to W of all trust assets. (That issue is addressed in, *McDougall v. Commissioner* 163 T.C. No. 5 (Sept. 17, 2024), discussed in Item 15 below, the same case in which the IRS had expressed its litigating position in CCA 202118008.) In addition, footnote 3 clarifies that because the court determined that no gifts resulted under §2519, the court did not have to address whether adequate disclosure had been made on the 2012 gift tax return such that the assessment of additional gift tax was barred by limitations.

Estate of Anenberg v. Commissioner, 162 T.C. No. 9 (May 20, 2024) (Judge Toro, with all judges in agreement).

b. **Basic Facts.** Alvin Anenberg (H) and Sally Anenberg (W) created a joint revocable trust that apparently included much (if not all) of their assets, including all the stock of a closely held company (Company) that owned and operated gas stations. H died in 2008, and various assets passed to Marital Trusts for the benefit of W, including almost half the stock of the Company. The remainder beneficiaries of the Marital Trusts following W's death were H's two sons by a prior marriage. H's executor made the QTIP election under §2056(b)(7).

In October 2011, one of the sons, as trustee of the QTIP trusts, filed a petition with a California state court to terminate the QTIP trusts and distribute all trust assets to W. "[A]ll beneficiaries (current and contingent)" consented to the court action. In March 2012, the court approved the termination and distribution to W of all the trusts' assets to W. At that time, the trusts' assets were worth $25.45 million and W's income interest was worth $2,599,463 (or 10.214% of the trust value, suggesting that W was 81 years of age at that time because the value of a life income interest in a trust for an 81 year-old person in March 2012, when the §7520 rate was 1.40%, was 10.214%).

In August 2012 (five months after the termination and distribution of the QTIP trusts' assets to W), W made a gift of about 6.4% of the shares of the Company she received from the QTIP trusts to trusts for the sons. In September 2012 (six months after the termination), W sold virtually all her remaining shares in the Company (including the roughly 50% that she had owned directly prior to H's death) to trusts for H's sons and grandchildren. Her sale proceeds were nine-year secured and partially guaranteed promissory notes with interest at the applicable federal rate (0.84%).

W timely filed a gift tax return for 2012, reporting the August 2012 gifts to trusts for the sons, and reporting the September 2012 sales as non-gift transactions.

The IRS reviewed the gift tax return, but W died in 2016 before the examination was completed. On December 1, 2020 (more than seven years after the gift tax return was filed), the IRS issued a Notice of Deficiency against W's estate determining that W was liable for more than $9 million in gift tax "as a result of the termination of the Marital Trusts and the subsequent sales of the [Company] shares" (under §2519) with an accuracy related penalty of over $1.8 million. In the Tax Court proceeding, the IRS's second amended answer alleged for the first time an alternative argument that the termination of the QTIP trusts by itself was a disposition of W's qualifying income interest for life, triggering gift tax liability as a result of the deemed transfer of the remainder interest under §2519.

W's estate filed motions for partial summary judgment addressing each of the IRS's two arguments and asking the court to determine "that (i) the termination of the Marital Trusts and the distribution of

the assets of the Marital Trusts to Sally did not result in a deemed gift under [section] 2519; [and that] (ii) Sally's sale of the [Company] shares received from the Marital Trusts in exchange for promissory notes did not result in a deemed gift under [section 2519]." (court's quotation of the motion). The IRS filed motions for partial summary judgment seeking the opposite results.

c. **Holdings That No Gift Tax Results From Alleged Section 2519 Deemed Transfers.**

(1) **Termination and Distribution to W of QTIP Trusts Assets**. "Assuming there was a transfer of property under I.R.C. § 2519 when the marital trusts were terminated, [W's estate] is not liable for gift tax under I.R.C. §2501 because W received back the interests in property that she was treated as holding and transferring under I.R.C. §§ 2056(b)(7)(A) and 2519 and made no gratuitous transfer, as required by I.R.C. §2501."

(2) **Sale of Company Shares**. "[W's estate] is not liable for gift tax on the sale of [Company] shares for promissory notes because after the termination of the marital trusts [W's] qualifying income interest for life in QTIP terminated and I.R.C. § 2519 did not apply to the sale."

d. **Court Analysis of Section 2519 Issues.**

(1) **QTIP Regime.** The policy behind the marital deduction is to allow property to pass untaxed to a spouse, but to apply a transfer tax when property passes from the spouse (either at the spouse's death or by a gift from the spouse). The terminable interest rule is designed to deny a marital deduction in situations when the estate tax would not apply at the spouse's subsequent death.

The QTIP regime is an exception to the terminable interest rule allowing a marital deduction even though the surviving spouse only receives an income interest for life and has no control over the ultimate disposition of the property if the executor makes an election to opt into the QTIP regime so that estate or gift tax will apply when the property passes from the QTIP trust to beneficiaries designated by the first spouse to die. The QTIP rules "create a legal fiction under which the surviving spouse is treated as receiving all of the QTIP, when in reality the surviving spouse acquired only a lifetime income interest in that property." Opinion at 4. The court reiterates that that this "QTIP regime" in effect "creates a legal fiction under which the surviving spouse is treated as receiving all of the QTIP passing from the deceased spouse, when in reality the surviving spouse has acquired only a lifetime income interest in that property." Opinion at 10. The court quotes from *Morgens v. Commissioner*, 678 F.3d 769 (9th Cir. 2012), *aff'g* 133 T.C. 402 (2009):

> The underlying premise of the QTIP regime is that the surviving spouse is deemed to receive and then give the entire QTIP property rather than just the income interest. The purpose of the QTIP regime is to treat the two spouses as a single economic unit with respect to the QTIP property while still allowing the first-to-die spouse to control the eventual disposition of the property.

678 F.3d at 771.

The court observes that "[o]ther Code provisions continue the fiction that the surviving spouse owns the QTIP outright to ensure that if not consumed by the surviving spouse during her lifetime, the QTIP ultimately is subject to either the estate or gift tax." Opinion at 10.

Observation: An interesting article emphasizes the "tax fiction" created by the QTIP regime that in effect treats the spouse as owning the trust assets for transfer tax purposes, as referenced in *Anenberg*. Irwin, *Removing the Scaffolding: The QTIP Provisions and the Ownership Fiction*, 84 NEB. L. REV. 571 (2005).

(2) **Section 2519.** Section 2519 addresses how a transfer tax is applied to QTIP assets when there is a disposition during life rather than at death. In relevant part, §2519 provides as follows:

> Sec. 2519(a). General Rule.—For purposes of this chapter [imposing the gift tax] and chapter 11 [imposing the estate tax], any disposition of all or part of a qualifying income interest for life in any [QTIP] shall be treated as a transfer of all interests in such [QTIP] other than the qualifying income interest.

Accordingly, for gift and estate tax purposes, §2519 treats any disposition of the spouse's income interest as if the surviving spouse transferred 100% of the remainder interests in the QTIP.

The court emphasizes, however, that §2519 merely results in a deemed "transfer" of the assets, but a gift does not occur that is subject to gift taxation if property is transferred in exchange for full and adequate consideration in money or money's worth. Reg. §25.2511-1(g)(1).

(3) **IRS Position.** The IRS contended that W disposed of her qualifying income interest for life, thus triggering a deemed transfer of the remainder interest under §2519 at one of two times: (i) when W agreed to the termination of the QTIP trusts and accepted complete ownership of the QTIP trusts, or (ii) when W, having accepted the QTIP assets, sold them in exchange for promissory notes.

Furthermore, the IRS contended that this triggering of §2519 treats W as transferring the full value of the QTIP assets less only the value of her qualifying income interest, and the full value of the QTIP remainder interest is treated as a gift.

(4) **Taxpayer Position.** W's estate argued (i) the 2012 transactions are not a disposition of a qualifying income interest but merely a conversion into an equivalent interest in other property (thus, §2519 does not apply), and in the alternative (ii) even if there was a disposition, no gift resulted because W received full and adequate consideration for the property she was deemed to transfer.

(5) **Court Analysis of the Parties' Positions Regarding Termination of QTIP Trusts and W's Acceptance of QTIP Assets.** The court does not decide if the termination of the Marital Trusts, followed by W's acceptance of the QTIP assets was a "disposition" within the meaning of §2519(a). The court said it did not need to resolve that question because it reasoned that even if there is a deemed transfer of the remainder interest under §2519, no gift resulted that is subject to gift taxation. Section 2519 may treat certain events as a deemed "transfer" of the remainder interest, but gift tax is imposed under §2501 only "on the *transfer* of property *by gift* during [the] calendar year." Opinion at 14 (emphasis in original). Any deemed transfer of the remainder interest in the Company shares owned by the QTIP trusts that may have occurred under §2519 did not result in a gift because W ended up with all those shares unencumbered.

> … [W's] deemed transfer of the remainder interest in the [Company] shares held in trust … resulted in her actual receipt of all the [Company] shares unencumbered …. At the end of the day, she gave away nothing of value as a result of the deemed transfer. Accordingly, the termination of the Marital Trusts did not result in any "gratuitous transfers" by [W], deemed or otherwise. [Citation omitted] Because there was no gratuitous transfer, she made no gift.
>
> …
>
> Before the termination of the Marital Trusts, [W] held a qualifying income interest for life in the QTIP. She was deemed for estate and gift tax purposes to hold the remainder interests as well. But these interests, even when considered together, did not equate to unencumbered ownership. She was not free to do what she wished with the QTIP, which was held in the trusts. After the Superior Court order, [W] received the QTIP free of any trust restrictions. In these circumstances, to the extent section 2519 viewed [W] as transferring away the interests in property that the QTIP regime treated her as holding in the first place, it is hard to understand why [W] would not have received full and adequate consideration in return when she was also at the receiving end of the transfer of the property unencumbered. Before the Marital Trusts terminated, she actually held an income interest in the Marital Trusts' property valued at approximately $2.6 million, but was deemed to hold the entirety of the Marital Trusts' property valued at approximately $25.5 million. Immediately after the Marital Trusts terminated and (we assume) [W] was deemed to transfer the residual value of the Marital Trusts' property (approximately $22.9 million), she actually held assets valued at approximately $25.5 million. [W] could thus be viewed as fully compensated for whatever interest she was deemed to transfer.

Opinion at 15, 17-18.

Considering all the facts of the case bolsters that conclusion: (i) no value passed to anyone else; and (ii) any purported gift would have been an incomplete gift because the termination was

conditioned on W receiving all the trust assets, so she could control their further disposition, Reg. §25.2511-2(b).

(6) **Court Analysis of Parties' Position Regarding Subsequent Sale of Assets Received from QTIP Trusts.** The court cited two reasons that W's subsequent sale of Company shares she received on termination of the QTIP trusts did not trigger the application of §2519.

First, if the termination of the QTIP trusts was a disposition of W's qualifying income interest, that would have triggered §2519, and it would no longer apply to a subsequent transfer. "[H]er future transactions in the [Company] shares would be covered by the ordinary estate and gift tax rules rather than the QTIP regime."

Second, if the termination of the QTIP trusts was not a disposition triggering §2519, the QTIP trusts no longer existed at the time of the sale, so a qualifying income interest for life no longer existed, thus "eliminating the mechanism needed to trigger section 2519 in the future." Opinion at 19. (Footnote 21 states that the gift of shares in August 2012 did not trigger §2519 for the same reason.)

(7) **Responses to IRS's Arguments** The court responded directly to various IRS arguments made to support its position.

(a) **Consideration of the QTIP Regime.** The court rejected the IRS's position that §2519 itself "imposes gift tax," because §2519 merely results in a deemed "transfer," but §2501 imposes gift tax only on transfers "by gift." Congress used the phrase "transfer by gift" in other Code sections that directly resulted in gift taxation. *E.g.*, §2056A(b)(13) (treating lifetime distributions from a qualified domestic trust "as a transfer by gift").

This result makes sense under the QTIP regime concepts, to permit deferral of transfer taxation until the death of or gift by the surviving spouse.

> Where, as here, a surviving spouse receives the QTIP with respect to which she is deemed to transfer remainder interests, the value of the marital assets is preserved in her estate and will be taxed upon her death, assuming she does not consume the property or transfer it by gift at a later date. This is the same result that obtains when the marital deduction applies without regard to the QTIP regime.

The IRS cited various cases (*Morgens*, *Novotny*, and *Kite*), rulings (Rev. Rul. 98-8), and examples from regulations (Reg. §25.2519-1(a), (f), (g) (examples 1 and 2)) to support its position that gift tax should be imposed whenever a surviving spouse disposes of her qualifying income interest in QTIP. However, in those various sources, "the surviving spouse either disposed of the entire qualifying income interest by gift (i.e. for no consideration whatsoever) or else received consideration for the value of the income interest only." The key policy conclusion from those sources is that a gift tax would be imposed if "the value of the remainder interest in QTIP would have passed out of the surviving spouse's hands (and thus out of the marital unit) without ever being subject to estate or gift tax, contrary to the policy underlying the marital deduction and QTIP rules." Opinion at 21. But in this case, W's "receipt of the QTIP (and later the promissory notes) preserves the value of the marital assets in her hands for future gift or estate taxation." Opinion at 22. Indeed, the termination of the QTIP trust and distribution of its assets to the spouse is somewhat analogous to the appointment of assets to the spouse under a power of appointment, which Reg. §25.2519-1(e) specifically says is not a disposition that triggers §2519.

(b) **Regulation §25.2519-1(a).** The IRS cited Reg. §25.2519-1(a) to support its view that a disposition of any part of the qualifying income interest in a QTIP trust results in a deemed gift of the remainder interest. The second and third sentences of that regulation are as follows:

> For example, if the donee spouse makes a disposition of part of a qualifying income interest for life in trust corpus, the spouse is treated under section 2519 as making a transfer subject to chapters 11 and 12 of the entire trust other than the qualifying income interest for life. Therefore, the donee spouse is **treated as making a gift** under section 2519 of the entire trust less the qualifying income interest, and

> is treated for purposes of section 2036 as having transferred the entire trust corpus, including that portion of the trust corpus from which the retained income interest is payable.

Reg. §25.2519-1(a) (emphasis added).

While the third sentence says the spouse is treated as making a "gift" of the remainder interest, it does not say §2519 deemed transfers are always treated as gifts. The third sentence merely

> completes the example posited by the second sentence, in which the donee spouse has disposed of part of a qualifying income interest for life, presumably for no consideration or for consideration matching the value of the disposed-of partial interest. (That is why the third sentence refers to the "trust corpus" rather than "property" and the donee spouse's "retained income interest.")

Opinion at 24. The third sentence does not state a general rule for all §2519 purposes; the general rule is in the first sentence, which provides simply that "the donee spouse is treated … as *transferring* interests in property other than the qualifying income interest." Reg. §25.2519-1(a) (emphasis added).

(c) ***Estate of Kite.*** IRS attacks under §2519 on QTIP trust planning have intensified following the Tax Court's opinion in *Estate of Kite v. Commissioner*, T.C. Memo. 2013-43, and the IRS "makes much of" *Kite* in this case. *Kite* involved rather complicated facts, but in very simple terms, in a three-day series of planned transactions, the wife-beneficiary of QTIP trusts appointed her children as trustees, they terminated the trusts and distributed all trust assets to the wife, and the wife sold the assets to her children for a deferred private annuity (payment would not begin for 10 years and the wife died before receiving any payments). The court determined that the value of deferred annuity was full and adequate consideration for sale of the QTIP trust assets. The *Anenberg* opinion summarized *Kite* as follows:

> … this Court (at the Commissioner's urging) applied the substance over form doctrine to treat the transactions as one integrated transaction … [a]nd, in doing so, the Court concluded that the termination of the trust and subsequent sale of property was a disposition for purposes of section 2519(a).

Anenberg distinguished Kite on two grounds. (1) *Kite* applied the substance over form doctrine, and (2) because of the sale of QTIP assets for the deferred private annuity in *Kite*, it "involved an apparent attempt to prevent estate or gift tax from ever being imposed on the residual value of the QTIP." Neither of those applied in *Anenberg*. (*Kite* is discussed further in Item 14.e(5) below.)

(d) **No Consideration.** The IRS reasoned that the value of the Company shares was already included in W's taxable estate before the termination of the QTIP trusts, so the receipt of the Company shares could not have constituted adequate and full consideration "because she was already deemed to own them." The court viewed this as a "wanting to have your cake and eat it too" argument by the IRS.

Under the QTIP regime, the value of the Company shares was included in W's estate before the QTIP trusts were terminated, and the court acknowledged that "section 2519(a) deemed [W] as giving up the remainder interests that she previously was deemed to have received from [H]. This in turn resulted in a (temporary as we will momentarily see) diminution of her estate." But that was only half the story.

> But the transaction did not stop there, and our analysis is not yet finished. The Superior Court ordered that all of the property held by the Marital Trusts be distributed to [W]…. The receipt of those shares "replenished" or "augmented" her (temporarily) diminished estate. In analyzing the tax consequences of the deemed transfer section 2519 contemplates, we cannot ignore that, as part of the same transaction, [W] in fact wound up with the unencumbered [Company] shares. We therefore decline the Commissioner's invitation to decide the case by taking into account only half of the relevant transaction.

Opinion at 26-27.

e. **Observations.**

(1) **Major Blow to IRS Attacks Under §2519.** Ever since the Tax Court's decision in *Kite v. Commissioner* over ten years ago, the IRS has increasingly been making §2519 attacks on planning involving existing QTIP trusts. The holdings and reasoning in the unanimous reviewed Tax Court opinion in *Anenberg*, delivered merely **three months** after the hearing on the motions for partial summary judgment, are a major blow to §2519 arguments the IRS has been making. If all the QTIP trust assets are distributed to the spouse-beneficiary, who later engages in transfer planning transactions, §2519 will not result in a deemed gift of the remainder interest subject to gift tax (at least if the termination/distribution/ transfer transactions are not part of an integrated plan under the substance over form doctrine – more about that in Item 14.e(3) below). The court's focus on the "QTIP regime," the tax fiction treating the spouse as owning the QTIP trust assets, and the key policy of deferring transfer taxation until the surviving spouse's subsequent death (or gifts) but avoiding a resulting double taxation may be the guidepost for future decisions.

(2) **Commutations.** Commutation transactions, in which a QTIP trust is terminated by paying the beneficiaries the actuarial values of their respective interests, will continue to be subject to §2519 attacks. If the spouse-beneficiary is merely paid the actuarial value of his or her qualifying income interest for life, the reasoning in *Anenberg* specifically indicates that §2519 generally will apply, and the spouse will be treated as making a gift of the value of the remainder interest.

Anenberg reasons that because the spouse received *all* the QTIP trust assets, the spouse did not make a gift. To the extent the spouse does not receive all the QTIP assets, the difference would be a gift (either of a portion of the income interest or, more likely, of the remainder interest under §2519).

Footnote 17 in *Anenberg* specifically says that §2519 would apply and a taxable gift of the remainder interest would result in the classic commutation situation in which the spouse receives just the actuarial value of her income interest.

> The result would be different if [W] had received only the value of her qualifying income interest for life when the Marital Trusts terminated. In such a case, [W] would have been left with assets valued at approximately $2.6 million. The gratuitous transfer under section 2519 would be plain (although deemed) and would total approximately $22.9 million ($25.5 million of assets deemed held before the termination less her $2.6 income interest).

An extension of *Anenberg* is what would happen if the spouse received more than just the value of the qualifying income interest for life, but less than the full trust value. The reasoning in *Anenberg* suggests that the spouse makes a gift only to the extent that a "gratuitous transfer" is made. For example, assume a $100 QTIP trust is terminated and the spouse receives $40 even though the value of her income interest is only $20. If that is treated as a disposition of any portion of the income interest that triggers §2519, is the spouse treated as making a gift of the full value minus the value of the income interest ($100 - $20 = $80)? That would not make sense under the *Anenberg* reasoning, because the spouse was deemed to own $100 under the "legal fiction" of the QTIP regime and ends up owning $40 after the transaction. How does a gratuitous transfer occur of more than $60 ($100 owned before the transaction - $40 owned after)? The court's emphasis on the "gratuitous transfer" requirement suggests that a gift tax would not be imposed on the full value of the remainder interest.

Observe, that conclusion appears to be a repudiation of *Kite II*, which refused to allow any offset in the determining amount of gift resulting from a §2519 transfer for amounts received by the spouse in a transfer that triggers §2519. See Item 14.e(5)(b) below.

(3) **Step Transaction Doctrine.** The court's reasoning to distinguish *Kite* from this case is in part that *Kite* involved a substance over form argument which the IRS did not allege in this case. (In *Kite*, the termination of the QTIP trusts, the distributions of all assets to the surviving wife, and the sale by the wife for the deferred private annuity all occurred within a *three-day* span, whereas the gifts and sales of the QTIP trust assets in *Anenberg* occurred five months and six months, respectively, after the trust termination.)

Even if trust termination and a *sale* of the assets received from the trust are treated as integrated transactions, the spouse may not be treated as making a gift of the remainder interest under §2519 under the reasoning of *Anenberg*. The court reasoned that the deemed transfer of the remainder interest when §2519 is triggered results in a gift for gift tax purposes under §2501 only to the extent it is a "gratuitous transfer." If the spouse ends up with promissory notes having a current value equal to the value of the QTIP trust assets, presumably no gratuitous transfer occurs.

On the other hand, if a QTIP trust termination and *gift* of assets are treated as an integrated transaction, a gratuitous transfer would occur and some taxable gift may result under §2519. However, the gift may result only as to the gifted assets, and not the full remainder value of the trust, because the spouse would still own the remaining QTIP trust assets that had been distributed to her following the QTIP trust termination. Those assets will be subject to transfer tax when the spouse subsequently dies or makes a gift of the assets, and the underlying premise of the QTIP regime and purpose of assuring that the QTIP trust assets will eventually be subject to a transfer tax would be served without imposing gift tax on the entire remainder interest under §2519 at the time of a gift of some portion of the assets in connection with the trust termination. That goes to the issue of whether *Anenberg* repudiates *Kite II* (as discussed in Item 14.e(5)(b) below). Treating the full remainder interest value as a taxable gift currently and subjecting the remaining assets to a transfer tax at death or upon a later gift would result in double taxation of that value. The court's summary in *Anenberg* suggests that double taxation would not be appropriate.

> To summarize, in each of the Commissioner's cited sources, imposing the estate or gift tax resulted in *one-time taxation* of the value of the remainder interests in QTIP at the time that value left (or was deemed to leave) the surviving spouse's hands.

Opinion at 28 (emphasis added).

(4) **Gift by Remainder Beneficiaries Who Consent to All QTIP Assets Being Distributed to Spouse-Beneficiary; CCA 202128008; *McDougall v. Commissioner*.** A significant risk exists that the remainder beneficiaries may be treated as making a taxable gift to the spouse by consenting to the spouse receiving all the trust assets rather than just the actuarial value of her lifetime income interest. The IRS took the position in CCA 202128008 that trust remaindermen made a gift when they consented to the surviving husband receiving all the QTIP trust assets in a nonjudicial settlement agreement terminating the QTIP trust. For a detailed discussion (and strong criticism) of CCA 202118008, see Item 8.h of Estate Planning Current Developments (Mar. 16, 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. The cases connected with that CCA are addressed in *McDougall v. Commissioner*, 163 T.C. No. 5 (Sept. 17, 2024), discussed in Item 15 below.

(5) **Impact of Kite v. Commissioner.**

(a) ***Kite v. Commissioner* Brief Summary.** Mrs. Kite ("Wife") created a QTIP trust for Mr. Kite ("Husband") who died a week later. (Presumably, that inter vivos QTIP trust was created to obtain a basis adjustment at Husband's death, despite the limitations imposed by §1014(e).) Under the terms of the trust the assets remained in the QTIP trust for Wife's benefit, and Husband's estate made the QTIP election to qualify for the estate tax marital deduction.

Subsequently, the assets of the QTIP trust as well as another QTIP trust and a general power of appointment marital trust (collectively the "Marital Trusts") were invested in a limited partnership. Eventually the trusts' interest in a restructured partnership was sold to the Wife's children (and trusts for them) for notes and the notes were contributed to a general partnership. In a three-day series of planned transactions, Wife replaced trustees of the Marital Trusts with her children as trustees, the children as trustees terminated the Marital Trusts (effective three months earlier) and distributed all of the trust assets (i.e., the interest in the general partnership) to Wife's revocable trust, the children contributed additional assets to the general partnership, and Wife (almost age 75) sold her partnership interests to her

children for a deferred private annuity (annuity payments would not begin for 10 years). Wife died three years later before receiving any annuity payments.

(The children's authority as trustees to terminate the Marital Trusts and distribute all the assets to Wife is unclear. The opinion describes the principal distribution standards for the QTIP trust that Wife originally created but not for the other trusts. Principal from that QTIP trust could be distributed for "maintenance" and the trust could be terminated if the trust corpus was too small to justify management as a trust.)

The court's initial decision, *Kite v. Commissioner*, T.C. Memo. 2013-43 (decision by Judge Paris) (referred to as "*Kite I*"), held as follows.

1. The transfer of assets in return for the private annuities was for full consideration, was not illusory, and did not lack economic substance. Using the IRS actuarial tables was appropriate, even though the annuity payments would not begin for 10 years and Wife had only a 12 1/2 year life expectancy, because Wife was not terminally ill at the time of the sale and she had at least a 50% chance of living more than one year. The sale was not illusory and was bona fide because the annuity agreement was enforceable and the parties demonstrated their intention to comply with the annuity agreement. "The annuity transaction was a bona fide sale for adequate and full consideration."

2. The transfer of assets from the QTIP Trusts to a limited partnership in return for limited partnership interests, the subsequent reorganization of the partnership as a Texas partnership (to save state income taxes), and the trusts' sale of the interests in the general partnership in return for 15-year secured notes did not constitute a disposition triggering §2519.

3. The liquidation of the QTIP trusts and the sale of the interests in the general partnership for the private annuities were part of an integrated transaction that was deemed to be a disposition of her qualifying income interest for life, that triggered §2519 and in turn caused a deemed transfer of the remainder interests in the QTIP trusts. The deemed transfer of the income interest was not a taxable gift under §2511 because Wife received full value. *Kite I* did not discuss what, if any, taxable gift resulted from the deemed transfer of the remainder interest. (The effect of the transfer of the income interest is determined under the general gift tax principles of §2511—the value of the portion of the income interest that is transferred less the consideration received for such transfer).

4. The transfer of assets from the general power of appointment marital trust to Wife was not a release of her general power of appointment causing a transfer under §2514 for gift tax purposes. The court only considered the termination of the marital trust and did not also consider the subsequent private annuity transaction as part of an integrated transaction in determining tax consequences of the transactions involving the general power of appointment marital trust.

Kite II is the court's Order and Decision regarding the Rule 155 computations of the gift tax as a result of the decision in *Kite I*. (Cause No. 6772-08, unpublished op. Oct. 25, 2013). The estate argued that no gift resulted from the deemed transfer of the remainder interest under §2519 because of the court's decision in *Kite I* that the Wife's sale of assets that she received from the QTIP trust in return for a deferred private annuity was a bona fide sale for adequate and full consideration.

Despite countervailing indications in the statute, regulations, and legislative history, the court in *Kite II* interpreted §2519 to mean that the full amount of the deemed transfer of the QTIP trust remainder interest is a gift, regardless of any consideration received by the surviving spouse. "[A] deemed transfer of a remainder interest under section 2519 cannot be made for adequate and full consideration or for any consideration."

The conclusion in *Kite II* that the amount of the *gift* resulting from the deemed *transfer* of the remainder interest was not offset by any payments made to the spouse was strongly criticized at the time it was published. *See Recent Developments*, 48th ANN. HECKERLING INST. ON EST. PL. (2014) (Ronald Aucutt ed.). Most planners and commentators had believed following *Kite I* that a zero gift would result from the deemed transfer of the remainder interest considering the court's determination that the wife received full value (an annuity) when she transferred the assets of the QTIP trust. *See e.g.,* Jeffrey Pennell, *Jeff Pennell on Estate of Kite: Will It Fly?* LEIMBERG EST. PL. EMAIL NEWSLETTER, Archive Message #2062 (Feb. 11, 2013).

For a more detailed discussion of *Kite I* and *Kite II*, see Akers, *Kite v. Commissioner*, Rule 155 Order and Decisions (Cause No. 6772-08, unpublished opinion October 25, 2013) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights)**.

(b) ***Estate of Anenberg* Largely (If Not Totally) Repudiates *Kite II.*** *Anenberg* goes a long way toward repudiating *Kite II* in many situations. *Anenberg* very clearly concludes that, at least in situations in which the entire QTIP trust assets are distributed to the spouse in a judicial termination of the trust, if there is a disposition of any of the qualifying income interest for life that results in a deemed "transfer" of the remainder interest under §2519, no taxable gift results of the remainder interest if the surviving spouse receives all the trust assets. No "gratuitous gift" has occurred, so no taxable gift of a deemed transfer of the remainder occurs following the disposition.

Whether that same result would apply if the termination of the trust and distribution of assets to the spouse and a sale by the spouse of the trust assets are treated as an integrated transaction under the "substance over form" doctrine was not addressed in *Anenberg*, but the reasoning in *Anenberg* would suggest that assets owned by the spouse following the integrated transaction (i.e., the promissory notes representing the sale proceeds) should offset any deemed gift of the remainder interest.

A further wrinkle in *Kite* is that the transaction involved a sale for a deferred private annuity with a structure that was planned to avoid subjecting any of the QTIP trust assets to estate or gift taxation, which is what happened in *Kite* because the Wife died before any annuity payments began and her annuity interest therefore terminated. Reducing the estate tax on the QTIP assets to zero was a byproduct of using a deferred private annuity sale transaction, but whether court after *Anenberg* would reach a differing result under §2519 on those facts cannot be known until a court rules directly on that situation.

(6) **Income Tax Consequences.** *Estate of Anenberg* does not discuss the income tax consequences of the judicial termination of the QTIP trusts (presumably, the IRS did not raise the issue). See Item 15.e(5) below.

(7) **Planning Regarding Spouse's Interest in QTIP Trusts.** For a discussion of QTIP trust planning alternatives, see Item 15.e(4) below.

15. QTIP Trust Planning; Do Remainder Beneficiaries Make Gifts by Consenting to Spouse Receiving All QTIP Assets?, *McDougall v. Commissioner,* 163 T.C. No. 5 (Sept. 17, 2024); CCA 202118008

a. **Brief Synopsis.** *McDougall* is a Tax Court case that involved planning for assets in a large (about $118 million) QTIP trust that had more than doubled since it was funded five years earlier. The trust was created following the wife's death, requiring that all net income be distributed to the surviving husband (H) and allowing principal distributions to him in the trustee's discretion for his health, maintenance, and support. H held a testamentary power of appointment to appoint the assets to the deceased wife's descendants, and in default of exercise the remainder at H's death would pass equally to their children (or the descendants of a deceased child).

Five years after the trust was created, H, as current beneficiary and trustee, and his two children ("Children") as remainder beneficiaries, and virtual representatives of the contingent remainder beneficiaries, entered into an agreement to have all the trust property distributed to H. On the same

day, H transferred "substantially all" the trust assets to trusts for the Children and their descendants in return for secured promissory notes.

This case was addressed in CCA 202118008. The IRS concluded that (1) descendants made gifts to H of their remainder interest, (2) H made a gift of the QTIP trust remainder interest under §2519, and (3) H used gift exclusion and would have notes from the sale included in his gross estate.

The Tax Court issued a reviewed opinion on September 17, 2024, deciding two issues raised in cross motions for summary judgment by the parties.

First, the court held that H did not make a gift of the remainder interest under §2519. Neither (1) the termination of the trust and distribution of all assets to H nor (2) the distribution of assets to H coupled with the sale of substantially all the assets to trusts in return for notes resulted in a gift under §2519. Relying on *Estate of Anenberg*, the court reasoned that it did not decide whether those events resulted in "disposition" of any part of H's qualified income interest that triggered §2519. Even assuming there was a disposition that triggered §2519, because H ended up with all the trust assets (or notes reflecting the value of the trust assets) he made no gratuitous transfer. (The *McDougall* majority opinion did not mention the alternative "incomplete gift" rationale discussed in *Estate of Anenberg*.)

Second, the court held that the Children made gifts to H by agreeing that all the trust assets could be distributed to H. *Estate of Anenberg* did not discuss whether the remainder beneficiaries made gifts by agreeing to have all assets distributed to the spouse, but the IRS did raise that issue in *McDougall*. The majority's reasoning to support its conclusion that the Children made gifts by agreeing that all assets could be distributed to H included the following.

- The "QTIP fiction" treating H as owning the property focuses on deferring, imposing, and collecting a single transfer tax, not on transactions that persons other than the spouse may take with respect to their own interests in the QTIP.
- There are no "reciprocal gifts" between H and the Children because H is not treated as making a gift to the Children under §2519; furthermore, they already owned the remainder interests and a deemed transfer of remainder interests to them under §2519 "added nothing to their bundle of sticks."
- H's existing interest in the QTIP does not negate a gift by the Children; he was deemed to hold rights to the QTIP assets for purposes of determining *his* transfer tax liability, not whether others made gifts to him of their interests in the trust.
- The economic positions of the parties changed as a result of the distribution of all assets to H.

The court will determine the value of the Children's gifts to H in a later proceeding. The court specifically observed that "under the terms of [the wife's] will, [H] could have decided in his own will to reduce one of the children's shares significantly," and added in a footnote that "the import (if any) of these terms for the value of [the Children's] remainder rights remains to be decided."

A concurring opinion by Judge Halpern (who was the trial judge) reasoned that H did not dispose of a qualifying income interest in the property and therefore did not trigger §2519 (observing, among other things, that a regulation analogously provides that a distribution of QTIP assets to the spouse under a power of appointment does not result in a disposition of the income interest by the spouse that triggers §2519 even if the spouse subsequently disposes of the appointed property.) Because H made no deemed transfer under §2519 to the Children, "their 'very real' transfers to him stand alone as taxable gifts."

The trial to determine the value of the children's gifts is set for June, 2025 (the case has been reassigned to Judge Halpern for the trial). All the gift issues have been resolved regarding H, and a final order and decision for his case was entered December 26, 2024. (Taxpayers resided in Washington, so an appeal would be heard by the Ninth Circuit Court of Appeals. Any notice of

appeals must be filed with Tax Court clerk within 90 days of the entry of the final decision; that would be March 26, 2025.)

McDougall v. Commissioner, 163 T.C. No. 5 (Sept. 17, 2024) (majority opinion by J. Toro, concurring opinion by J. Halpern).

b. **Basic Facts.** Husband (H) was the beneficiary of a QTIP trust created by his deceased wife, who died in 2011. The trust was funded with about $54 million, and five years later it had more than doubled to about $118 million. The trust required that all net income would be distributed to H and allowed principal distributions to H in the trustee's discretion to provide for H's "health, maintenance and support in his accustomed manner of living." H held a testamentary power of appointment to appoint the assets to the decedent-wife's descendants. To the extent the power of appointment was not exercised, the remainder would be divided following H's death "into equal shares, one share for each of [the wife's] children who is then living and one share for each of [her] children who is then deceased with descendants then living."

In 2016, H, as current beneficiary and trustee, his two Children as remainder beneficiaries, and virtual representatives of the contingent remainder beneficiaries, entered a nonjudicial agreement to have all the trust property distributed to H. On the same day, H transferred "substantially all" the trust assets to trusts for the Children and their descendants as a sale in return for secured promissory notes.

Notices of Deficiency asserted that H made a gift of the remainder interest under §2519 equal to about $106.8 million and the Children made gifts in an equal amount back to H. H's gift tax deficiency was about $47.7 million and the Children's gift tax deficiency was about $43.4 million, resulting in total gift tax deficiencies of over $90 million. In addition, H was left owning promissory notes equal to the value of the QTIP assets that would be subject to transfer tax in the future.

The net results to the taxpayers from the positions taken in CCA 202118008 were: (1) the Children were treated as making gifts to H of their remainder interest; (2) H was treated as making a deemed gift under §2519 of the full value of the remainder interest; and (3) the gift/sale by H of the trust assets utilized a small portion of his gift exclusion amount and H would have the value of notes included in his estate for estate tax purposes. For a detailed discussion of CCA 202118008, see Item 8.h of Estate Planning Current Developments (Mar. 16, 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

The three gift tax cases involving H and each of the two Children were consolidated for trial. *McDougall v. Commissioner*, Docket Nos. 2458-22, 2459-22, and 2460-22 (Petitions filed February 18, 2022, Judge Halpern). (The taxpayers are represented by John Porter, Keri Brown, and Tyler Murray.) For a detailed description of the IRS's and taxpayers' arguments in the case, see Item 30 of Akers, Aucutt, and Nipp, *Estate Planning Current Development and Hot Topics* (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

c. **Majority Opinion Analysis.**

(1) **No Gift of the Remainder Interest by H Under Section 2519; Analysis Relying on *Estate of Anenberg*.** The majority opinion summarized "lessons from *Estate of Anenberg*." *Estate of Anenberg v. Commissioner*, 162 T.C. No. 9 (May 20, 2024), addressed similar facts. It reasoned that the court did not need to decide if the spouse-beneficiary made a disposition of any part of the qualifying income interest that triggered a deemed transfer of the remainder interest under §2519. Even if it did, that only resulted in a deemed "transfer" of the remainder interest, but no gift resulted because the surviving spouse ended up actually owning all the assets unencumbered. "At the end of the day, she gave away nothing of value as a result of the deemed transfer." *Estate of Anenberg v. Commissioner*, slip op. at 15.

The IRS in *McDougall* maintained that H made a deemed gift of the remainder interest under §2519(a) arguments: (1) because of "the implementation of the Nonjudicial Agreement"; or (2) by "the implementation of the Nonjudicial Agreement coupled with the subsequent sale of the trust

property for promissory notes." The court rejected the IRS's position. Footnote 5 of the majority opinion in *McDougall* stated (similar to *Estate of Anenberg*) that the court did not decide whether a disposition of H's qualifying income interest occurred that triggered §2519. Even if it did, no gift of the remainder interest resulted "for the reasons we set out in Estate of Anenberg." *McDougall v. Commissioner*, slip op. at 11.

(2) **Children Made Gifts.** The majority rejected various arguments by the taxpayers to support that the Children made no taxable gifts by agreeing that H could receive all the trust assets.

(a) **Scope of the QTIP Fiction.** Taxpayers argued that the QTIP fiction (treating the spouse as owning the QTIP) means "the children simply had nothing that they could give away." *Id*. at 13. The court observed that the QTIP fiction does not apply for all purposes (citing *Estate of Mellinger v. Commissioner*, 112 T.C. 26 (1999)), but more importantly reasoned that the QTIP provisions focus on deferring transfer tax until the death of or gift by the surviving spouse. They focus on the transfer of marital assets outside the marital unit but "say nothing about, and do not apply to, transactions that transferees outside the marital unit, such as [the Children], may undertake with respect to their own interests in QTIP." *McDougall v. Commissioner*, slip op. at 13.

(b) **Reciprocal Gifts.** The taxpayers argued that H and the Children made reciprocal gifts that offset each other. However, the court's determination that H did not make a gift under §2519 meant that no reciprocal gifts could have occurred. Furthermore, the Children could not receive anything of value as a result of the nonjudicial agreement because "they already had the remainder rights" and a deemed transfer under §2519 "added nothing to their bundle of sticks." *Id*. at 14.

(c) **H's Existing Interest in the QTIP.** Taxpayers argued that while the Children may have interests under state law as trust remainder beneficiaries, H is treated as the owner of the assets for tax purposes under the fiction of the QTIP regime. How can one make a gift of an asset to a donee who already owns the asset for tax purposes? The court disagreed. "Any rights [H] may have been deemed to hold because of the QTIP fiction do not negate the very real interests [the Children] held …." *Id*. at 15. If the Children had transferred their rights to a third party, the transfers would clearly be a gift; that H was the recipient does not change this conclusion.

(d) **Economic Position of the Parties.** The taxpayers maintained that the economic positions of the parties were unchanged, but the court explained why the economic positions of the parties clearly changed. H did not own the assets outright before the trust termination but afterward he did. The Children owned remainder interests before the termination and afterward they did not. *Id*.

(3) **Value of Children's Gifts.** The court will determine the value of the Children's gifts to H in a later proceeding. *Id*. at 12, n.7. The trustee could make discretionary principal distributions to H, and H held a testamentary power of appointment to appoint trust assets to the wife's descendants. The court specifically observed that "under the terms of [the wife's] will, [H] could have decided in his own will to reduce one of the children's shares significantly," *id*. at 15-16, and added in a footnote that "[t]he import (if any) of these terms for the value of [the Children's] remainder rights remains to be decided." *Id*. at 16, n.10. (Because the valuation issue is still pending regarding gifts by the children, there is no final judgment, and periods to appeal the children's cases are not running.)

d. **Concurring Opinion Analysis.** The fourteen-page majority opinion (ten pages of which discussed the legal issues) is followed by a thirteen-page concurring opinion by Judge Halpern (who is the trial judge) describing how he would analyze the case differently than the other thirteen judges to arrive at the conclusion that the Children made gifts by joining in the nonjudicial agreement terminating the trust and leaving all the trust assets to H.

(1) **Adequate Consideration vs. Incomplete Transfer Rationale.** *Estate of Anenberg* discussed two alternate approaches for its conclusion that the surviving spouse did not make a gift of the

remainder interest under §2519: (1) the spouse received adequate consideration offsetting the value of a deemed transfer of the remainder interest; or (2) the spouse's deemed transfer under §2519 resulted in an incomplete gift. The *Estate of Anenberg* opinion relied primarily on the adequate consideration rationale.

(2) **That Approach Yields Incongruous Results in *McDougall*.** The issue in *McDougall* is whether the Children made gifts. The concurring opinion interprets the majority analysis as treating H as receiving adequate consideration for his deemed transfer of the remainder interest "but, from [the Children's] perspective, their transfers were wholly gratuitous and thus taxable gifts." *McDougall v. Commissioner*, slip op. at 21. Judge Halpern questions "whether the bounds of the QTIP fiction are so clearly delineated as to justify that differential treatment." *Id*.

(3) **Scope of QTIP Fiction.** Section 2519(a) does not "expressly provide that the surviving spouse can be treated as having received consideration for a deemed transfer of interests" [the issue explored in the controversial *Kite II* order], and Judge Halpern asks how far the QTIP fiction can be extended beyond the express terms of the relevant statutory provisions. *Id.* at 22. After striking down what Judge Halpern perceives as several red herrings (reciprocal gift arguments and whether the *U.S. v. Grace* doctrine applies to perceived reciprocal gifts), the concurring opinion reasons that the majority justifies treating H but not the Children as receiving adequate consideration, in its "selective recognition of offsetting transfers by perceived limits on the scope of the QTIP fiction." *Id*. at 23. But Judge Halpern observes philosophically: "Transfers that, from [H's] perspective, were consideration paid *to him* should be viewed, from [the Children's] perspective, as consideration paid *by them*." *Id*. at 24 (emphasis in original). Judge Halpern believes that philosophical dichotomy could be avoided with an alternate analysis.

(4) **Alternative Analysis Using Incomplete Gift Rationale.**

(a) **Following the Incomplete Gift Rationale.** If any deemed transfer was a wholly incomplete gift, "it cannot have provided adequate and full consideration to [the Children] for their transfers to him." *Id*. Judge Halpern believes the wholly incomplete gift analysis may "prove too much." *Id*. But it calls into question whether, because of the interests and control H had in and over the trust assets, "a disposition of [H's] qualifying income interest in the [trust] property occurred in the first instance." *Id*.

(b) **No Disposition Under §2519(a)**. That H relinquished his beneficial interest in the QTIP "*trust*" "is of no moment." *Id*. at 25. Section 2519(a)'s references to "any disposition of all or part of a qualifying income interest in property to which this section applies" is to the property for which a marital deduction was allowed–the property that funded the QTIP trust. The issue "is not whether [H] disposed of his interest in the *trust* but whether he disposed of his qualifying income interest in the *trust property*." *Id*. (emphasis added).

After the trust termination H may have relinquished his beneficial interest in the trust, but he "owned *all* the interests in the property." *Id*. (emphasis in original). While the termination of the trust may have terminated H's qualifying income interest in the property, he retained all interests he owned in the trust property before the termination (which included the right to all income) and also received additional rights (outright ownership). "Acceptance of additional rights to property that add to those previously owned cannot be viewed as a relinquishment of the previously owned rights." *Id*. at 26.

Accordingly, Judge Halpern concludes that the disposition of all the trust property to H "did not effect a disposition of his qualifying income interest in the trust property" under §2519(a). That is consistent with the policy of the QTIP regime because the property (or sales proceeds from the sale of the property as pointed out in footnote 4 of the concurring opinion) would be included in H's gross estate under §2033.

On the other hand, a commutation of the trust with H receiving only the value of the income interest "would have effected a disposition of [H's] qualifying income interest in the trust assets" because he "would have relinquished any interest in the trust assets distributed to [the Children]." *Id*. at 27.

Judge Halpern points out the analogy the taxpayers had noted to Reg. §25.2519-1(e), stating that "[t]he exercise … of a power to appoint [QTIP] to the donee spouse is not treated as a disposition under section 2519, even though the donee spouse subsequently disposes of the appointed property." The regulation further supports that the distribution of all trust assets to H did not result in a disposition triggering §2519 because "the distribution of all trust property to [H] had the same effect as the exercise of a power to appoint the [trust] property to [H]." *Id*. at 28.

(5) **Conclusion**. If the distribution of all trust property to H pursuant to the nonjudicial agreement was not a deemed transfer under §2519(a) from H to the Children, "then, as the majority concludes, he made no taxable gifts to them, and their 'very real' transfers to him stand alone as taxable gifts." *Id*. at 29. Judge Halpern points out that, unlike the analysis in the majority opinion, this analysis "does not depend on treating a single exchange differently from the perspective of the transferors and the transferee …. Concluding that the implementation of the Nonjudicial Agreement did not effect a disposition of [H's] qualifying income interest provides a more straightforward justification for the conclusions that [H] did not make a taxable gift but [the Children] made taxable gifts to him." (The majority responded in footnote 11 at the end of the majority opinion that "the analytical path [the concurring opinion] offers is neither more straightforward nor sounder than the one we adopt.")

e. **Observations.**

(1) **Analysis Important for Growing Attacks by IRS on Transactions With QTIP Trusts**. Planning for surviving spouses who are beneficiaries of substantial QTIP trusts is complicated but very important because assets remaining in a QTIP trust at the surviving spouse's death will be included in the surviving spouse's gross estate for estate tax purposes. The §2519 issue appears to be a focus of the IRS, and the IRS has been attacking transactions involving QTIP trusts under §2519 with growing frequency. John Porter, one of the attorneys representing the taxpayer in *Estate of Anenberg* and in *McDougall*, says he is aware of several of these types of cases currently in litigation. Various attorneys indicate they have pending examinations involving §2519.

Estate of Anenberg and *McDougall* make clear that those attacks under §2519 will be unsuccessful in situations where all QTIP assets are distributed to the spouse-beneficiary. The key to the §2519 analysis in both cases is that assets passing to the spouse-beneficiary can be applied to offset deemed transfers of the remainder interest under §2519, repudiating the result in *Kite II*. (*Kite I* and *Kite II* are discussed in Item 14.e(5) above.) *McDougall,* however, indicates that gift issues may arise for remainder beneficiaries when QTIP trusts are terminated early with the consent of the remainder beneficiaries.

(2) **Commutations**. That "offsetting transfer" analysis would not prevent a classic commutation of beneficial interests in a QTIP trust from resulting in a deemed gift under §2519. To the extent the spouse does not receive all the QTIP assets, the difference would be a gift (either of a portion of the income interest or, more likely, of the remainder interest under §2519). Footnote 17 *in Estate of Anenberg* and Judge Halpern's concurring opinion in *McDougall* specifically pointed out that §2519 could be triggered under a classic commutation of beneficial interests. *See also* Letter Ruling 202016002 (commutation of a spouse's qualifying income interest in a QTIP trust in return for the actuarial value of the income interest treated as a transfer under §2519 of all interests in the trust other than the qualifying income interest; remainder interest was held by charitable trust and deemed transfer by the spouse to the charitable trust qualified for the gift tax charitable deduction). The spouse would be treated as disposing of a qualifying income interest if the spouse does not receive all the trust assets on the early termination of the trust because the spouse "would have relinquished any interest in the trust assets distributed to" other beneficiaries. *McDougall v. Commissioner*, slip op. at 28.

(3) **Step Transaction Analysis.** *Estate of Anenberg* did not address whether the combination of the distribution of all QTIP assets to the spouse followed by the sale of the assets would trigger §2519. That seemed to be the general approach of *Kite I* (finding that the combination of the distribution of all assets to the surviving wife followed by her sale of the assets for a deferred

private annuity triggered §2519). The IRS did not make that step transaction argument in *Estate of Anenberg*, but it did in *McDougall*, and the court rejected the argument. Combining an early termination of QTIP assets distributed entirely to the spouse with even an immediate sale of the assets by the spouse is safe from a step transaction attack under §2519 in the Tax Court because of *McDougall*.

(4) **QTIP Planning Considerations in Light of *Estate of Anenberg* and *McDougall***. Estate freezing strategies are helpful to minimize the growth in the QTIP assets that will ultimately be subject to transfer tax.

(a) **Estate Freezing by the QTIP Trust**. One alternative is for the trustee to enter the estate freezing transaction directly with the QTIP trust assets. This could be as simple as having the trust invest in fixed income portfolios and having other trusts for the family invest in more aggressive equity portfolios. The combined trust portfolios (presumably for the same beneficiaries) could represent an appropriately diversified portfolio. Fiduciary issues obviously should be considered. Beyond that, the QTIP trust might sell assets to other family trusts or entities that are not subject to the transfer tax in return for notes. If accomplished shortly after the first spouse's death, the basis adjustment under §1014 might mean that relatively little gain would be recognized on the sale.

(b) **Distributions to Spouse.** Another alternative is to take steps to get the QTIP trust assets into the hands of the spouse-beneficiary via distributions so that person can enter into freezing transactions (for example, gifts or sales). Consider making principal distributions to the spouse in accordance with the distribution standards.

If large principal distributions to the spouse-beneficiary cannot be justified under the distribution standard in the trust agreement, do not assume the IRS will just acquiesce in improperly made distributions to the spouse.

i. **Gift by Beneficiaries Who Fail to Object.** The IRS may take the position that remainder beneficiaries make gifts to the spouse by not objecting and taking actions to prevent the improper distributions. *See* CCA 202352018 (trust beneficiaries made gift to grantor by consenting to modification action to add reimbursement power; result would have been the same if the beneficiaries had not explicitly consented if they had notice of the modification and a right to object but failed to exercise their right to object). For a detailed discussion of CCA 202352018, see Item 9 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

ii. **Improperly Distributed Asset Treated as Still in Trust.** The IRS may take the position that the improperly distributed assets should be treated as if they were still in the trust. *See Estate of Lillian Halpern v. Commissioner*, T.C. Memo. 1995-352 (distributions from general power of appointment marital trust to descendants; spouse consented but the distributions were not authorized; court recognized the distributions that were made when the spouse was competent but did not recognize distributions made after the spouse had become incompetent because a guardian could have set aside the distributions, so those distributions were included in the spouse's estate under §2041); *Estate of Hurford v. Commissioner*, T.C. Memo. 2008-278 (beneficiary-trustee made distribution to self, contrary to standards in trust, and sold those assets for private annuity; trust assets included in decedent's gross estate under §2036 and the distributed assets were not excluded from the decedent's gross estate merely because of ascertainable standards in the trust); *Estate of Hartzell v. Commissioner*, T.C. Memo. 1994-576 (court rejected IRS argument that assets distributed from marital trust to decedent during her lifetime and given to family were includable in her gross estate because the distributions were improper transfers from the trust; Ohio court would have approved the transfers because distribution standard of "comfort, maintenance, support, and general well-being" would include distributions to assist her desire to continue giving gifts to family members to ensure family control of family businesses); *Estate of Council*

v. Commissioner, 65 T.C. 594 (1975) (IRS argued that trustee did not have the authority to distribute trust assets to spouse for gifting purposes; court stated that the issue was not whether a state court would have approved the distributions beforehand but whether a state court would rescind the distributions after made; conclusion that trustees acted within the bounds of reasonable judgment); *cf. United Food & Commercial Workers Unions v. Magruder Holdings, Inc.*, Case No. GJH-16-2903 (S.D. Md. Mar. 27, 2019) (failure to comply with fiduciary constraints regarding trust distributions caused a trust to be treated as a grantor trust for non-tax purposes); *SEC v. Wyly,* 2014 WL 4792229 (S.D.N.Y. Sept. 25, 2014) (SEC recoupment case; court reasoned that a failure to comply with fiduciary constraints regarding trust distributions caused a trust to be treated as a grantor trust for non-tax purposes).

(c) **Additional Transfers to Spouse.** If the goal is to get more assets to the spouse than can be justified under the distribution standards, trust modification actions may be considered to get assets to the spouse-beneficiary. This could be a traditional commutation (with the spouse receiving the actuarial value of his or her interest in the trust) or be a complete distribution of trust assets to the spouse in an early termination (as was done in *Estate of Anenberg* and *McDougall*). (Beware that early terminations of trusts can have disastrous income tax consequences, as discussed in Item 15.e(5) below.)

i. **Traditional Commutation.** A traditional commutation would not be covered by the rationale of the Tax Court in the *Estate of Anenberg* and *McDougall* cases and would result in the spouse being treated as making a gift of the full remainder interest in the trust under §2519. See Item 15.e(2) above.

ii. **Termination and Distribution of All Assets to Spouse.** If the spouse receives all the assets (by agreement with the remainder beneficiaries), the spouse should avoid making a gift under §2519, but the remainder beneficiaries may be treated as making a gift of their interests in the trust to the spouse. The amount of the gift by each remainder beneficiary *may* be reduced because of contingencies (possible principal distributions to the spouse or possible exercises of powers of appointment appointing assets away from the particular beneficiary).

iii. **Decanting.** Using decanting rather than judicial termination or nonjudicial settlement agreement to transfer assets to the spouse (perhaps by adopting a broad distribution standard) may avoid having explicit consent from remainder beneficiaries, but there are fiduciary concerns and the IRS took the position in CCA 202352018 that failing to object would result in a gift, the same as with consent. See Item 15.e(4)(b)i above. But at least that approach may avoid direct consent by the remainder beneficiaries.

iv. **Aggressive Transactions?** In the face of the growing attacks by the IRS under §2519 and *McDougall*, planners may view these types of transfers as aggressive transactions.

v. **Particular Significance in 2025.** Planning with QTIP trusts to get assets to the spouse so the spouse can make gifts is especially significant in 2025 when the spouse may be looking for ways to make gifts to utilize the large gift exclusion amount before it may be reduced in 2026 (although that now appears unlikely).

(d) **Disclaimer by Spouse.** Another way for the spouse to make a transfer of assets in the QTIP trust, so they will not be in the spouse's gross estate, would be to make a disclaimer of the spouse's interest in the QTIP trust. If the disclaimer is a qualified disclaimer, the transfer of assets to the QTIP trust will not qualify for the marital deduction, so a transfer tax would be owed by the donor or decedent who created the QTIP trust. If the disclaimer is not a qualified disclaimer, the spouse would be treated as giving the income interest, which would trigger a deemed transfer of the remainder interest under §2519. See Letter Rulings 202504006-202504007 (non-qualified disclaimer by spouse of one of two QTIP trusts following severance, non pro rata severance did not cause gain recognition because trust agreement permitted trustee to make non pro rata division between trusts, disclaimer of all income

interest of trust 1 will not cause a gift of trust 2, trust 1 will not be included in taxpayer's gross estate, disclaimer will not cause interest in trust 2 to be valued at zero under §2702).

(e) **Drafting Issue: Power of Appointment to Appoint Assets to Spouse.** In drafting QTIP trusts to leave the flexibility of getting trust assets to the spouse-beneficiary, consider giving a third party a power of appointment to appoint assets to the spouse. Reg §25.2519-1(e) ("[t]he exercise … of a power to appoint [QTIP] to the donee spouse is not treated as a disposition under section 2519, even though the donee spouse subsequently disposes of the appointed property").

If an existing trust does not include such a power of appointment, consider if the trust could be decanted to a trust that would add such a power of appointment (if permitted under the state decanting statute). If such decanting is within the proper exercise of the trustee's discretion, the children should not be treated as making a gift because of the decanting.

If assets are moved into the hands of the spouse-beneficiary by the exercise of a power of appointment, that should avoid the possibility of the IRS arguing that the transaction should be treated as a gift from the remainder beneficiaries to the spouse-beneficiary or as a purchase of the spouse-beneficiary's interest by the remainder beneficiaries, resulting in a gain recognition transaction (discussed in Item 15.e(5) below).

(f) **Drafting Issues: Power of Appointment Over Remainder.** As in *McDougall*, giving the spouse (or someone) a power of appointment to appoint the remainder at the spouse's death provides an argument for minimizing the gift amount by any particular beneficiary resulting from the beneficiary's consent or nonobjection to an early termination of the QTIP trust.

(g) **Division Into Separate QTIP Trusts.** If the goal is to do freeze planning with only part of the QTIP trust assets, first divide the QTIP trust proportionately into separate trusts. Do the freeze planning with one of the trusts, leaving the other trust untouched to avoid §2519 and gift issues. Many PLRs have allowed taxpayers to sever QTIP trusts in anticipation of this type of planning. *E.g.*, Letter Rulings 202504006-202504007 (non pro rata severance did not cause gain recognition because trust agreement permitted trustee to make non pro rata division between trusts, disclaimer of all income interest of trust 1 will not cause a gift of trust 2, trust 1 will not be included in taxpayer's gross estate, disclaimer will not cause interest in trust 2 to be valued at zero under §2702); 202146001.

(h) **Resources.** Be forewarned that planning with large QTIP trusts is difficult. *See* Joy Miyasaki & Read Moore, *Estate Planning Strategies for QTIP Trusts: Do Good Things Come to Those Who Defer?*, AMERICAN COLLEGE OF TRUST & ESTATE COUNSEL 2023 ANNUAL MEETING (Mar. 2023); 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). For a discussion of other planning alternatives (including planning for distributions to the spouse, and the risks of unauthorized distributions, so the spouse can make estate planning gifts and transfers of those assets), see Item 9.h of Estate Planning Current Developments and Hot Topics 2022 (December 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. *See also* Richard S. Franklin, *Lifetime QTIPs—Why They Should Be Ubiquitous in Estate Planning*, 50th HECKERLING INST. ON EST. PL. ch. 16 (2016); Richard S. Franklin & George Karibjanian, *The Lifetime QTIP Trust – the Perfect (Best) Approach to Using Your Spouse's New Applicable Exclusion Amount and GST Exemption*, 44 BLOOMBERG TAX MGMT. ESTS., GIFTS & TR. J. 1 (Mar. 14, 2019).

(5) **Income Tax Consequences.** Apparently, the IRS did not take the position in either *Estate of Anenberg* or *McDougall* that the early termination of the QTIP trust resulted in an income taxable transaction between the income and remainder beneficiaries. The IRS views the early termination of trusts as income tax events. The remainder beneficiaries in Letter Rulings 202509010 and 201932001-201932010 were treated as having purchased the interests of the life beneficiary and the contingent remainder beneficiaries (and the life beneficiary had a zero basis in his interest under the uniform basis rules of §1001(e) so the total amount paid to the life

beneficiary was capital gain). (The taxpayers requested those rulings – presumably following discussions with the IRS that the early termination would be treated as a recognition event and to obtain rulings that the income recognition would be long-term capital gain.) The remainder beneficiaries, as the deemed purchasers, do not pay tax on amounts **received** in the commutation (as the fictional purchasers, they are just receiving what is left in the trust after they have bought out everyone else), but they "realize gain or loss on the property exchanged." So, they recognize gain on the assets **paid out** to others less the amount of their uniform basis attributable to those assets. Massive income taxation can result, which could be totally avoided by not terminating the trust early. For a detailed discussion of the 2019 letter rulings and the income tax effects of early terminations of trusts, see Item 16 of Estate Planning Current Developments and Hot Topics (December 2020) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

What the effect would be when the full trust value is paid to the income beneficiary of a QTIP trust is not clear. It would be strange to treat the remainder beneficiary as having purchased the interest of the life beneficiary when the remainder beneficiary ends up with nothing. At least for income tax purposes, the remainder beneficiary may be treated as making a gift to the income beneficiary of the value of the remainder interest, which amount therefore would not be taxable income under §102(a). *See Commissioner v. Duberstein*, 363 U.S. 278, 284-286 (1960) ("detached and disinterested generosity"). Perhaps any deemed purchase by the remainder beneficiary would be limited to the value of the income interest. Prior to the Tax Court's decision in *McDougall*, it is conceivable that the remainder interest might have been treated as a gift for income tax purposes (and therefore not taxable income to the income beneficiary under §102) but not a gift for transfer tax purposes (because for transfer tax purposes the spouse is treated as the owner of the full value of the QTIP assets under the legal fiction created in the QTIP regime); however, *McDougall* rejected that analysis for transfer tax purposes.

(6) **Valuation Issue.** The valuation issue is very interesting. Any particular remainder beneficiary has significant contingencies on actually receiving trust assets. How will the court value those contingencies? Collectively, all the remainder beneficiaries in *McDougall* were assured of receiving the trust assets (other than assets that might have been distributed to H under the trust distribution standard) because H's power of appointment was to appoint the assets to the deceased wife's descendants, and they happened to be the remainder beneficiaries. But H could cut off any particular remainder beneficiary's interest. How would each such remainder beneficiary's interest be valued under that contingency? (The IRS dismissed the impact of H's power of appointment in CCA 202118008 and apparently is taking the position in *McDougall* that the early termination of the trust means the power of appointment no longer exists and is irrelevant to the valuation issue.)

Why did the IRS take the position that the gifts were made merely by the two children rather than allocating gifts among all of the descendants who were remainder beneficiaries?

Will the valuation issue be settled (most valuation disputes end up being settled)? If so, we will never know how the court would have addressed the valuation issue. However, attorneys for the parties anticipate that the valuation issue will go to trial. The case has been reassigned to Judge Halpern for trial of the valuation issue, and a trial date has been set in June 2025.

16. Estate Tax Value of Corporate Shares Included Proceeds of Corporate-Owned Life Insurance to Fund Buy-Sell Agreement, Not Offset by Redemption Obligation; Buy-Sell Agreement Did Not Meet §2703(b) Safe Harbor or Other Requirements to Fix Estate Tax Value, *Connelly v. United States*, 602 U.S. 257 (June 6, 2024) *aff'g* 70 F.4th 412 (8th Cir. June 2, 2023), *aff'g* 128 AFTR 2d 2021-5955 (E.D. Mo. Sept. 2, 2021)

a. **Synopsis.** A buy-sell agreement for a corporation owned by two brothers gave the surviving brother the option to purchase the decedent's shares, or if not exercised, required the corporation to buy the decedent's shares. 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 the company would 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).

The estate reported the shares at about $3 million, taking the position that the $3 million used to purchase the shares should not be included in determining the value of the corporation; under that approach, the corporation 's value was $3.86 million, and the decedent's 77% interest was worth approximately $3 million. The IRS assessed an additional $890,000 of estate tax, maintaining the $3 million of life insurance proceeds should have been taken into consideration in determining the value. The estate paid the additional estate tax and sued for a refund.

The court considered whether the buy-sell agreement set a $3 million price that controlled for estate tax purposes, and if not, the only issue after stipulations was whether the $3 million of life insurance proceeds used to purchase the estate's shares should be considered in determining the value of the shares for estate tax purposes.

The district court and Eighth Circuit determined that the agreement did not set a price that was binding for estate tax purposes. In valuing the stock without regard to the agreement, both the district court and Eighth Circuit determined that the $3 million should be included in determining the value of the decedent's shares. Both courts disagreed with the Eleventh Circuit's rationale in *Estate of Blount v. Commissioner* (2005) 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.

The U.S. Supreme Court affirmed, reasoning (1) a redemption of shares at fair market value does not affect any shareholder's economic interest, (2) no willing buyer purchasing the decedent's shares would have treated the corporation's obligation to redeem the shares at fair market value as a factor that reduced the value of those shares, (3) treating the redemption obligation as a liability cannot be reconciled with the basic mechanics of a stock redemption, and (4) that this result makes succession planning more difficult is simply a consequence of how the parties structured the purchase obligation but other options existed that could have avoided the result of insurance proceeds increasing the value of the decedent's shares. *Connelly v. United States*., 602 U.S. 257 (June 6, 2024) (Justice Thomas, unanimous), *aff'g* 70 F.4th 412, (8th Cir. 2023), *aff'g* 128 AFTR 2d 2021-5955 (E.D. Mo. 2021).

b. **Basic Facts.** The basic facts were concisely summarized in the unofficial syllabus of the Supreme Court opinion:

> Michael and Thomas Connelly were the sole shareholders in Crown C Supply, a small building supply corporation. The brothers entered into an agreement to ensure that Crown would stay in the family if either brother died. Under that agreement, the surviving brother would have the option to purchase the deceased brother's shares. If he declined, Crown itself would be required to redeem (*i.e*., purchase) the shares. To ensure that Crown would have enough money to redeem the shares if required, it obtained $3.5 million in life insurance on each brother. After Michael died, Thomas elected not to purchase Michael's shares, thus triggering Crown's obligation to do so. Michael's son and Thomas agreed that the value of Michael's shares was $3 million, and Crown paid the same amount to Michael's estate. As the executor of Michael's estate, Thomas then filed a federal tax return for the estate, which reported the value of Michael's shares as $3 million. The Internal Revenue Service (IRS) audited the return. During the audit, Thomas obtained a valuation from an outside accounting firm. That firm determined that Crown's fair market value at Michael's death was $3.86 million, an amount that excluded the $3 million in insurance proceeds used to redeem Michael's shares on the theory that their value was offset by the redemption obligation. Because Michael had held a 77.18% ownership interest in Crown, the analyst calculated the value of Michael's shares as approximately $3 million ($3.86 million x 0.7718). The IRS disagreed. It insisted that Crown's redemption obligation did not offset the life-insurance proceeds, and accordingly, assessed Crown's total value as $6.86 million ($3.86 million + $3 million).The IRS then calculated the value of Michael's shares as $5.3 million ($6.86 million x 0.7718). Based on this higher valuation, the IRS determined that the estate owed an additional $889,914 in taxes. The estate paid the deficiency and Thomas, acting as executor, sued the United States for a refund. The District Court granted summary judgment to the Government. The court held that, to accurately value

> Michael's shares, the $3 million in life-insurance proceeds must be counted in Crown's valuation. The Eighth Circuit affirmed.

c. **District Court and Eighth Circuit Analysis of Whether Buy-Sell Agreement Set $3 Million Value Binding For Estate Tax Purposes.** The district court determined that the buy-sell agreement did not fix the value of the shares for federal estate tax purposes. First, it did not satisfy the §2703(b) safe harbor; although the agreement met the bona fide business purpose test, it failed to meet the device test (because the purchase price did not include the life insurance proceeds in determining the company's value, the *process* of selecting the redemption price indicates the agreement was a testamentary device, and the agreement prohibited considering control premiums or minority discounts) and the comparability test (the estate "failed to provide any evidence of similar arrangements negotiated at arms' length"). Second, the agreement did not satisfy requirements recognized by various courts for buy-sell agreements to fix estate tax values: the agreement did not provide a fixed and determinable price; it was not binding at death (evidenced by the fact that its procedures were not followed); and it was a substitute for a testamentary disposition for less than full consideration.

The Eighth Circuit agreed, reasoning more succinctly that the agreement did not set the estate tax value of the decedent's stock because the agreement did not establish a "fixed and determinable price." (Even if the pricing mechanism in the agreement had been followed, the court expressed reservations about whether those pricing mechanism would have been sufficient to establish a fixed and determinable price.)

For a more detailed discussion of the district court and Eight Circuit analysis of this issue, see Item 28.c-d of LOOKING AHEAD – Estate Planning in 2024 & Current Developments (Including Observations from Heckerling 2024) (April 2024) found **here** and Item 39.c of Estate Planning Current Developments (December 2021) found **here**, both available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

d. **District Court and Eighth Circuit Analysis of Whether $3 Million of Insurance Proceeds Used to Redeem Decedent's Stock Should be Included in Determining Value of Decedent's Shares.** Under stipulated facts, the only valuation issue was whether the $3 million of life insurance proceeds paid to the company that were used to redeem the decedent's stock should be considered in valuing the decedent's shares for estate tax purposes.

The estate's primary argument relied on the Eleventh Circuit's opinion in *Estate of Blount v. Commissioner,* 428 F.3d 1338 (11th Cir. 2005). The district court summarized the *Blount* holding and rationale:

> The Eleventh Circuit reasoned that the stock-purchase agreement created a contractual liability for the company, offsetting the life insurance proceeds. [Citation omitted] The Eleventh Circuit concluded that the insurance proceeds were "not the kind of ordinary nonoperating asset that should be included in the value of [the company] under the treasury regulations" because they were "offset dollar-for-dollar by [the company's] obligation to satisfy its contract with the decedent's estate."

The district court in *Connelly* disagreed with the Eleventh Circuit's analysis, preferring the reasoning of the Tax Court in *Estate of Blount*: a redemption obligation is not a "value-depressing corporate liability when the very shares that are the subject of the redemption obligation are being valued." A hypothetical willing buyer purchasing a company subject to a redemption obligation would not reduce the value of the company by the redemption obligation; the hypothetical buyer "would not consider the obligation to *himself* as a liability that lowers the value of the company to *him*." The district court concluded that the Eleventh Circuit's opinion in *Estate of Blount* is "demonstrably erroneous" and there are "cogent reasons for rejecting [it]."

The Eighth Circuit agreed with, and expanded upon, the district court's rejection of the rationale of *Estate of Blount* that the insurance proceeds were offset by the company's obligation to use the proceeds to redeem the shares:

> The IRS has the better argument. *Blount*'s flaw lies in its premise. An obligation to redeem shares is not a liability in the ordinary business sense…. Consider the willing buyer at the time of [the decedent]'s death. To own [the company] outright, the buyer must obtain all its shares. At that point, he could then extinguish the stock-purchase

agreement or redeem the shares *from himself*. This is just like moving money from one pocket to another. There is no liability to be considered—the buyer controls the life insurance proceeds**.**

The Eighth Circuit added a simple example and concluded: "In sum, the brothers' arrangement had nothing to do with corporate liabilities. The proceeds were simply an asset that increased the shareholders' equity. A fair market value of Michael's shares must account for that reality."

e. **Supreme Court Review and Opinion.** The U.S. Supreme Court granted the estate's petition for a writ of certiorari on December 13, 2023 (surprisingly, to most planners). For a summary of arguments in the parties' briefs, in various amicus briefs, and of observations from the oral arguments before the Court, see Item 28.e of LOOKING AHEAD – Estate Planning in 2024 & Current Developments (Including Observations from Heckerling 2024) (April 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

The U.S. Supreme Court affirmed the Eighth Circuit's finding on June 7, 2024, in a unanimous opinion written by Justice Thomas. At oral argument, one Justice said he found the issues in the case "extremely difficult." The Court viewed the issue differently from *Blount*; instead of deciding whether the life insurance is included as a corporate asset in valuing the decedent's shares, the Court said that "all agree that life-insurance proceeds payable to a corporation are an asset that increases the corporation's fair market value." The issue was whether the corporation's contractual obligation to purchase the decedent's shares "offsets the value of life-insurance proceeds committed to funding that redemption." The Court affirmed, holding that "redemption obligations are not necessarily liabilities that reduce a corporation's value for purposes of the federal estate tax." 602 U.S. 257 (June 6, 2024) (Justice Thomas, unanimous). The Court offered several reasons supporting this holding:

- Redemption of stock at fair market value does not affect any shareholder's economic interest;
- A hypothetical buyer of the estate's shares would not view the redemption obligation as reducing the value of the shares;
- Offsetting the value of shares by the amount of a redemption obligation to purchase the shares values the corporation on a post-redemption basis;
- One cannot reconcile reducing the value of shares by the amount of a redemption obligation to purchase the shares in light of the basic mechanics of a stock redemption; and
- That refusing to offset the value of shares by a redemption obligation makes succession planning difficult is no defense because planning options other than a redemption are available.

More Detailed Discussion. For a more detailed discussion of the *Connelly* facts and analysis of the various court opinions, see Item 31 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here**, Item 28.c-d of LOOKING AHEAD – Estate Planning in 2024 & Current Developments (Including Observations from Heckerling 2024) (April 2024) found **here**, and Item 39.c of Estate Planning Current Developments (December 2021) found **here**, all available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

f. **Observations.**

(1) **Result Not Surprising; Makes Economic Sense Though Inconsistent With Prior Circuit Level Case.** Given the many lapses in how the *Connelly* redemption transaction was implemented, the taxpayer's loss is not unexpected. Including the life insurance proceeds received by a company at the decedent's death in valuing the decedent's interest in the corporation for estate tax purposes makes economic sense, as aptly summarized by the Supreme Court. Prior cases had been inconsistent; 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. discussed 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); and *Estate of Blount v. Commissioner*, 428 F.3d 1338 (11th Cir. 2005). The Court's opinion is very significant as a specific repudiation of the contrary holding by the Eleventh Circuit Court of Appeals in *Estate of Blount*.

(2) **Buy-Sell Agreement With Life Insurance Funding.** One of the factors in determining whether to use a corporate purchase or a cross purchase arrangement in structuring a buy-sell agreement funded with life insurance, is that life insurance proceeds received by the company may be included in the estate tax value of a decedent's shares, resulting in escalating values of the shareholders' interests in the company. (If the purchase price is fully funded with life insurance, as each owner's interest is purchased at death using the life insurance proceeds the company value remains constant, but the remaining owners have increasing percentage interests in the entity as each owner dies, which increases the value of their interests and requires more life insurance funding.) A pricing formula that does not include the full amount of insurance proceeds payable to the company is very suspect as failing to satisfy the §2703(b) safe harbor (as evidenced by the *Connelly* district court opinion).

The economic impact of not including insurance proceeds in valuing a decedent's shares is to produce a huge windfall to the surviving shareholders. They end up owning the company free of the decedent's shares without having to pay anything following the decedent's death.

The windfall to the surviving shareholders may be greatly reduced by including the amount of the insurance proceeds on the decedent stockholder's life in the value of the corporation. However, this approach will be circular and thus greatly increase the amount of insurance coverage needed to fund fully the buy-sell agreement. But including life insurance proceeds in determining the value of the company following a shareholder's death reflects the economic reality of the value of the company at that time. The Supreme Court's conclusion that the estate tax value of the decedent's shares following an insured shareholder's death should reflect that economic reality is not surprising.

(3) **Buy-Sell Agreement Structuring.** A very important issue in structuring a buy-sell agreement is whether an entity purchase or cross purchase arrangement will be used. For example, the *Connelly* agreement gave the surviving shareholders the first option to purchase a decedent's shares, but if that option was not exercised, the agreement required the corporation to buy the shares.

- Entity Purchase – the parties may feel more comfortable with the entity taking steps to fund the purchase agreement rather than relying on other owners to accumulate funds (or purchase life insurance) to fund a purchase obligation, but the funding in the entity (such as life insurance) may increase the value of the entity (as in *Connelly*); for a corporation, tax considerations include whether the redemption of stock by the corporation will be given sale or exchange vs. dividend treatment.
- Cross Purchase – the parties must rely on the remaining owners to purchase their interests at death, funding will be outside the entity, not increasing the entity's value at the death of an owner, and a basis step up for the units purchased will be permitted; these advantages are quite significant; if an entity has multiple owners, one approach is to have the owners form a separate partnership to own a life insurance policy on each owner's life rather than having each owner purchase a life insurance policy on each other owner's life. *See* Private Letter Ruling 200747002 (LLC owned life insurance for funding of cross-purchase buy-sell agreement of S corporation, with all shareholders of the S corporation as members of the LLC).

(4) **"Fixed and Determinable Price in the Agreement" Dictum by Eighth Circuit Suggests That Many Buy-Sell Agreements Would Not Set the Estate Tax Value.** The Eighth Circuit held that a "fixed and determinable price" was not established under the stock purchase agreement, partly because the parties did not follow the pricing mechanisms set out in the agreement. Even if those procedures had been followed, however, the Eighth Circuit suggested (presumably in dictum) that would not have been sufficient to determine the estate tax value of the stock. That

observation by the court is quite significant because the pricing procedures in the buy-sell agreement in *Connelly* ((1) annual valuation agreements and (2) appraisal procedures) are often found in buy-sell agreements. A purchase under a binding agreement pursuant to those procedures might not be recognized as the value for estate tax purposes of the purchased interest under the reasoning of this dictum in *Connelly*.

The Supreme Court did not address this aspect of the Eighth Circuit opinion.

(5) **Effect of Considering Life Insurance Proceeds in Determining Value.** If a buy-sell agreement does not effectively fix the estate tax value of the stock, the corporate insurance proceeds should be considered as a factor in determining the corporation's value, and the proceeds should not merely be added to the value of the corporation determined without regard to the proceeds. *See Estate of Huntsman*, 66 T.C. 861, 872-76 (1976), *acq*. 77-1 C.B. 1 ("determine fair market value … by giving 'consideration' to the insurance proceeds"); *Newell v. Commissioner,* 66 F.2d 102, 103-04 (7th Cir. 1933) (key shareholder's estate established that stock increase was offset by decrease in corporation's value caused by loss of key shareholder).

17. Purchase Agreement Not Respected for Valuation Purposes under §2703, *Huffman v. Commissioner,* T.C. Memo. 2024-12

a. **Synopsis.** Chet Huffman, son of donors, entered into an agreement in 1993 with a trust funded by donors (the trust presumably was a revocable trust) and an agreement with an S corporation owned entirely by his mother. The agreement gave Chet an option to purchase the shares of a Company that manufactured and supplied engineering components to the aerospace industry (the "RTP agreements"). Chet had become the CEO of the Company six years earlier (when his father, who was the prior CEO, had a near fatal off-road racing accident [he was a member of the Off-Road Motorsports Hall of Fame]). The RTP agreements gave Chet the right to acquire the shares for a price not to exceed $3.6 million and $1.4 million, respectively, at the deaths of his parents or under a right of first refusal. An addendum gave Chet the right to acquire the shares at any time but required consent from various people to override alienability restrictions. The Company would have to increase in value by a very large amount, from about $0.49/share to $11.83/share (2,314%!) [i.e., increase of $11.83 - $0.49 = $11.34; and 11.34/0.49 = 23.14, or 2,314%] before the shares would be "in the money." Chet exercised the right to purchase the shares in 2007, paying the $5 million with a note.

No 2007 gift tax return was filed. The accountant never suggested to Chet's parents there was potential gift tax liability or the need to file a gift tax return. At some point, the IRS argued that a gift was made from the parents in 2007 when Chet purchased shares that were worth more than the $5 million exercise price.

The court determined that the burden of proof did not shift from the donors to the IRS. A 5%-6% reduction in the IRS's valuation position at trial as compared to the notice of deficiency was not enough to shift the burden of proof.

The court found that §2703 applied, so the agreement could not "be respected for valuation purposes." The first two elements of the safe harbor in §2703(b) were satisfied, but the third was not. (1) The parties agreed the agreement had a valid business purpose (maintaining managerial control or family ownership). (2) The agreement was not a testamentary device to transfer property to members of the family for less than full consideration because Chet paid adequate consideration for the option agreements (taking into consideration reduced compensation he received as CEO) and because the "unusual" level of growth suggested the agreement was meant to incentivize Chet rather than to transfer property to him for less than full value. (3) The third requirement, that the terms of the agreement were comparable to similar arrangements entered into in an arm's length transaction, was not satisfied. A suggested comparable arrangement was, in fact, not comparable, in part because of procedural issues (the other agreement was not entered into evidence). Aside from the evidentiary issue, the other agreement was not comparable largely because Chet's agreement could be exercised at any time but the other could be exercised only at a person's death or under a right of first refusal.

The court reviewed the opinions of the parties' experts (government's expert at $31.3 million and taxpayers' expert at $16.3 million as the value of the purchased shares) and determined that the IRS's appraisal was more appropriate (with several revisions). The gift was determined top be the difference between the appraised value (as adjusted) and the $5 million paid by Chet in exercising the option. (The adjustments to the position of the government were not clear from the opinion but may have been as much as $10 million.) The IRS's expert opinion concluded that a 10% lack of control and 20% lack of marketability discount were appropriate.

The court also addressed income tax issues (for example, in one transaction the parties overvalued the portion of sale proceeds from a subsequent sale of assets by the corporation and affiliated entities that were allocated to goodwill; correcting that resulted in increased capital gain to the corporation and a constructive dividend to the taxpayers). The court also addressed accuracy-related penalties under §6662 and failure to file and pay penalties under §6651. The court determined that the reasonable cause exception applied (except for one conceded matter) because of reasonable reliance on professional advice, so penalties generally were not applicable. *Huffman v. Commissioner*, T.C. Memo. 2024-12 (January 31, 2024) (Judge Ashford).

b. **Burden of Proof.** The court determined that the burden of proof did not shift from the donors to the IRS. *See* §7491(a). The taxpayers argued that the burden of proof should shift to the IRS because the asserted valuation at trial was less than in the notices of deficiency. The court considered prior cases holding that the IRS forfeits the presumption of correctness by conceding the assessed deficiency was erroneous (*Estate of Simplot*) and that the IRS had assumed the burden of proof by reducing the alleged valuation at trial by 19%, which caused the court to find that the initial assessment was "arbitrary and excessive" (*Estate of Mitchell*). The court determined that the 5%-6% reduction at trial in this case did not mean the initial valuation was "arbitrary and excessive."

The burden of proof determination was important because the court did not base its decision on a preponderance of the evidence, but the donors "failed to meet the burden of proof regarding why their expert's valuation is correct."

c. **Section 2703.** The court found that §2703 applied, so the agreement could not "be respected for valuation purposes."

Section 2703(a)(1) provides that the value of any property must be determined without regard to "any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right)." Section 2703(b) provides an exception to §2703 for any agreement that meets all of three listed requirements. The first two elements of the safe harbor in §2703(b) were satisfied, but the third was not.

(1) **Business Purpose Test.** The parties agreed that the agreement had a valid business purpose (maintaining managerial control or family ownership was an appropriate purpose).

(2) **Device Test.** The agreement was not a device to transfer property to members of the family for less than full consideration. The court gave two reasons. First, one factor is "the fairness of the consideration received by the transferor when it executed the transaction" (citing *Estate of Morrissette v. Commissioner*, T.C. Memo. 2021-60, and *Estate of True v. Commissioner*, T.C. Memo. 2001-167). The court concluded that Chet paid adequate consideration when he entered into the option agreements (taking into consideration reduced compensation he received as CEO). Second, the court noted the "unusual and unexpected" huge level of growth required before the agreement would be exercised, which "incentivized Chet both to stay with the company and to increase its per-share value," and which suggested the agreement was not intended to transfer shares to him for less than full consideration. (The court did not mention the conclusion in *Kress v. U.S.*, 123 AFTR 2d 2019-1224 (DC Wis. 2019), that the reference in §2703(b)(2) to "members of the decedent's family" means that the device test applies only to transfers at death and not to inter vivos transfers.)

(3) **Comparability Test.** The third requirement, that the terms of the agreement were comparable to similar arrangements entered into by persons in an arm's length transaction, was not satisfied.

The court noted that the §2703(b) exception is "more of a safe harbor than an absolute requirement that multiple comparables be shown" (quoting *Estate of Morrissette v. Commissioner*, T.C. Memo. 2021-60) and that an "isolated comparable" can be used to satisfy the comparability test (citing *Estate of Amlie v. Commissioner*, T.C. Memo. 2006-76).

The donors pointed to a somewhat similar agreement with an unrelated party regarding the Company's stock. An agreement entered in 1990 (the "Lloyd-Barneson agreement") gave Chet's father (Lloyd) the right to purchase shares in the Company owned by Barneson, an unrelated shareholder, for a price not to exceed a certain amount, which could be exercised at Barneson's death or under a right of first refusal. The father assigned his rights under that agreement to Chet in 1993, and later that year Chet and Barneson agreed that Chet would buy Barneson's shares for $150,000. The Lloyd-Barneson agreement was presented as a "comparable arrangement." The taxpayers pointed out various similarities with RTP agreement, including: (1) a right to purchase on the death of the grantor and by a right of first refusal; (2) a maximum purchase price; and (3) no specific termination or exercise date. The court determined that this other agreement was not comparable partly on procedural grounds because the Lloyd-Barneson agreement had not been introduced as evidence. Even aside from the evidentiary issue, the court noted some provisions that made Chet's agreement less valuable (he had to obtain more consents to transfer his purchase rights), but others that made it more favorable (he could exercise it any time rather than just at death or upon a right of first refusal). Those differences were enough to make it not comparable. The court cited *Estate of Blount v. Commissioner*, T.C. Memo. 2004-116 (finding that mere testimony without production of comparable agreements was insufficient to satisfy §2703(b)(3)), *aff'd in part, rev'd in part and remanded*, 428 F.3d 1338 (11th Cir. 2005).

d. **Ultra-Strict Comparability Analysis.** The *Huffman* analysis seems remarkably strict in its application of the comparability test (aside from the procedural evidentiary issues). Look at the similarities between the RTP agreement and the comparable agreement with the unrelated third party, Barneson:

- Both agreements involved the exact same Company.
- Both agreements involved an option-to-purchase arrangement rather than a mandatory purchase.
- Both agreements allowed the person holding the option to exercise a right of first refusal if someone else wanted to buy the stock.
- Both agreements would extend through the deaths of the sellers.
- Both agreements were signed in the same general time frame. Chet negotiated to purchase shares from the third party (presumably using the framework of the 1990 Lloyd-Barneson agreement and the price at which Chet knew he could purchase Barneson's shares at his death) in August 1993, and Chet entered the RTP agreement in November 1993.
- Both agreements were transferable, but Chet's agreement required that he get more consents than in the comparable agreement.
- Neither agreement involved put rights, drag along rights, or tag-along rights.

As buy-sell agreements go, that's a **lot** of similarities.

The big difference the court latched onto was that Chet could exercise his option under the RTP agreements at any time whereas the comparable was exercisable only at the death of Barneson or in the exercise of a right of first refusal. But this arrangement under the RTP agreements was one where the option was not going to be exercised in any event for a considerable length of time. There would be no reason to exercise the option until the company had grown by 23 times its value!! (The IRS's expert valued the shares at $0.51/share. Even in that expert's view, the company would have to grow by 22 times before it would be "in the money" [$11.83 - $0.51 = $11.32; $11.32/$0.51 = 22.20, or 2,220%].) The court observed that based on the assumptions of Chet and Barneson in their arm's length negotiation in 1993, "the RTP agreements would have taken between 50 and 70 years

to reach an 'in the money' value." Chet's parents would have both died within that 50-70 year time frame. Even if the RTP agreements had been exercisable only at death, the expectation at the time they signed the agreements was that they would not have been exercised before that time anyway. In that respect, the timing of purchases under the two agreements was not that different.

The big difference, in terms of comparability, would seem to be the price terms, but the court expressed no concern over pricing differences between the two agreements. The court also did not express any concern with whatever differences may or may not have existed between the payment terms.

The court could have based its decision on the evidentiary issue, and that would have been totally understandable. But to base its decision in part on the lack of comparability with the Barneson agreement is hard to fathom. It's almost as if the only way to satisfy the comparability test is to come up with an agreement involving the same company for exactly the same terms. That flies in the face of statements in the §2703 regulations. *E.g.*, Reg. §25.2703-1(b)(4)(i) ("if it conforms with the general practice of unrelated parties under negotiated agreements in the same business"); §25.2703-1(b)(4)(ii) ("a right or restriction does not fail to evidence general business practice merely because it uses only one of the recognized methods. It is not necessary that the terms of a right or restriction parallel the terms of any particular agreement."). And the legislative history similarly anticipated the use of a much more reasonable comparability standard. This is from the Conference Report:

> The conferees do not intend the provision governing buy-sell agreements to disregard such an agreement merely because its terms differ from those used by another similarly situated company. The conferees recognize that general business practice may recognize more than one valuation methodology, even within the same industry. In such situations, one of several generally accepted methodologies may satisfy the standard contained in the conference agreement.

At the time the option was exercised by Chet, the Company had grown tremendously (under *his* leadership, not because of what the parents did), and the price per share was much higher than under the option agreement. How could anyone have anticipated that dramatic growth when the RTP option agreements were entered? But it's as if the court was convinced a gift tax should apply when a transfer is made with that big of a valuation disparity between the current value and option price and was looking to find SOME reason not to be bound by the lower price in the option agreement. To reach that conclusion, the court latched onto a pretty small difference between otherwise very similar option agreements.

e. **Section 2703(b) Analysis Consistent With Various Other Cases Regarding Comparability Analysis.** Unfortunately, the *Huffman* court is following the trend of cases that have applied the comparability test strictly in requiring examples or evidence of actual comparable arrangements negotiated at arm's length. *E.g.*, *Connelly v. United States of America, Department of the Treasury, Internal Revenue Service*, 128 AFTR 2d 2021-5955 (E.D. Mo. 2021), *aff'd*, 70 F.4th 412 (8th Cir. June 2, 2023), *aff'd on other grounds,* 602 U.S. 257 (2024) (estate "failed to prove any evidence of similar arrangements negotiated at arms' length" [about determining the purchase price without including life insurance proceeds received by company at decedent's death]); *Kress v. United States*, 123 AFTR 2d 2019-1224 (E.D. Wi. 2019) ("Though Plaintiffs contend *restrictions* like the Kress Family Restriction are common in the commercial world, they have not produced any evidence that unrelated parties at arms' length would agree to such an arrangement."); *Estate of Blount v. Commissioner*, T.C. Memo. 2004-116, *aff'd in part, rev'd in part*, 428 F.3d 1338 (11th Cir. 2005) ("He did not present evidence of other buy-sell agreements or similar arrangements, where a partner or shareholder is bought out by his coventurers, *actually entered into* by persons at arm's length. … Because Mr. Grizzle has failed to provide any evidence of *similar arrangements actually entered into* by parties at arm's length, as required by section 2703(b)(3), and his opinion is based solely on his belief that the purchase price for decedent's BBC shares was set at fair market value, Mr. Grizzle's conclusion that the terms of the Modified 1981 Agreement are comparable to similar agreements entered into by parties at arm's length is unsupportable."); *Smith v. Commissioner*, 94 AFTR 2d 2004-5283 (W.D. Pa. 2004) ("In this case, both parties concede that it would be inherently difficult to find an agreement between unrelated parties dealing at arm's length that would be comparable to a

family limited partnership, which, by its terms, is restricted to related parties. … Nevertheless, Plaintiffs have submitted the affidavits of two attorneys … who essentially state that restrictive provisions requiring installment payments and charging interest at the applicable federal rate are common in both family limited partnerships and transactions involving unrelated parties. … Upon review, these affidavits merely state opinions that are conclusory in nature and do not constitute evidence sufficient to dispel any genuine issue of material fact as to whether of [*sic*] the restrictive provision in the Smith FLP agreement meet the test set forth in Section 2703(b)(3).")

The comparability test was satisfied in *Amlie v. Commissioner*, T.C. Memo. 2006-7, involving a rather complicated fact pattern. The court concluded that an agreement met the comparability test because it was based on price terms in an earlier agreement, which was based on a survey of comparables.

18. Overruling of *Chevron* Doctrine Regarding the Validity of Regulations, *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (June 28, 2024)

a. **Brief Synopsis.** The Supreme Court, in a major shift of approach in analyzing the validity of actions of federal agencies (including published regulations), overruled a 40-year rule announced in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *Chevron* pronounced a two-step approach: (1) first, determine if a particular statutory provision is ambiguous ("the statute is silent or ambiguous with respect to the specific issue"), and if so; (2) second, the regulation would be upheld if it is a "permissible" construction of the statute, even if a court would have reached a different interpretation. The Court held that approach is inconsistent with the Administrative Procedure Act (APA), which requires "the reviewing court" to "decide *all* relevant questions of law" and "interpret statutory provisions." (emphasis added, as quoted by the Court).

In determining the validity of regulations, the "judgment of [the administrative agency] may help inform the court of the proper interpretation of the statute," but the court will ultimately determine the "best" interpretation of the statute.

> … even if some judges might (or might not) consider the statute ambiguous, there is a best reading all the same—"the reading the court would have reached" if no agency were involved. [citation to *Chevron* omitted]. It therefore makes no sense to speak of a "permissible" interpretation that is not the one the court, after applying all relevant interpretive tools, concludes is best. In the business of statutory interpretation, if it is not the best, it is not permissible.

Statutes sometime explicitly authorize an agency to interpret or provide details about implementation of a statutory provision. If so, the courts will consider if the delegation was within constitutional limits and whether the agency acted within the scope of the delegation. [*Chevron* had noted that a statute may include "express delegation of authority to the agency to elucidate a specific provision of the statute by regulation…. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute."]

Prior cases addressing the validity of agency actions that relied on the *Chevron* framework are not called into question. The holdings of those cases are subject to *stare decisis*; they may be overruled only if a "special justification" applies, and '[m]ere reliance on *Chevron* cannot constitute a "special justification….. That is not enough to justify overruling a statutory precedent."

The unofficial syllabus of the Court's decision summarized the holding very briefly:

> The Administrative Procedure Act requires courts to exercise their independent judgment in deciding whether an agency has acted within its statutory authority, and courts may not defer to an agency interpretation of the law simply because a statute is ambiguous; *Chevron* is overruled.

The majority decision concluded by summarizing its ruling as follows:

> *Chevron* is overruled. Courts must exercise their independent judgment in deciding whether an agency has acted within its statutory authority, as the APA requires. Careful attention to the judgment of the Executive Branch may help inform that inquiry. And when a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring that the agency acts within it. But courts need not and under the APA may not defer to an agency interpretation of the law simply because a statute is ambiguous.

The Court remanded the cases to district courts to consider the appropriateness of the regulations requiring paid observers on vessels in light the Court's overruling of *Chevron*.

Tax regulations have been subject to the *Chevron* analysis, and the overruling of *Chevron* may lead to more attacks on the validity of various tax regulations.

Loper Bright Enterprises, et al. v. Raimondo, Secretary of Commerce, et al., 603 U.S. 369 (June 28, 2024) (opinion by C.J. Roberts joined by J. Thomas, J. Alito, J. Gorsuch, J. Kavanaugh, and J. Barrett; separate concurring opinions by J. Thomas and J. Gorsuch; dissenting opinion by J. Kagan joined by J. Sotomayor and J. Jackson [but Justice Jackson took no part in the decision as to one of the two cases]); together with *Relentless, Inc., et al. v. Department of Commerce*, et al., Cause No. 22-1219.

b. **Summary of Analysis of Majority.**

(1) **Basic Facts.** Petitioners (commercial fishermen) in two separate cases had argued that a 1976 law requiring certain fishing vessels to carry federal observers to collect data to prevent overfishing did not authorize a 2020 regulation requiring that the boat owners pay for the observers. The D.C. Circuit and First Circuit had upheld the rules under the *Chevron* doctrine. The Supreme Court granted certiorari in both cases, "limited to the question whether *Chevron* should be overruled or clarified."

(2) **Pre-*Chevron* Brief History.** The Court began its analysis by noting that Article III of the Constitution assigns to the federal judiciary the responsibility and power to adjudicate "cases" and "controversies," and the Framers of the Constitution envisioned that the final "interpretation of laws" would be by the courts. Exercising independent judgment often included affording due respect to Executive Branch interpretations, especially when the interpretation was issued contemporaneously with the enactment of the statute and remained consistent over time. While the views of the Executive Branch could inform the judiciary, they would not supersede it.

The New Deal ushed in a rapid expansion of actions by federal agencies. The courts during that period often treated agency determinations of fact as binding on the courts if there was evidence to support the facts. But "[t]he interpretation of the meaning of statutes as applied to justiciable controversies," was "exclusively a judicial function." *United States v. American Trucking Assns., Inc.*, 310 U.S. 534, 544 (1940). Executive Branch interpretations, especially when issued contemporaneously with the enactment of a statute, were entitled to "great weight." *Id*. In *Loper Bright* the Court summarized what had come to be known as the "*Skidmore* analysis":

> **…** in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), the Court explained that the "interpretations and opinions" of the relevant agency, "made in pursuance of official duty" and "based upon . . . specialized experience," "constitute[d] a body of experience and informed judgment to which courts and litigants [could] properly resort for guidance," even on legal questions. *Id.*, at 139–140. "The weight of such a judgment in a particular case," the Court observed, would "depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Id.*, at 140.

Congress in 1946 enacted the APA "as a check upon administrators whose zeal might otherwise have carried them to excesses not contemplated in legislation creating their offices." *United States v. Morton Salt Co.*, 338 U.S. 632, 644 (1950).

(3) **Express Delegation to Agency.** Statutes sometime give explicit authority to an agency to interpret ("give meaning to a particular statutory term") or "fill up the details" about implementation of a statutory provision. If so, the courts "interpret the statute and effectuate the will of Congress … by recognizing constitutional delegations, 'fix[ing] the boundaries of [the] delegated authority,' … and ensuring the agency has engaged in 'reasoned decisionmaking' within those boundaries." Slip Opinion at 17-18.

The Court discussed express delegation to agencies in the context of responding to an argument about policymaking:

> That is not to say that Congress cannot or does not confer discretionary authority on agencies. Congress may do so, subject to constitutional limits, and it often has. But to stay out of discretionary policymaking left to the political branches, judges need only fulfill their obligations under the APA to independently identify and

> respect such delegations of authority, police the outer statutory boundaries of those delegations, and ensure that agencies exercise their discretion consistent with the APA.

Slip Opinion at 26.

[*Chevron*, discussed immediately below, had noted that a statute may include "express delegation of authority to the agency to elucidate a specific provision of the statute by regulation." *Chevron* said "[s]uch legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute."]

(4) ***Chevron* Approach.** *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), announced a two-step approach for analyzing the validity of agency actions and regulations. First, determine if a particular statutory provision is ambiguous ("the statute is silent or ambiguous with respect to the specific issue"). If the statute is not ambiguous, the court should reject agency administrative constructions of statutes that were inconsistent with congressional intent. Second, if the statute is ambiguous, the regulation would be upheld if it is a "permissible" construction of the statute, even if a court would have reached a different interpretation.

> If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, [footnote omitted] as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

467 U.S. at 843.

(5) ***Chevron* is Inconsistent With APA.** The Court held that *Chevron* deference is inconsistent with the APA, which requires "the reviewing court" to "decide *all* relevant questions of law" and "interpret statutory provisions." (emphasis added, as quoted by the Court).

(a) **No Presumption of Implicit Delegation to Agencies.** Statutory ambiguities are not presumptively implicit delegations to agencies. Statutory ambiguities may arise for various reasons, including unintentional ambiguities, and that does not "reflect a congressional intent that an agency, as opposed to a court, resolve the resulting interpretive question." Slip Opinion at 22. Indeed, most ambiguities may be "unintentional," and agencies have "no special competence in resolving statutory ambiguities." Slip Opinion at 23.

> Courts, after all, routinely confront statutory ambiguities in cases having nothing to do with *Chevron*—cases that do not involve agency interpretations or delegations of authority. Of course, when faced with a statutory ambiguity in such a case, the ambiguity is not a delegation to anybody, and a court is not somehow relieved of its obligation to independently interpret the statute. … Courts instead understand that such statutes, no matter how impenetrable, do—in fact, must—have a single, best meaning. That is the whole point of having written statutes; "every statute's meaning is fixed at the time of enactment." [Citation omitted]. So instead of declaring a particular party's reading "permissible" in such a case, courts use every tool at their disposal to determine the best reading of the statute and resolve the ambiguity.
>
> In an agency case as in any other, though, even if some judges might (or might not) consider the statute ambiguous, there is a best reading all the same—"the reading the court would have reached" if no agency were involved. *Chevron*, 467 U. S., at 843, n. 11. It therefore makes no sense to speak of a "permissible" interpretation that is not the one the court, after applying all relevant interpretive tools, concludes is best. In the business of statutory interpretation, if it is not the best, it is not permissible.

Slip Opinion at 22-23.

(b) **Purported Reasons That Agency Interpretations Should Be Favored.**

i. **Subject Matter Expertise.** *Chevron* applies even in cases having little to do with the agency's technical subject matter expertise. Courts will have the benefit of the perspectives of parties and *amici* (both are "steeped in the subject matter") and the agency's subject matter expertise (its "body of experience and informed judgment"). The agency's interpretation may be "especially informative" when it rests on "factual premises" within its expertise.

> For those reasons, delegating ultimate interpretive authority to agencies is simply not necessary to ensure that the resolution of statutory ambiguities is well informed by subject matter expertise. The better presumption is therefore that Congress expects courts to do their ordinary job of interpreting statutes, with due respect for the views of the Executive Branch. And to the extent that Congress and the Executive Branch may disagree with how the courts have performed that job in a particular case, they are of course always free to act by revising the statute.

Slip Opinion at 25.

ii. **Uniform Construction of Federal Law.** "[T]here is little value in imposing a uniform interpretation of a statute if that interpretation is wrong." Slip Opinion at 25.

iii. **Policymaking Suitable for Political Actors.** "Courts interpret statutes. No matter the context, based on the traditional tools of statutory construction, not individual policy preferences." Slip Opinion at 26.

(c) **Many Exceptions to *Chevron* Have Been Applied.** "[W]e have spent the better part of four decades imposing one limitation on *Chevron* after another, pruning its presumption …. Confronted with this byzantine set of preconditions and exceptions, some courts have simply bypassed *Chevron*, saying it makes no difference for one reason or another." Slip Opinion at 27-28.

(d) **Stare Decisis.** Stare decisis does not require persisting with the *Chevron* doctrine.

> The only question left is whether *stare decisis*, the doctrine governing judicial adherence to precedent, requires us to persist in the *Chevron* project. It does not. *Stare decisis* is not an "inexorable command," …, and the *stare decisis* considerations most relevant here—"the quality of [the precedent's] reasoning, the workability of the rule it established, . . . and reliance on the decision," …—all weigh in favor of letting *Chevron* go.

Slip Opinion at 29.

(6) **Effect on Prior Cases.** Prior cases addressing the validity of agency actions that relied on the *Chevron* framework are not called into question. The holdings of those cases are subject to *stare decisis*; they may be overruled only if a "special circumstance" exists, and '[m]ere reliance on *Chevron* cannot constitute a "special justification…. That is not enough to justify overruling a statutory precedent." Slip Opinion at 34-35.

The dissent speculates that future courts will find ways to relook at the validity of regulations addressed in those prior cases because of the overruling of *Chevron*:

> The majority says that a decision's "[m]ere reliance on *Chevron*" is not enough to counter the force of *stare decisis*; a challenger will need an additional "special justification." ... The majority is sanguine; I am not so much. Courts motivated to overrule an old *Chevron*-based decision can always come up with something to label a "special justification." Maybe a court will say "the quality of [the precedent's] reasoning" was poor.... Or maybe the court will discover something "unworkable" in the decision—like some exception that has to be applied.... All a court need do is look to today's opinion to see how it is done.

Slip Opinion, Dissent at 31.

(7) **Summary.** The very end of the majority opinion has an excellent brief summary of how courts will analyze the validity of agency rules and regulations in the future:

> *Chevron* is overruled. Courts must exercise their independent judgment in deciding whether an agency has acted within its statutory authority, as the APA requires. Careful attention to the judgment of the Executive Branch may help inform that inquiry. And when a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring that the agency acts within it. But courts need not and under the APA may not defer to an agency interpretation of the law simply because a statute is ambiguous.

Slip Opinion at 35.

c. **Concurring Opinions.** A concurring opinion by Justice Thomas maintains that *Chevron* deference is constitutionally suspect. "I write separately to underscore a more fundamental problem: *Chevro*n deference also violates our Constitution's separation of powers." Slip Opinion, Thomas Concurring at 2. A lengthy concurring opinion by Justice Gorsuch observes that the majority opinion "places a

tombstone on *Chevron* no one can miss" and explains his view of "why the proper application of the doctrine of *stare decisis* supports [overruling *Chevron*]. Slip Opinion, Gorsuch Concurring at 1-2.

d. **Dissenting Opinion.** A dissenting opinion by Justice Kagan, joined by Justices Sotomayor and Jackson (Justice Jackson participated only in one of the two case) gives various reasons why *Chevron* deference is appropriate and criticizes overruling this 40-year doctrine. Some of the reasons given include the following.

(1) **Fill Statutory Gaps.** Agency action is needed to fill gaps or ambiguities in statutes.

(2) **Subject Matter Expertise of Agencies.**

> [A]gencies often know things about a statute's subject matter that courts could not hope to. The point is especially stark when the statute is of a "scientific or technical nature." [citation omitted]. Agencies are staffed with "experts in the field" who can bring their training and knowledge to bear on open statutory questions. *Chevron*, 467 U. S., at 865. Consider, for example … [w]hen does an alpha amino acid polymer qualify as a "protein"? ... I don't know many judges who would feel confident resolving that issue. (First question: What even *is* an alpha amino acid polymer?) But the FDA likely has scores of scientists on staff who can think intelligently about it, maybe collaborate with each other on its finer points, and arrive at a sensible answer.

Slip Opinion, Dissent at 9.

(3) **Experience with Complex Regulatory Regimes.** "Congress would value the agency's experience with how a complex regulatory regime functions, and with what is needed to make it effective." Slip Opinion, Dissent at 10. For example, a statute may require adjusting Medicare reimbursements for geographic wage differences. Many variables could impact that analysis, including hard data, the ease of administering approaches on a nationwide basis, how regulators have dealt with similar questions in the past, and what hospitals think would work best. "Congress knows the Department of Health and Human Services can do all those things—and that courts cannot." Id.

(4) **Policy Issues.** A regulatory decision may be "less one of construing a text than of balancing competing goals and values… Again, that is a choice a judge should not be making, but one an agency properly can. Agencies are 'subject to the supervision of the President, who in turn answers to the public.'" [citation omitted] Slip Opinion, Dissent at 11.

(5) **Summary of Those Issues.**

> [The majority opinion] insists that "agencies have no special competence" in filling gaps or resolving ambiguities in regulatory statutes; rather, "[c]ourts do." ... Score one for self-confidence; maybe not so high for self-reflection or -knowledge. Of course courts often construe legal texts, hopefully well. [Several specific regulatory issues are listed.] The idea that courts have "special competence" in deciding such questions whereas agencies have "no[ne]" is, if I may say, malarkey. Answering those questions right does not mainly demand the interpretive skills courts possess. Instead, it demands one or more of: subject-matter expertise, long engagement with a regulatory scheme, and policy choice. It is courts (not agencies) that "have no special competence"—or even legitimacy—when those are the things a decision calls for.

Slip Opinion, Dissent at 13.

(6) ***Chevron* Deference Has Been Fine-Tuned.**

> None of this is to say that deference to agencies is always appropriate. The Court over time has fine-tuned the *Chevron* regime to deny deference in classes of cases in which Congress has no reason to prefer an agency to a court. The majority treats those "refinements" as a flaw in the scheme, … but they are anything but.

Slip Opinion, Dissent at 11.

(7) **APA is Compatible With Chevron Deference.** The dissent addresses the majority's reference to the APA dictating that courts should "decide all relevant questions of law."

> The majority highlights the phrase "decide all relevant questions of law" (italicizing the "all"), and notes that the provision "prescribes no deferential standard" for answering those questions. ... But just as the provision does not prescribe a deferential standard of review, so too it does not prescribe a *de novo* standard of review (in which the court starts from scratch, without giving deference). In point of fact, Section 706 does not

specify *any* standard of review for construing statutes. [citation omitted] And when a court uses a deferential standard—here, by deciding whether an agency reading is reasonable—it just as much "decide[s]" a "relevant question[] of law" as when it uses a *de novo* standard. §706. The deferring court then conforms to Section 706 "by determining whether the agency has stayed within the bounds of its assigned discretion—that is, whether the agency has construed [the statute it administers] reasonably." [citing a Harvard Law Review article]. [S]ee *Arlington v. FCC*, 569 U. S. 290, 317 (2013) (ROBERTS, C. J., dissenting) ("We do not ignore [Section 706's] command when we afford an agency's statutory interpretation *Chevron* deference; we respect it").

Slip Opinion, Dissent at 16.

(8) **Abandonment of *Stare Decisis*.** The dissent, in particular, decries the overruling of *Chevron* as subverting the principle of *stare decisis* and threatening the interests of parties who have relied for years on agency regulations (some of which may have specifically been upheld by the courts under *Chevron* deference).

And still there is worse, because abandoning *Chevron* subverts every known principle of *stare decisis*. Of course, respecting precedent is not an "inexorable command." *Payne* v. *Tennessee*, 501 U. S. 808, 828 (1991). But overthrowing it requires far more than the majority has offered up here. *Chevron* is entitled to *stare decisis*'s strongest form of protection. The majority thus needs an exceptionally strong reason to overturn the decision, above and beyond thinking it wrong…. In particular, the majority's decision today will cause a massive shock to the legal system, "cast[ing] doubt on many settled constructions" of statutes and threatening the interests of many parties who have relied on them for years. [*Kisor v. Wilkie*,] 588 U. S., at 587 (opinion of the Court).

…

On the other side of the balance, the most important *stare decisis* factor—call it the "jolt to the legal system" issue—weighs heavily against overruling *Chevron*…. [P]rivate parties have ordered their affairs—their business and financial decisions, their health-care decisions, their educational decisions—around agency actions that are suddenly now subject to challenge. In *Kisor*, this Court refused to overrule *Auer* [which requires judicial deference to agencies' interpretations of their own regulations] because doing so would "cast doubt on" many longstanding constructions of rules, and thereby upset settled expectations. 588 U.S., at 587 (opinion of the Court). Overruling *Chevron*, and thus raising new doubts about agency constructions of statutes, will be far more disruptive.

Slip Opinion, Dissent at 24, 30.

(9) **Effect on Prior Decisions.** The dissent responded to the position in the majority opinion "that judicial decisions that have upheld agency action as reasonable under *Chevron* should not be overruled on that account alone" by observing that "courts motivated to overcome an old Chevron-based decision can always come up with something to label a 'special justification.' … All a court need do is look at today's opinion to see how it is done." Slip Opinion, Dissent at 30-31.

(10) **No Reliance on *Chevron* For Sixteen Years.** The majority opinion observed that the Supreme Court had not relied on *Chevron* for 16 years. The dissent viewed that as a bootstrap because it reflects an effort over that 16-year period by some Justices ultimately to overrule *Chevron*.

The majority says differently, because this Court has ignored *Chevron* lately; all that is left of the decision is a "decaying husk with bold pretensions." … The majority's argument is a bootstrap. This Court has "avoided deferring under *Chevron* since 2016" [cross reference citation omitted] because it has been preparing to overrule *Chevron* since around that time. That kind of self-help on the way to reversing precedent has become almost routine at this Court. Stop applying a decision where one should; "throw some gratuitous criticisms into a couple of opinions"; issue a few separate writings "question[ing the decision's] premises" [cross reference citation omitted]; give the whole process a few years . . . and voila!—you have a justification for overruling the decision…. I once remarked that this overruling-through-enfeeblement technique "mock[ed] *stare decisis*." *Janus* [*v. State, County, and Municipal Employees*], 585 U. S., at 950 (dissenting opinion). I have seen no reason to change my mind.

Slip Opinion, Dissent at 27.

e. **Observations.**

(1) **Overview Regarding Estate Tax Regulations.** In the much celebrated (at least by taxpayers) case of *Walton v. Commissioner*, 115 T.C. 589 (2000), the Tax Court invalidated the notorious

Example 5 in the GRAT regulations (Reg. §25.2702-3(e), Ex. (5)) as being "an unreasonable interpretation and an invalid extension of section 2702." The court applied the *Chevron* deference test to determine whether this "interpretive regulation" was reasonable (as opposed to the stricter "arbitrary, capricious, or manifestly contrary to the statute" test for "legislative regulations" issued under a specific grant of authority in the pertinent statute). The court said that it did not need to reach the issue of whether the regulation was adopted in violation of the APA. The holding in *Walton* allows the full actuarial value of the retained annuity interest in a GRAT to be subtracted in determining the net value of the gift upon the creation of a GRAT (thus almost or perhaps completely "zeroing out" the GRAT). After focusing on the statute's "origin and purpose for further guidance," *Walton* viewed the restriction in Example 5 from netting the gift amount by the value of the reversionary interest passing to the donor's estate as "an unreasonable interpretation and an invalid extension of section 2702." 115 T.C. at 604.

Since that time almost twenty-five years ago, very few cases in the estate planning arena have addressed the validity of Treasury regulations and notices, and very few have addressed the invalidity of regulations for failure to comply with the APA or have validated regulations by reason of the *Chevron* doctrine.

(2) **Continuation of Recent Trend Attacking Regulations; Statute of Limitations Regarding Attacks on Old Regulations (*Corner Post, Inc. v. Board of Governors of the Federal Reserve System*).** *Loper Bright* is the latest link in a chain of recent attacks on the validity of regulations. See Item 12 above for discussion about a number of recent cases beginning in late 2021 that have addressed the validity under the APA of regulations and other IRS guidance (not only for final regulations but also temporary regulations and even subregulatory guidance).

Indeed, the Supreme Court followed *Loper Bright* with an opinion several days later saying that the six-year statute of limitations "after the right of action first accrues" under 28 U. S. C. §2401(a) for claims against the United States would not bar attacks on even very old regulations as being in violation of the Administrative Procedure Act requirements for valid agency actions. The Court concluded that the six-year statute does not begin to run until a particular plaintiff is injured by agency action. *Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, 603 U.S. 799 (July 1, 2024) (J. Barrett writing for majority; Dissent by J. Jackson, jointed by J. Sotomayor and J. Kagan). Section 2401(a) has a six-year statute of limitations to challenge a final agency action. A practical problem with that limit is that the Anti-Injunction Act (§7421(a)) prevents challenges to tax regulations until a taxpayer is affected (i.e., has a notice of deficiency, a refusal of a refund, or other dispute with the IRS). *CIC Services LLC v. United States*, 593 U.S. 209 (2021). That may be far longer than six years after the regulation was finalized. When taxpayers have challenged some regulations, the government has argued that the statute of limitations had run under 28 U.S.C. §2401(a) on the taxpayer's ability to challenge the regulation's validity. Under *Corner Post*, old regulations may still be challenged, as long as the challenge is brought within six years of when a taxpayer is injured by the regulation. Some commentators suggest that "*Corner Post* is a much bigger deal for tax than *Loper Bright*," with its opening of old regulations to challenges. *See* Sheppard, *Supreme Court Reverses* Chevron *Doctrine*, 184 TAX NOTES FEDERAL 379 (July 15, 2024).

(3) **General Application to Tax Regulations.** *Mayo Foundation v. U.S.*, 562 U.S. 44 (2011), regarding the validity of a Treasury regulation that impacted a requested refund of FICA taxes, specifically held that *Chevron* deference applies to tax regulations. "[W]e are not inclined to carve out an approach to administrative review good for tax law only…. The principles underlying our decision in *Chevron* apply with full force in the tax context." 562 U.S. at 55. *Mayo Foundation* rejected an argument that tax matters should be treated differently than other areas of administrative law. That meant that issues that had been raised regarding agency interpretations prior to *Chevron* (such as whether agency interpretation had been consistent or had been promulgated years after the relevant statute was enacted or because of the way in which the regulation evolved or because the regulation was prompted by litigation) would not apply to the Court's review of the FICA regulation.

(4) **Effect of Specific Statutory Authorization for Regulations**. Many Treasury regulations have been promulgated pursuant to the Treasury Department's general authority under §7805 to "prescribe all needful rules and regulations for the enforcement of" the Internal Revenue Code. Prior to *Chevron*, several Supreme Court cases said the Court owed less deference to the Treasury Department's interpretation that is issued under that general authority in §7805(a) than when it is issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision. *Rowan Cos.* v. *United States*, 452 U.S. 247, 253 (1981); *United States* v. *Vogel Fertilizer Co.*, 455 U.S. 16, 24 (1982) (quoting *Rowan*). That changed, however, following the *Chevron* case. *Mayo Foundation* stated that the administrative landscape changed significantly after *Rowan* and *Vogel* were decided. 562 U.S. at 56.

> We have held that *Chevron* deference is appropriate "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." [*United States v. Mead Corp.*], 533 U. S., at 226–227. **Our inquiry in that regard does not turn on whether Congress's delegation of authority was general or specific.**

562 U.S. at 56-57 (emphasis added).

That statement by the Supreme Court in 2011, drawing no distinction between general or specific delegations of authority to the Treasury Department in tax statutes, appears to be a change in the position taken by the Court in *Chevron*, which applied a high standard for disregarding "legislative regulations" in response to "an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. According to *Chevron*, such legislative regulations were given controlling weight unless they were arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. 837, at 843-844 (1984). Various cases after *Chevron* have drawn a distinction between interpretive regulations issued under the general authority of §7805(a) and legislative regulations issued under a specific grant of authority for a particular statute.

For example, the Tax Court in *Walton v. Commissioner*, 115 T.C. 589 (2000), invalidated the notorious "Example 5" in the initial GRAT regulations by applying a "reasonable manner" standard for interpretive regulations, as opposed to the much stricter "arbitrary, capricious, or manifestly contrary to the statute" standard for reviewing legislative regulations.

> The regulations at issue here are interpretative regulations promulgated under the general authority vested in the Secretary by section 7805(a). Hence, while entitled to considerable weight, they are accorded less deference than would be legislative regulations issued under a specific grant of authority to address a matter raised by the pertinent statute. See Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843-844 (1984) (Chevron); United States v. Vogel Fertilizer Co., 455 U.S. 16, 24 [49 AFTR 2d 82-491] (1982). A legislative regulation is to be upheld unless "arbitrary, capricious, or manifestly contrary to the statute." Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., supra at 843-844.
>
> With respect to interpretative regulations, the appropriate standard is whether the provision "implement[s] the congressional mandate in some reasonable manner." United States v. Vogel Fertilizer Co., supra at 24 (quoting United States v. Correll, 389 U.S. 299, 307 [20 AFTR 2d 5845] (1967)). In applying this test, we look to the following two-part analysis enunciated by the Supreme Court [in *Chevron*].

115 T.C. at 597.

Other cases (prior to *Loper Bright*) have acknowledged that the issuance of a regulation after following the notice-and-comment procedures of the APA are a "significant" sign that the regulation merits *Chevron* deference. *Mayo Foundation*, *United States v. Mead Corp.*, *Long Island Care at Home Ltd. v. Coke*.

The Court in *Loper Bright* did not specifically address the effect of general vs. specific statutory authority for issuing regulations. The Court acknowledged that different types of statutory authority may exist for issuing regulations.

> In a case involving an agency, of course, the statute's meaning may well be that the agency is authorized to exercise a degree of discretion. Congress has often enacted such statutes. For example, some statutes "expressly delegate[]" to an agency the authority to give meaning to a particular statutory term. *Batterton* v. *Francis*, 432 U. S. 416, 425 (1977) (emphasis deleted). Others empower an agency to prescribe rules to "fill

up the details" of a statutory scheme, *Wayman* v. *Southard*, 10 Wheat. 1, 43 (1825), or to regulate subject to the limits imposed by a term or phrase that "leaves agencies with flexibility," *Michigan* v. *EPA*, 576 U. S. 743, 752 (2015), such as "appropriate" or "reasonable." [footnotes omitted]

Slip Opinion at 17.

The Court did not refer to how its analysis would vary depending on the type of statutory authorization other than to recognize that courts should determine the boundaries of the delegated authority and ensure "that the agency has engaged in 'reasoned decisionmaking' within those boundaries." Slip Opinion at 18. The end of the majority's opinion in *Loper Bright* merely observes that "when a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring that the agency acts within it. But courts need not and under the APA may not defer to an agency interpretation of the law simply because a statute is ambiguous." The only limitation specifically mentioned is that the courts "must respect the delegation" and must determine that regulations that are issued are within the scope of the delegated authority. However, some commentators believe that under *Loper Bright*, regulations issued pursuant to a specific grant of authority will continue to be afforded more weight than mere interpretive regulations issued under §7805's general grant of authority. *E.g.*, Mitchell Gans & Jonathan Blattmachr, *Loper Bright Enterprises v. Raimondo, Where in a Generational Shift, the Supreme Court Overruled the Chevron Doctrine*, LEIMBERG ESTATE PLANNING NEWSLETTER #3130 (July 2, 2024) (hereinafter Gans & Blattmachr, Generational Shift).

All tax regulations are issued under the general authority of §7805, stating that "the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." But some regulations are also issued under more specific statutory authority, typically included in the relevant Code provision.

For example, Ron Aucutt (Lakewood Ranch, Florida) points to the "consistent basis" proposed regulations. Section 1014(f) specifically authorizes regulation to "provide exceptions to the application of this subsection." Mr. Aucutt asks: "Does that permit regulations that assign a zero basis to an after-discovered or accidentally omitted asset, even though its value has been neither "determined" under §1014(f)(1)(A) nor reported under §1014(f)(1)(B) and therefore it appears that §1014(f) does not apply to that asset at all? I don't think so." In contrast, §6035 requires providing basis information to recipients, and §6035(b) authorizes regulations that are "necessary to carry out" §6035. Mr. Aucutt points out that Treasury officials have informally cited §6035(b) "to perhaps justify requiring the successive reporting by donors and other transferors in non-realization transfers, but §6035 only requires reporting and does not assign basis like §1014(f) does. Moreover, even §6035(b)'s use of 'necessary' may be viewed as weak compared to the 'necessary or appropriate' standard in §2001(g)(2) (clawback) and §2010(c)(6) (portability)."

Relatively very few of the Code sections regarding estate and gift taxes include specific statutory authorization for regulations. Some exceptions include §2001(g)(2) (clawback, "necessary or appropriate"), §2010(c)(6) (portability, "necessary or appropriate"), §2014(c)(2) foreign tax credit, "regulations prescribed by the Secretary"), §2016 (recovery of taxes claimed as credit, "regulations prescribed by the Secretary"), §2014(c)(2) foreign tax credit, "regulations prescribed by the Secretary"), §2032A(f)(1) (special use valuation statute of limitations, "such manner as the Secretary may be regulations prescribe"), §2037(b)(2) (value of reversionary interest, "regulations prescribed by the Secretary"), §2053(d)(1) (deductibility of certain foreign death taxes, "regulations prescribed by the Secretary"), §2055(e)(H) (estate tax charitable deduction, "as may be necessary to carry the purposes of this paragraph"), §2056A(a)(2) and (e) (qualified domestic trusts, "may by regulations prescribe to ensure the collection of any tax imposed by subsection (b)" and "[t]he Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section"), §2108(d) (application of pre-1967 estate tax provisions regarding taxes paid to foreign country, "necessary or appropriate to implement this section"), §2204(b) (discharge of fiduciary from personal liability, "for purposes of carrying out the provisions of this section as the Secretary may require by regulations"), §§2513 (a)(2), 2513(b),

and 2513(c) (split gift election, "such manner as is provided under regulations"), §2522(e)(1)(B) (gift tax charitable deduction limitations for fractional gifts, "may, by regulation, provide"), §2522(e)(2)(A) (gift tax charitable deduction recapture, "Secretary shall provide"). Section 2663 authorizes regulations "as may be necessary or appropriate" regarding all the generation-skipping transfer tax Code provisions (and specifically including three listed topics). That leaves most of the estate and gift tax Code sections with no specific authorization for regulations. In summary, **very few** estate and gift tax regulations have been issued pursuant to specific statutory authority other than the general authority of §7805.

For an outstanding discussion of the importance of whether and how courts may restrict the scope of express delegations to write regulations, see Jasper Cummings, Chevron: *How to Read a Supreme Court Opinion*, 185 TAX NOTES FEDERAL 87 (Oct. 7, 2024).

(5) **Review Standards Prior to *Chevron (Skidmore* and *National Muffler)*.** Before the *Chevron* decision in 1984, courts had typically used the review standards originally announced by the Supreme Court in 1944 in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944):

> We consider that the rulings, interpretations and opinions of the Administrator under this Act, while not controlling upon the courts by reason of their authority; do constitute a **body of experience and informed judgment** to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon **the thoroughness** evident in its consideration, the **validity of its reasoning**, its **consistency** with earlier and later pronouncements, and all those factors which give it **power to persuade**, if lacking power to control.

323 U.S. at 140 (emphasis added).

Factors mentioned by *Skidmore* (in the quotation immediately above) that courts should consider in determining what weight to give to agency interpretations in looking to them for "guidance" are (1) their thoroughness, (2) the validity of their reasoning, (3) their consistency with earlier and later pronouncements, and (4) all factors relevant to their power to persuade.

The Supreme Court subsequently summarized *Skidmore* as saying an agency's interpretation of a statute is entitled to "respect proportional to its 'power to persuade.'" *United States v. Mead Corp.*, 533 U.S. 218, 235 (2001) (quoting *Skidmore*).

The *Skidmore* analysis was applied with more detail by the Supreme Court in *National Muffler Dealers Assn. v. United States*, 440 U.S. 472 (1979).

> In determining whether a particular regulation carries out the congressional mandate in a proper manner, we look to see whether the regulation **harmonizes with the plain language of the statute, its origin, and its purpose**. A regulation may have particular force if it is a **substantially contemporaneous** construction of the statute by those presumed to have been aware of congressional intent. If the regulation dates from a **later period, the manner in which it evolved merits** inquiry. Other relevant considerations are the **length of time** the regulation has been in effect, the **reliance** placed on it, the **consistency** of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during **subsequent re-enactments of the statute**.
>
> …
>
> In short, while the Commissioner's reading of 501(c)(6) perhaps is not the only possible one, it does bear a fair relationship to the **language of the statute**, it reflects the **views of those who sought its enactment**, and it matches **the purpose** they articulated. It **evolved as the Commissioner administered the statute** and attempted to give to a new phrase a content that would reflect congressional design. The regulation has **stood for 50 years**, and the Commissioner infrequently but **consistently** has interpreted it to exclude an organization like the Association that is not industrywide. The Commissioner's view therefore merits serious deference.

440 U.S. at 477-78 (emphasis added).

(6) **Does the *Skidmore* Review Standard Apply Following *Loper Bright*?** *Loper Bright* does not specifically address what standard should be used by courts in reviewing whether regulations appropriately interpret statutory provisions. Some commentators have suggested that following *Loper Bright*, courts will consider "the relevant factors under *Skidmore* deference." *E.g.*, Gans & Blattmachr, Generational Shift. Other commentators believe that the standard to be applied after

the overruling of *Chevron* is not clear. *See Skidmore Deference: Agency Actions Without the Force of Law*, BLOOMBERG LAW (July 2024) ("The *Skidmore* standard was cited in the briefs in *Loper Bright* and *Relentless*, and was the subject of questions during oral argument as well. It's a frontrunner to be a *Chevron* replacement, though nothing is certain yet.").

The first post-*Loper-Bright* Tax Court case addressing the validity of a tax regulation quoted the *Skidmore* analysis at length. *Varian Medical System, Inc. v. Commissioner*, 163 T.C. No. 4 (2024). See Item 19.a below.

One commentator believes that the *Skidmore* framework will be applied, observing that it is not "deference" to agency interpretation (*Loper Bright* emphasizes that courts interpret and construe statutes and should never "defer" to agency interpretations) but is a process for "uncovering statutory meaning."

> … [I]n *Loper Bright* the Court not only cited *Skidmore* with seeming approval, but repeatedly emphasized the "respect" traditionally afforded to longstanding, consistent agency interpretations, especially when offered close in time to the statute's passage….
>
> … But it doesn't want to call *Skidmore* "deference," because it believes the thing called deference is not allowed under the APA. And so we also get some language endorsing de novo review.
>
> … *Skidmore* is really about uncovering statutory meaning. So, the *Loper Bright* majority might say, using it does not constitute deference any more than consulting a dictionary does. *Chevron* was different in that it was premised on the idea that the law had "run out," and the agency simply got to decide the question. *Loper Bright* seems to embrace something like this distinction in footnote 3.

Daniel Deacon, *Loper Bright, Skidmore, and the Gravitational Pull of Past Agency Interpretations*, BLOG FROM YALE JOURNAL ON REGULATION AND AMERICAN BAR ASSOCIATION ADMINISTRATIVE LAW AND REGULATORY PRACTICE SECTION (June 30, 2024).

The contrast between the "uncovering statutory meaning" approach of *Skidmore* and the "deference" approach of *Chevron* was explained in Ryan Doerfler, *How Clear is "Clear"?*, 109 VA. L. REV. 651, 709 (2023) ("unlike *Chevron*, however, *Skidmore* appears to treat an agency's views as evidence of statutory meaning…. Again, under *Skidmore*, an agency's views are evidence of statutory meaning. Under *Chevron*, by contrast, those views constitute a legal basis for deciding a case if statutory meaning is unknown.").

(7) **Possible Practical Implications of *Loper Bright* on Tax Regulations Going Forward.**

(a) **More Attacks on Validity of Regulations.** The overruling of *Chevron* deference will allow much more flexibility to courts in reviewing the validity of regulations and whether they correctly reflect the "plain language…, … origin, and … purpose" (quoting *National Muffler*) of pertinent statutes, likely leading to more attacks on the validity of regulations. "No longer will the IRS be entitled to a near-automatic win if it can establish that the statute is ambiguous. No longer is it a *fait accompli* that a court will uphold a challenged regulation." Thomas Sykes, Loper Bright: *A Tax Litigator's Quick Take*, 184 TAX NOTES FEDERAL 451 (July 15, 2014) (hereinafter Sykes, Tax Litigator's Quick Take). (In addition, the recent court attacks under the APA on a conservation easement tax regulation will likely lead to more litigation about the validity of regulations under the APA. See Item 12 above.)

Examples of tax regulations that may be subject to attack (or that already are under attack) include the Bipartisan Budget Act's partnership audit regime, conservation easements, the partnership anti-abuse rule in Reg. §1.701-2, the "blocked income regulation" (Reg. §1.482-1(h)(2)) under §482 (the reflection of income statute in the international context), and the repatriation regulation (Reg. §1.965-5(c)(1)(ii)) that denied credit for some foreign income taxes. *See* Sheppard, *Supreme Court Reverses* Chevron *Doctrine*, 184 TAX NOTES FEDERAL 379 (July 15, 2024); Sapirie, Chevron *is Dead. Long Live* Skidmore *and the APA?*, 184 TAX NOTES FEDERAL 393 (July 15, 2024). The basis-shifting final regulations (issued January 10, 2025, may be subject to a *Loper-Bright* attack. *See* Parillo, *Validity of Some Partnership Regs in Doubt After* Loper Bright, 185 TAX NOTES FEDERAL 342 (Oct. 14, 2024).

Another example is the regulatory requirement of the timing for updating information on beneficial ownership reports under the Corporate Transparency Act. Updates or corrections of reports must be made within 30 days of changes (not within 30 days of when the reporting company learns of a change). However, the statute merely requires that updating of reports must be filed "in accordance with regulations prescribed by the Secretary of the Treasury, … in a timely manner, and not later than 1 year after the date on which there is a change." 31 U.S. CODE §5336(b)(1)(D). Courts may address whether a 30-day timeline is the "best reading" of the statutory requirement of "a timely manner, and not later than 1 year after the date on which there is a change," and that decision would include an analysis of the scope of the authorization for regulations.

> Obviously, the foreshortened deadline, however helpful to Treasury's Financial Crimes Enforcement Network, is a trap for tens of millions of small business owners just trying to stay afloat — owners who perhaps have little contact with professional advisers. That is dubious public policy and antithetical to the textually expressed congressional intent.

Sykes, Tax Litigator's Quick Take.

(b) **Procedural Details for Challenges.** Procedural details regarding challenges of the validity of a regulation are summarized.

> If a practitioner concludes that a Treasury regulation is possibly invalid under *Loper Bright*, it might make sense to file a refund claim, depending on the amount of tax involved in open and future tax years. A taxpayer ordinarily has three years from when a return was filed, or two years from when tax was paid, to file a timely and sufficient refund claim detailing the facts and grounds on which the taxpayer is relying. [Footnote citing §6511.] Both the Internal Revenue Manual and case law provide that a taxpayer who wishes to have the IRS take no action on a refund claim that is premised on the outcome of pending litigation (perhaps brought by others) may file a protective claim for refund within the applicable limitations period.
>
> If the IRS has disallowed a refund claim, a taxpayer generally has two years within which to file suit in U.S. district court or the Court of Federal Claims, [footnote citing §6501] unless the taxpayer previously signed a Form 2297, "Waiver of Statutory Notice of Claim Disallowance," in which case the two years begins to run when that form is signed. A taxpayer who has received a notice of deficiency from the IRS has only 90 days to file its petition in Tax Court, and that deadline may not be extended. If the taxpayer wishes to challenge a dubious regulation, the challenge should be teed up in the taxpayer's petition.
>
> Any original return, refund claim, Tax Court petition, or similar document that is premised on a position that contradicts a Treasury regulation should, out of an abundance of caution, be accompanied by a Form 8275-R, "Regulation Disclosure Statement," disclosing the conflict and detailing the basis for the taxpayer's position. This will help protect the taxpayer from possible penalties if the challenge is rejected.
>
> Tax practitioners should not overlook the recent activity around the six-year "outer limit" limitations statute found in 28 U.S.C. section 2401(a). If a taxpayer could have, but did not, mount a court challenge to a regulation within six years after its promulgation, a court challenge may be barred. That is, taxpayers sometimes don't bother to challenge a regulation because the tax liability stemming from its application is insufficient to warrant the expense and effort. If, however, the tax at stake increases sharply in a future tax year, a challenge at that time might make financial sense. But at that point, if the six-year limit of section 2401(a) has passed, would the IRS assert that section 2401(a) bars the challenge, despite the various other tax-specific limitations periods found in the code? [Footnote citing *Corner Post* (six-year limit starts to run when a litigant is adversely affected by the regulation).]

Sykes, Tax Litigator's Quick Take.

(c) **Attacks on Regulations Previously Found to be Valid Under the *Chevron* Standard.** The majority in *Loper Bright* attempted to clarify that prior cases addressing the validity of agency actions that relied on the *Chevron* framework are not called into question. The dissent, however, expressed that courts would still find a way to re-examine prior cases by finding the existence of some "special circumstance" to overcome the *stare decisis* doctrine. See Item 18.b(6) above.

(d) **Less Changing of Agency Interpretations in Regulations.** Courts may be much less inclined to give weight to agency interpretations that are inconsistent with prior

interpretation. Inconsistency is a negative factor under *Skidmore*. At oral argument in *Loper Bright*, some Justices were particularly concerned with the power that *Chevron* gave agencies to "change their minds."

> It's evident from the opinions (as well as oral argument) that what perhaps most bugged some of the justices about the *Chevron* regime was the ability it gave agencies to change their minds. This aspect of the new doctrine may dissuade agencies from doing so, even if they think they have pretty good support for the new interpretation.

Daniel Deacon, *Loper Bright, Skidmore, and the Gravitational Pull of Past Agency Interpretations*, BLOG FROM YALE JOURNAL ON REGULATION AND AMERICAN BAR ASSOCIATION ADMINISTRATIVE LAW AND REGULATORY PRACTICE SECTION (June 30, 2024).

Agencies may be less inclined to rewrite or eliminate prior regulations "when a new administration takes office." Gans & Blattmachr, Generational Shift (observing that *Loper Bright* reiterated that "every statute's meaning is fixed at the time of enactment").

(e) **Perhaps More Emphasis on Revenue Rulings Than on Regulations.** The Gans & Blattmachr article notes that regulations enjoyed substantial deference under *Chevron*, whereas revenue rulings enjoyed much less deference under the *Skidmore* standard.

> With Chevron now overruled and regulations and rulings both subject to Skidmore, perhaps the IRS will decide to issue more revenue rulings and less regulations though the IRS's argument in favor of a regulation will be somewhat stronger, even under Skidmore, given the notice-and-comment procedure.

Gans & Blattmachr, Generational Shift. *See also* Slowey, *The Ripple Effect of Chevron Doctrine: Tax Fallout, Explained*, BLOOMBERG DAILY TAX REPORT (July 15, 2024) ("The agency may decide it's not worth that regulation if the rule will be in the hands of the courts anyway.").

(f) **Less Declaring Victory by Regulation Following Court Losses.** The Gans & Blattmachr article also points out that the issuance of a regulation in the heat of litigation (such as the "anti-Hubert" regulations) is a negative factor regarding regulation validity under *Skidmore*.

(g) **IRS Position in Administrative Proceedings.** *Loper Bright* may have an impact on the IRS's stance in an administrative proceeding regarding an issue governed by an existing regulation and its position regarding settlement. *See* Sykes, Tax Litigator's Quick Take.

(h) **Taxpayer's Approach For a Position in Tension With Existing Regulation.** Taxpayers will consider how they will move forward (or abandon) a position in conflict with an existing regulation regarding the taxpayer's position (1) on a return, (2) in an administrative proceeding, or (3) in litigation. *See Id*.

(i) **Treasury's Approach in Issuing New Guidance.** Treasury may reassess how it will proceed regarding a position in new regulations that may be questioned as to whether it is the "best meaning" of the approach contemplated by the statute. *See Id*.

(j) **Congress's Approach in Structuring Legislation.** *Loper Bright* may place more focus on structuring legislation to provide implementation details rather than risking how courts may interpret details as to the "best meaning" of a statute and how it should be implemented. Special attention will be devoted to any express delegation to Treasury in tax statutes to provide "needful rules and regulations" (§7805(a)). Courts will carefully analyze the scope of any such express delegation of rulemaking authority and whether Treasury has engaged in "reasoned decisionmaking" within those boundaries. See Item 18.e(4) above.

The Joint Committee on Taxation may play an even larger role going forward in crafting tax legislation and producing detailed legislative history.

> The decision in *Loper Bright Enterprises v. Raimondo* holds big implications for tax policy, as Congress often gives the IRS and the Treasury Department leeway to fill in gaps in tax laws when crafting final regulations.
>
> Now, the House Ways and Means and Senate Finance committees may need to be more specific in delegating authority to the agencies and produce more detailed legislative histories for the courts to

understand what Congress intended. Some lawmakers have said they may need backup from key partners like the Joint Committee on Taxation, which works closely with tax writers analyzing the impact of tax proposals.

"The bulk of that is going to go on the Joint Committee staff, if Congress is serious in writing bills that they actually want to do and not letting the courts rewrite it," said George Yin, who served as the chief of staff at the JCT from 2003 to 2005.

…

Depending on how courts approach the legal challenges, there may be a greater emphasis on the legislative history and committee reports that the JCT is a key player in drafting, said Steve Rosenthal, a senior fellow at the Urban-Brookings Tax Policy Center who previously served as a legislation counsel at JCT.

Congress will need help from JCT in choosing how to delegate authority to the IRS and Treasury and explaining the context, but JCT is prepared to take on that task, Rosenthal said.

Handler, *Congress's Tax Scorekeeper Gets Spotlight After Chevron Ruling*, BLOOMBERG DAILY TAX REPORT (July 23, 2024).

(8) **Summaries of Transformative Effect of *Loper Bright* on Administrative Law.** The Gans & Blattmachr article concludes with an observation about the transformative effect of *Loper Bright*:

Loper is a transformative decision. It will dramatically alter administrative law, severely diminishing the interpretive authority of the agencies and giving it to the courts instead. The impact will be substantial on all manner of regulation. In the tax area, taxpayers faced with problematic regulations will now have a stronger argument in terms of their validity.

A summary of *Loper Bright* by Miller & Chevalier (a law firm headquartered in Washington D.C. with substantial experience in legislative and administrative law matters) concludes with a discussion of the unsettling and dramatic impact of *Loper Bright*:

The impact of *Loper Bright* on federal courts and agencies, Congress, and parties challenging agency action cannot be underestimated. The opinion will surely give rise to an increase in legal challenges to agency regulations and administrative actions and in forum shopping by litigants wishing to get those cases before their desired judges and circuit courts. Federal agencies will lose the significant advantage in those cases that *Chevron* deference afforded them and they will likely take additional steps in issuing guidance and rulemaking to shore up the foundation and persuasiveness of their regulatory actions.

It will take years for the rebalancing of federal government power over the administrative state to fully take shape following *Chevron*'s demise. Because district and appellate courts will exercise independent judgment when interpreting ambiguous legislation and undoubtedly will not see eye to eye on many issues, some laws federal agencies are charged to implement and enforce will be more unsettled for both regulated parties and those agencies. This uncertainty will create both burdens and opportunities for regulated parties.

(9) **Proposed Legislation to Codify *Chevron* Doctrine.** Eleven Democratic Senators on July 23, 2024, introduced the Stop Corporate Capture Act to codify the *Chevron* doctrine. The 35-page bill includes a wide variety of detailed requirements. Following is a link to the press release describing the legislation, which has links to the bill text and a section-by-section description of the bill. Very similar proposed legislation was introduced as H.R. 1507 in March 2023.

19. Regulation Validity Issues Post-Loper Bright; Mechanisms for Attacking Regulation Validity; Anti-Injunction Act.

a. **Tax Court Approach Going Forward; IRS Cannot Fix Statutory Mistakes With Regulations, *Varian v. Commissioner*.** The Tax Court acted quickly to give its first view of the new post-*Loper Bright* world in *Varian Medical System, Inc. v. Commissioner*, 163 T.C. No. 4 (2024). A "glitch" in the 2017 TCJA created (allegedly) unintended benefits for certain corporate taxpayers. A Technical Correction Act was never passed, and the IRS tried to remove the advantage by regulations. The Tax Court, in a unanimous opinion issued soon after the *Loper Bright* case, reasoned that the statute was clear and applied the statute as written. That could have decided the case, but the court went further, addressing the regulation at length and providing a roadmap for how it would evaluate challenges to regulations going forward. It quoted *Skidmore* analysis of factors at length, noting this factor in particular: "Does the statute authorize the challenged agency action?" The Tax Court

concluded: "No matter what the revised regulation intended to interpret, it cannot contradict the clear effective date provided for in the statutory text." *See also FedEx Corp. v. United States*, Cause No. 2:20-cv-02794 (W.D. Tenn February 13, 2025) (grant of motion for partial summary judgment denying reduction of $84.6 million refund, which was based on tax credits for taxes paid on foreign subsidiaries, referring to *Loper Bright* in concluding that IRS arguments "ignore the plain language of the dispositive statutory provisions").

If the IRS cannot fix statutory glitches by regulation, it might be expected to use common law doctrines like economic substance or substance over form to attack what it views as abusive transactions.

b. **Possibility of Court Attacks on Taxpayer-Friendly Regulations, *Memorial Hermann*.** An accepted principle is that the *IRS* cannot disavow its own regulations if it ultimately determines that a regulation takes a too-friendly taxpayer approach. However, a recent case suggests that taxpayers cannot blindly rely on regulations—the *court* on its own accord invalidated a regulation as providing a taxpayer-friendly approach that goes beyond the statutory authority. The issue was whether an organization qualified as a social welfare organization under §501(c)(4). The statute requires that such organizations be "operated exclusively for the promotion of social welfare." The Supreme Court has interpreted "operated exclusively" in other contexts to mean the presence of a single substantial nonexempt purpose will preclude exempt status. However, the regulations state that an organization will be treated as being "operated exclusively" for a social welfare purpose "if it is primarily engaged in promoting in some way the common and general welfare" of the community. Reg. §1.501(c)(4)-1(a)(2)(i). The ordinary meaning of "primarily engaged" (at least 51%) is much less restrictive than an "operated exclusively" standard. The IRS did not argue against its own regulation but contended that the "primarily engaged" and "operate exclusively" standards were not meaningfully different. The court determined that the organization did not meet either test, but the court went on to reject the taxpayer's reliance on the regulation: "Importantly, we no longer are required to provide '*Chevron* deference' to the Treasury's interpretation of § 501(c)(4) (although we can certainly consider it)… [T]he IRS's embrace of a legal standard cannot supplant our independent interpretation of the statutory text." *Memorial Hermann Accountable Care Org. v. Commissioner*, 120 F.4th 215 (5th Cir. Oct. 28, 2024).

There was no briefing regarding the validity of the regulation, and no party argued the regulation was invalid, but the court *sua sponte* disregarded the regulation. Neither party has an incentive to appeal; the government won and the taxpayer would lose even under the regulation's test. The case creates uncertainty about the ability of planners to rely on regulations. Do not overread the case, however; panelists noted it was not briefed, it is not well reasoned, and the comment questioning the regulation was a "throwaway line."

c. **Methods of Attacking Validity of Regulations; Anti-Injunction Act.** Only three possibilities exist for bringing a court action to test the validity of tax regulations:

(1) Going through an examination, appeals, and having a Notice of Deficiency issued (which can take years), at which time a Tax Court petition could be filed;

(2) Filing a return consistent with the regulation and paying tax, filing a claim for refund taking the position that the regulation is invalid, and eventually filing an action in the District Court (but that may require paying a big tax up front unless the issue could be raised in a small transaction with a small tax at risk); or

(3) Filing suit in district court contesting the regulation's validity under the Administrative Procedure Act; but the Anti-Injunction Act (codified in §7421(a)) broadly prohibits lawsuits that aim to restrain the assessment or collection of taxes, with some specified exceptions. Its counterpart in the Declaratory Judgment Act (28 U.S.C. §2201) reinforces this prohibition by excluding tax matters from declaratory relief. To the contrary, an attack on the validity of agency action requiring onerous information reporting (for example, for "Reportable transactions") that is not directly related to a tax liability but merely relates to information the government may use to determine whether to audit a transaction is not prohibited by the Anti-Injunction Act. The Supreme Court has agreed these types of

cases are not barred by the Anti-Injunction Act because they involve an issue separate from the tax itself, but they have potential civil or criminal penalties. *CIC Services LLC v. United States*, 593 U.S. 209 (2021).

In summary, the Anti-Injunction Act (§7421(a)) prevents challenges to tax regulations until a taxpayer is affected (i.e., has a notice of deficiency, a refusal of a refund, or other dispute with the IRS). Federal agencies' actions other than tax regulations do not have this problem; for example, the CTA regulations can be attacked directly because they would not forestall collection of a tax. See *CIC Services LLC v. United States*, 593 U.S. 209 (2021) (regulations prescribing reporting requirements can be challenged pre-enforcement without violating the Anti-Injunction Act or the Declaratory Judgment Act).

An attack on a regulation can be either a procedural challenge (for failure to follow the procedural requirements of the Administrative Procedure Act) or substantive challenge (the regulation is ambiguous and unreasonable on its face or takes an arbitrary and capricious position not supported by the statute).

Indeed, the six-year statute of limitations "after the right of action first accrues" for claims against the United States under 28 U. S. C. §2401(a) would not bar *substantive challenges* to regulations because the statute does not begin to run until a particular plaintiff is injured by agency action. *Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, 603 U.S. 799 (July 1, 2024). However, a cryptic footnote near the end of the opinion suggests the opinion was not dealing with procedural challenges to regulations, so some question remains as to the period of limitations for raising procedural challenges to regulations.

d. **Available Remedies; Nationwide Injunctions.** A hotly debated issue is whether the appropriate remedy, if a court finds a regulation to be invalid, is to enjoin enforcement of the regulation nationwide for all parties, or just for the parties in the suit. The APA authorization to "set aside" an agency action is unclear as to whether that means the action should really be "set aside" as if it does not exist, meaning it would not be enforced against anyone. This is referred to as a "universal vacatur." A concurring opinion by Justice Cavenaugh in *Corner Post* takes the position that the APA does authorize a vacatur of agency actions. He concludes: "The Government's newly minted position [that the APA does not allow vacatur] is both novel and wrong. It 'disregards a lot of history and a lot of law.' M. Sohoni, The Past and Future of Universal Vacatur, 133 Yale L. J. 2305, 2311 (2024)."

This is a difficult issue. On the one hand, requiring every separate individual injured by a regulation to bring a lawsuit challenging the regulation is wasteful. On the other hand, is it appropriate to give a single district judge the power to invalidate a regulation throughout the nation for all parties? That issue is now involved in the lawsuits challenging the constitutionality of the CTA and regulations requiring the filing of beneficial ownership reports. A nationwide injunction is now in place, and the Supreme Court may ultimately rule on whether a nationwide temporary injunction is appropriate while the constitutionality of the statute and regulation is being determined. See Item 10.d above.

20. Taxation of Unrealized Amounts Other Than as an Income Tax, *Moore v. United States*, 602 U.S. __ (June 20, 2024)

a. **Very Brief Synopsis.** Lowers courts held that taxpayers were liable for the "mandatory repatriation tax" imposed by the 2017 TCJA. It applied to U.S. persons owning at least 10% of the stock of a controlled foreign corporation in 2017 on undistributed post-1986 earnings. These earnings had not been realized directly by the taxpayers but they were still in the corporations. Lower courts held that the tax was not constitutional because of its retroactive application. Taxpayers also argued that the tax was unconstitutional under the Apportionment Clause of the U.S. Constitution (Art. I, Section 9, Clause 4) which prohibits any "direct tax" that is not apportioned among the states according to their population. However, the Sixteenth Amendment authorizes tax on "incomes, from whatever source derived." The Ninth Circuit held that the tax was constitutional and within the scope of the Sixteenth Amendment. The U.S. Supreme Court granted certiorari to the taxpayer's question that framed the issue: "Whether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states." In effect, the question posed for which the Supreme Court

accepted certiorari was whether the tax was an income tax authorized by the Sixteenth Amendment even though the sums subject to taxation had not been realized by the taxpayers.

In a 7-2 decision, the Supreme Court found the tax to be constitutional. The Supreme Court's majority opinion, joined by five Justices, approved the tax, but it framed the issue much more narrowly, focusing on the attribution of income rather than realization. It cited a number of cases confirming that "Congress can attribute the undistributed income of an entity to the entity's shareholders or partners." Footnotes in the majority opinion directly stated, "we do not address the Government's argument that a gain need not be realized to constitute income under the Constitution" and that it did not address "taxes on holdings, wealth, or net worth … or … appreciation." Four Justices, in a concurring opinion and dissenting opinion, made clear that they view realization as a constitutional requirement.

b. **Significance.** The Supreme Court opinion had been anticipated as a possible seminal event regarding the government's taxation limitations. As suggested by the footnote in the majority opinion, it could have placed constitutional limitations on the ability to tax "holdings, wealth, … net worth, … or appreciation." For example, it could have placed constitutional limits on recent proposals for a wealth tax or taxation on deemed realization at the death of an individual. A strict realization requirement could have implications for a variety of Code provisions, such as the taxation of original issue discount, mark-to-market tax on dealers, §7872 deemed interest income, §678 income attributed to certain trust beneficiaries, the rules for taxing trusts and estates and partnerships, etc.

21. Step Transaction Doctrine Discussed in Connection with Purported Life Insurance Proceeds Inclusion Because of Alleged Lack of Insurable Interest, *Estate of Becker v. Commissioner,* T.C. Memo. 2024-89 (Sept. 24, 2025)

a. **Basic Facts.** The decedent loaned money to an irrevocable life insurance trust (Trust) to pay $1.7 million in premiums on two life insurance policies with a combined death benefit of $19.5 million. The decedent borrowed that $1.7 million from the insurance agent who in turn borrowed it from another lender. Three months later the notes (secured by the policies) were assigned to a third party entity that committed to advance loans for future premiums (the third party entity never actually advanced additional loans). The decedent died unexpectedly in a car accident about a year and a half afterward, and the $19.5 million of death proceeds were paid to the Trust.

b. **IRS Position.** The IRS argued that the third party entity did not have an insurable interest in the policies and under Maryland law, the insured's estate was entitled to the death proceeds. However, the Trust that initially acquired the polices had an insurable interest, and under Maryland law a subsequent assignment of the policy would be legal whether or not the person had an insurable interest. Despite those Maryland law issues, the IRS argued that the estate was the beneficiary of the policy under a convoluted step transaction doctrine argument.

c. **Step Transaction Doctrine.** The step transaction doctrine has been applied under any of three separate tests:

(1) **"Binding Commitment Test."** "At the time that the first step is undertaken, the taxpayer was under a formal commitment to complete the remaining steps, often when a substantial period has passed between the steps that are subject to scrutiny."

(2) **"End Result Test."** "[T]ransactions will be collapsed if it appears that a series of formally separate steps are really prearranged parts of a single transaction intended from the outset to reach the ultimate result." This is a "subjective test that focuses on the parties' actual intent at the time that the transaction was entered into."

(3) **"Interdependence Test."** "The steps are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series."

(4) **Application to Facts.** None of those tests applied.

(a) The parties agreed that the "binding commitment test" did not apply (in part because there was no substantial period of time between the separate steps).

(b) The "end result test" did not apply because the third party "was unidentified at the time the … policies were issued."

(c) The "interdependence test" did not apply because no additional premiums would be required for 30 months, the decedent had enough assets to continue loans to the Trust to pay future premiums, and invoking the commitment by the third party to advance loans for payment of future premiums was not necessary.

d. **Court's Conclusion.** The step transaction doctrine does not apply. "Rather, the picture that emerges is that, of several financing options available to [the decedent] and the Trust to secure funding for possible future premiums, they simply chose the option that they viewed to be the most financially beneficial." There was no violation of Maryland's insurable interest doctrine, and the estate had no claim to the insurance proceeds, so there was no estate inclusion.

Interesting Aside. The financing agreement with the third party entity that committed to make advances to the Trust to pay future premiums provided that the third party would be repaid its advances plus interest **plus 75% of the policy proceeds**. Why would anyone agree to that??? The third party argued after the decedent's death that it was entitled to $14.8 million of the $19.5 million of the death proceeds; it eventually settled for $9 million (and it never actually advanced any additional funds to the Trust).

22. Section 2036 Applied to "Eve of Death" Funding of Limited Partnership by Decedent's Agent, *Estate of Fields v. Commissioner,* T.C. Memo 2024-90 (Sept. 26, 2024, corrected opinion issued Nov. 4, 2024)

a. **Synopsis.** Decedent's grand-nephew (N), acting under a power of attorney, for decedent transferred about $17 million of assets (all of her assets except $1.5 million of liquid assets and $600,000 of illiquid assets) to a limited partnership (LP) in return for a 99% limited partnership interest. N owned the LLC that was the 1% general partner. The LP and LLC were created and funded when decedent was in "end stages" of Alzheimer's disease, and she died less than a month after the LP was funded (the largest asset contributed was transferred just 10 days before her death, after the decedent had been placed in hospice care). The assets retained by the decedent were not sufficient to satisfy her debts, cash bequests in her will, and estate taxes.

On these facts, it is not surprising that the court determined that the LP assets were included in the decedent's estate under §2036.

(1) §2036(a)(1): Acting through N as her agent, the decedent had access to the transferred assets (because N owned the LLC that was the general partner, which could control distributions from the LP); use of a significant portion of LP assets to pay various debts and expenses after one's death is evidence of a retained interest.

(2) §2036(a)(2): The partners unanimously could dissolve the LP, so the decedent (through N as her agent), in conjunction with others, could obtain the assets and then designate their disposition, citing *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017).

(3) The bona fide sale for adequate consideration exception to §2036 did not apply. The adequate consideration requirement was met (citing the test from *Kimbell v. United States*, 317 F.3d 257, 266 (5th Cir. 2004)), but the bona fide sale requirement was not met because there was no nontax reason as a significant purpose for creating the LP. Nontax reasons asserted by the estate were: (a) preventing financial elder abuse; (b) providing for management succession; (c) avoiding difficulties of managing assets under a power of attorney; and (d) streamlining of management.

The court listed eight reasons those were not viewed as actual purposes for creating the LP, including: (a) lack of planning prior to the decedent's precipitous declining health; (b) lack of contemporaneous documentary evidence of motivations for the transaction other than the attorney's reference to "obtaining deeper discounts"; (c) absence of business interests requiring active management; and (d) depletion of liquidity to the point post-death obligations could not be paid.

The §2043 analysis from *Estate of Moore v. Commissioner*, T.C. Memo 2020–40, was applied (but did not result in additional estate inclusion because the assets did not appreciate between the time of funding the LP and the time of death).

A 3.5% block of thinly traded company stock was entitled to an illiquidity discount, but the IRS's expert's 5.7% discount rather than the taxpayer's expert's 10% discount was used (because the IRS expert had a more detailed analysis of 32 transactions of private sales of restricted stock that could not be sold for 6-12 months and analogized that to a large block of stock).

The court applied the 20% accuracy-related penalty under §6662(a) & (b)(1) for underpayments attributable to negligence or disregard of rules or regulations. The reasonable cause and good faith exception did not apply. A reduction of $6.2 million in value by interposing an LP interest between the decedent and her assets "on the eve of death would strike a reasonable person in [N's] position as very possibly being too good to be true." Therefore, reasonable cause would not exist absent good faith reliance on professional tax advice, but there was no specific evidence that any professional advised that the assets could be reported at the claimed discount.

Estate of Fields v. Commissioner, T.C. Memo 2024-90 (Sept. 26, 2024, corrected opinion issued Nov. 4, 2024) (J. Copeland)

b. **Observations.**

(1) **Overview of §2036.** Section 2036(a)(1) requires estate inclusion of assets transferred with a retained right to possession or enjoyment of, or the right to income from the property.

Section 2036(a)(2) requires estate inclusion of property transferred with "the right, either alone or in conjunction with any other person, to designate the persons who shall possess or enjoy the [transferred] property or the income therefrom."

An exception applies under §2036, however, for a "bona fide sale for an adequate and full consideration in money or money's worth."

(2) **Action Under Power of Attorney on the Eve of Death; Decedent's Agent Controlling Distributions as General Partner.** The funding of an LP by an agent under a power of attorney on the eve of death is pretty uniformly the "kiss of death" against §2036 arguments. One of the facts causing estate inclusion under §2036(a)(1) was that N was the decedent's agent under a power of attorney and was also the owner of the LLC that was the general partner of the LP, and the general partner made distribution decisions for the LP. Therefore, decedent, through N as her agent, had access to all the LP assets, and the documents reflect an express retention of access to transferred assets.

(3) **Implied Retained Access to Pay Post-Death Obligations Is Sufficient to Invoke §2036(a)(1); Other Cases (But Not All) Have Also Applied This Reasoning; Planning Considerations.** Cases uniformly have held that a retained interest under §2036(a)(1) does not have to be express but can be implied. Although the decedent likely retained enough liquid assets outside the LP ($1.5 million) to cover her anticipated living expenses (due to her short life expectancy), the court reasoned that the necessity of obtaining distributions from the LP by the estate to cover post-death obligations (including cash bequests and estate taxes) demonstrated an implied agreement of retained enjoyment of the assets transferred to the LP.

Whether needing to access LP assets to satisfy post-death obligations triggers §2036(a)(1) has been addressed in many cases, with varying results. Attorneys have argued in various cases that post-death use of partnership assets should not be used as evidence of retained enjoyment by the decedent (§2036 refers to retained enjoyment by the decedent for life or for any period before death), but various cases have viewed the use of partnership assets to pay post-death obligations as reflecting retained enjoyment under §2036(a)(1). Those cases are *Rosen*, *Korby*, *Thompson*, *Erickson*, *Jorgensen*, *Miller*, *Liljestrand*, *Rector*, and *Beyer* (Tax Court cases) and the *Strangi* Fifth Circuit Court of Appeals case. *Miller* and *Erickson* are two cases in which the court looked primarily to post-death distributions and redemptions to pay estate taxes as triggering §2036(a)(1). In *Erickson*, T.C. Memo. 2007-107, the court emphasized particularly that the

partnership provided funds for payment of the estate tax liabilities. (The only liabilities mentioned in the case were gift and estate tax liabilities.) The court viewed that as tantamount to making funds available to the decedent. Although the disbursement was implemented as a purchase of assets from the estate and as a redemption, "the estate received disbursements at a time that no other partners did. These disbursements provide strong support that Mrs. Erickson (or the estate) could use the assets if needed."

Interestingly, Judge Chiechi (the trial court judge in *Beyer*) was not troubled by post-death payments of estate taxes and other liabilities of the decedent's estate in *Estate of Mirowski v. Commissioner*. In *Mirowski*, the LLC distributed $36 million to the decedent's estate to pay transfer taxes, legal fees, and estate obligations. The court observed that the decedent's death was not anticipated at the time of the transfers, and there was no understanding to make LLC distributions to pay the taxes or other amounts due after her death. A distinction in *Mirowski* is that the decedent held a 52% interest in the LLC at her death that would have been sufficient to support the $36 million of distributions, but the distribution was not accomplished by purchasing assets from the decedent's estate or redeeming her interest in the LLC.

What if there are non-liquid assets in the estate and insufficient liquid assets for paying all post-death expenses? John Porter (Houston, Texas) has these recommendations:

(a) It is best is to borrow from a third party, but a bank may be unwilling to make a loan using only the partnership interest as collateral. The bank may want a guarantee by the partnership. If so, partnerships should be paid a guarantee fee. There is a legitimate reason for the LP to give a guarantee, because there will be an IRS lien against the partnership, and the partnership will not want the bank to foreclose on a partnership interest.

(b) Borrow from an insurance trust or a family entity, secured by the partnership interest.

(c) There are three options for utilizing partnership funds: redemption, distribution or loan. *Erickson* involved a purchase of assets and redemption but held against the taxpayer. Pro rata distributions are a possibility, but if they are made on an "as needed basis" that plays into the IRS's hands on the §2036 issue; the estate can argue that distributions for taxes are made all the time from partnerships, but usually for income taxes. John Porter prefers borrowing from the partnership on a bona fide loan, using the partnership interest as collateral. It is best to use a commercial rate rather than the AFR rate (that looks better to the government as an arm's length transaction).

Some attorneys suggest that the preferred approach is to have other family members or family entities purchase some of the decedent's partnership interest to generate cash flow to the estate for paying post-death expenses, so that the necessary cash never comes directly from the partnership.

(4) **Roadmap to Flunking Bona Fide Transfer Requirement.** The reasons given by the court as to why the stated nontax reasons were not significant reasons motivating the creation of the LP provide a roadmap of what to avoid in planning. The court discussed the following eight reasons:

- No discussion of creating the LP until the eve of death;
- No changes in the assets, suggesting that no need for management existed before the LP's creation;
- No financial elder abuse other than what had occurred years earlier;
- No contemporaneous documentary evidence of motivations for creating the LP other than the attorney's reference to "obtaining a deeper discount";
- No pooling of assets for joint enterprise or obvious creation of synergies;
- No business interests requiring active management;
- All transactions by the agent, with the decedent not involved in any planning; and

- A depletion of liquidity to the point that the estate could not pay cash bequests or estate taxes.

(5) **Incorporates Groundbreaking Analysis from Relatively Recent §2036 Cases; *Estate of Powell* and *Estate of Moore*.** The *Estate of Fields* case incorporates the reasoning and approach of several groundbreaking cases in the last several years.

(a) **"In Conjunction With" Section 2036 (a)(2) Argument.** *Estate of Fields* applies the analysis in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017), which applied §2036(a)(2) to a situation in which the partners could act unanimously to dissolve the partnership because the decedent could act "in conjunction with others" to designate who could enjoy the partnership assets. Planners have been concerned that the "in conjunction with" analysis could be applied so broadly that any partnership in which a decedent owns any interest could be subject to §2036(a)(2) because all the partners could amend any partnership agreement. But *Estate of Levine v. Commissioner*, 158 T.C. 58 (2022), fortunately held that the mere ability to amend a contract was not sufficient to trigger the "in conjunction with" clause in §2036(a)(2) and §2038. The "alone or in conjunction with" analysis has been the focus of various cases in the last several years following the *Powell* case. For a discussion of *Powell*, *Cahill*, *Morrissette*, and *Levine* regarding the §2036(a)(2) issue, see Item 17 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** For further discussion of ways to avoid the *Powell* issue, see Item 24.e below.

(b) **Section 2043 Analysis.** *Estate of Fields* is the first case to repeat and rely on the analysis in *Estate of Moore v. Commissioner*, T.C Memo. 2020-40, of the interaction of §2033, §2036, and §2043. (That analysis of §2043 had been described briefly in *Powell v. Commissioner*.) Under the §2043 analysis, a person may have more estate inclusion by creating an LP than if the person had just retained the assets outright. Under the *Estate of Moore* analysis, the aggregate net value included in the gross estate under §2033, §2036, and §2043 is stated algebraically as V = A+B-C, where:

A is the estate's interest in the partnership (at its date of death discounted value) (included in the gross estate under §2033);

B is the date of death value (undiscounted) of the assets contributed to the LP (included in the gross estate under §2036); and

C is the discounted value of the partnership interest received when assets were contributed to the LP (subtracted under §2043.)

In *Moore*, because the decedent died only 27 days after the partnership was funded and because there was no evidence the asset values changed in that time period, "A" and "C" in the formula cancelled each other out, so the value included in the gross estate was the date of death value of the assets contributed to the partnership (undiscounted).

The effect, compared to not creating the LP and continuing to own all the assets outright, is that extra inclusion may result to the extent the date of death discounted value of the LP interest exceeds the date of funding discounted value of the partnership interest. For a detailed discussion of the §2043 analysis in *Estate of Moore*, see Akers & Aucutt, *Estate of Moore v. Commissioner* Summary (April 2020) available **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

(6) **Overview of Prior Cases Addressing Section 2036 Issues.** For an overview discussion of §2036 issues for FLPs and LLCs, including the bona fide sale for full consideration defense and §2036(a)(1) retained interests, see Item 8 of Estate Planning Current Developments and Hot Topics for 2022 (December 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** About 35 reported cases have arisen. The cases seem to be decided largely on a "smell test" basis.

(a) **Section 2036(a)(1).** The IRS typically argues that assets should be included under §2036(a)(1) as a transfer to the FLP/LLC with an implied agreement of retained enjoyment. The most recent case applying §2036(a)(1) to an FLP before *Estate of Fields* was *Estate of Moore v. Commissioner*, T.C. Memo. 2020-40 (April 7, 2020, Judge Holmes), *aff'd*, 128 AFTR 2d 2021-6604, Docket No. 20-73013 (9th Cir. Nov. 8, 2021). (It also had an interesting discussion of the application of §2043, following up on the discussion of §2043 in *Estate of Powell v. Commissioner*, with its own lengthy analysis, and the effect of a formula charitable transfer, which was the only subject of the appeal.) For a detailed discussion of *Estate of Moore*, see Item 20 of Estate Planning Current Developments and Hot Topics (Mar. 2021) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

(b) **Section 2036(a)(2).** In a few cases, the IRS has also made a §2036(a)(2) argument, that the decedent has enough control regarding the FLP/LLC to designate who could possess or enjoy the income or property contributed to the entity. Two cases have applied §2036(a)(2) where the decedent had some interest as a general partner (*Strangi* and *Turner*), and one case applied §2036(a)(2) when the decedent held merely a limited partnership interest based on the ability, "in conjunction with others" to dissolve the partnership (*Powell*).

A possible defense to inclusion under §2036(a)(2) may apply if distributions are subject to cognizable limits. *See Estate of Cohen v. Commissioner*, 79 T.C. 1015 (1982), Traditionally, planners have relied on the *Byrum* Supreme Court case for the proposition that investment powers are not subject to §2036(a)(2) (though *Strangi* and *Morrissette* made arguments attempting to distinguish *Byrum*).

Section 2036(a)(2) and the "alone or in conjunction with" analysis has been the focus of several cases in the last several years following the *Powell* case. For a discussion of *Powell*, *Cahill*, *Morrissette*, and *Levine* regarding the §2036(a)(2) issue, see Item 17 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

(7) **Summary of §2036 FLP/LLC Cases (14-24, with 2 Cases on Both Sides).** For a summary of the various FLP/LLC cases that the IRS has chosen to litigate under §2036 (up to 2022), see Item 9.f of Estate Planning Current Developments (Mar. 16, 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

(8) **Ramifications.** Ramifications if the IRS is successful in applying §2036 or 2038 to bring all assets of the entity into the estate include: (1) estate inclusion of entity assets may apply even if interests in the entity are transferred during life (*Harper*, *Korby*), (2) the marital or charitable deduction may not be applicable or may be greatly reduced (*Turner*), and (3) double counting of assets included in the gross estate may result (*Powell, Moore,* and *Fields*).

(9) **Overview of Planning Alternatives for Avoiding §2036.** For a listing of planning alternatives for avoiding inclusion under §2036 (and in particular, §2036(a)(2)) in light of *Powell, Cahill*, and *Fields*, see Item 24.e below.

(10) **Bona Fide Sale for Full Consideration Defense.** The bona fide sale for full consideration defense is the best defense to any §2036 attack. Planners should accordingly consider documenting the purposes of transfers to entities at the time of the creation of the entities. John Porter points out that factors that have been applied in finding that a "significant and legitimate non-tax reason" (*Bongard*) existed under a case-by-case for an entity are:

- Centralized asset management (*Stone, Kimbell, Mirowski, Black*)
- Involving next generation in management (*Stone, Mirowski, Murphy*)
- Protection from creditors/failed marriage (*Kimbell, Black, Murphy, Shurtz*)
- Preservation of investment philosophy (*Schutt, Murphy, Miller*)
- Avoiding fractionalization of assets (*Church, Kimbell, Murphy*)
- Avoiding imprudent expenditures by future generations (*Murphy, Black*)

(11) **Investment and Management Decisions for LPs and LLCs.** If the donor serves as a manager of or in some other management position with the entity, the IRS could possibly argue under *Powell* and *Fields* that the donor's authorities "in conjunction with others" could impact beneficial enjoyment of the transferred assets. See Item 24.g(3) below.

(12) **Review of Court Cases Valuing Partnership/LLC Interests.** Despite the many cases that have addressed the applicability of §2036 to limited partnership or LLC interests, fewer cases have actually reached the point of valuing partnership interests. Observe that some cases have allowed discounts even for controlling interests in FLPs or LLCs. *E.g.*, *Estate of Warne v. Commissioner*, T.C. Memo. 2021-17 (4% lack of control discount for controlling majority interests in LLCs); *Estate of Streightoff v. Commissioner*, T.C. Memo. 2018-178, *aff'd*, 954 F.3d 713 (5th Cir. 2020) (18% lack of marketability discount for estate's de facto controlling interest in LLC holding cash and marketable securities). John Porter summarizes discounts that have been allowed by the courts in FLP/LLC cases as follows (some additional cases and explanations have been added to the table):

Case	Assets	Court	Discount from NAV/ Proportionate Entity Value
Strangi I (2000)	Securities	Tax	31%
Knight (2000)	Securities/real estate	Tax	15%
Jones (2001)	Real estate	Tax	8%; 44%
Dailey (2001)	Securities	Tax	40%
Adams (2001)	Securities/real estate/minerals	Fed. Dist.	54%
Church (2002)	Securities/real estate	Fed. Dist.	63%
McCord (2003)	Securities/real estate	Tax	32%
Lappo (2003)	Securities/real estate	Tax	35.4%
Peracchio (2003)	Securities	Tax	29.5%
Deputy (2003)	Boat company	Tax	30%
Green (2003)	Bank stock	Tax	46%
Thompson (2004)	Publishing company	Tax	40.5%
Kelley (2005)	Cash	Tax	32%
Temple (2006)	Marketable securities	Fed. Dist.	21.25%
Temple (2006)	Ranch	Fed. Dist.	38%
Temple (2006)	Winery	Fed. Dist.	60%
Astleford (2008)	Real estate	Tax	30% (GP); 36% (LP)
Holman (2008)	Dell stock	Tax	22.5%
Keller (2009)	Securities	Fed. Dist.	47.5%

Case	Assets	Court	Discount from NAV/ Proportionate Entity Value
Murphy (2009)	Securities/real estate	Fed. Dist.	41%
Pierre II (2010)	Securities	Tax	35.6%
Levy (2010)	Undeveloped real estate	Fed. Dist. (jury)	0 (valued at actual sales proceeds with no discount)
Gallagher (2011)	Publishing company	Tax	47%
Koons (2013)	Securities	Tax	7.5%; Estate owned 70.42% of voting interests and could remove limitation on distributions
Richmond (2014)	Marketable securities	Tax	46.5% (37% LOC/LOM & 15% BIG)
Giustina (2016)	Timberland; forestry	Tax	25% with respect to cash flow valuation (Tax Court applied 75% weight to cash flow factor and 25% weight to asset value method); BUT reversed by 9th Circuit and remanded to reconsider without giving 25% weight to asset value method)
Streightoff (2018)	Securities	Tax	0% lack of control discount because the 88.99% LP interest could remove the general partner and terminate the partnership; 18% lack of marketability discount
Kress (2019)	Manufacturing	Tax	Lack of marketability discounts of 25% for 2007-2008 gifts & 27% for 2009 gifts (those numbers include 3% downward adjustment because a family transfer restriction was not taken into account); additional adjustment for minority interest in non-operating assets
Jones (2019)	Sawmill & timber	Tax	35% lack of marketability discount from value of noncontrolling interest
Grieve (2020)	Securities	Tax	35% for one LLC and 34.5% for another LLC (98.8% non-voting LLC interest)
Nelson (2020)	FLP owned 27% of holding company that owned various subsidiaries with operating businesses	Tax	FLP's interest in holding company valued with 15% lack of control discount and 30% lack of marketability discount (combined 40.5% discount); transferred limited partner interest in FLP valued with 5% lack of control discount and 28% lack of marketability discount (combined 31.6% discount)
Warne (2021)	Majority interests in five LLCs (each over 70%) owning real estate	Tax	Four majority LLC interests not passing to charity: 2% lack of control discount (court might have found no LOC discount but parties agreed some LOC discount was proper) and 5% lack of marketability discount; One wholly owned LLC interest passing to two charities: for charitable deduction, parties stipulated a 4% discount for a 75% LLC interest and 27.385% discount for a 25% LLC interest
Smaldino (2021)	Ten rental real estate properties	Tax	36% combined lack of control and marketability discount (accepting view of IRS expert) for transfers of minority nonvoting interests

Adapted from John Porter, A View from the Front Lines – Current Issues in Estate and Gift Tax Audits and Litigation, 58TH ANN. HECKERLING INST. ON EST. PL. (2024); John Porter, *A View from the Trenches: Current Issues in Estate and Gift Tax Audits and Litigation,* 56TH ANN. HECKERLING INST. ON EST. PL. (2022).

23. Creative Alternative Approach That Might Avoid Section 2036 Attacks on Amounts Contributed to FLPs/LLCs

Consider the following approach, coming from the ever-creative mind of Carlyn McCaffrey (New York, New York). Rather than contributing assets directly to an FLP or LLC, the individual would transfer the assets to an incomplete gift trust that would, for example, give the individual a power to shift benefits from one beneficiary to another or to add or remove beneficiaries, Reg. §25.2511-2(c)). The individual might be included as a discretionary beneficiary. The trustees of the incomplete gift trust, which would not include the individual, might then contribute assets to an FLP or LLC in return for units in the entity. The individual has not made a transfer to and even if she did, she does not own any interest in or hold any control over the assets in the FLP or LLC; it would seem that the individual has not retained any interest or power over the assets of the FLP or LLC that would be subject to taxation under §2036 or §2038.

The assets of the incomplete gift trust (i.e., discounted interests in the FLP or LLC) will be included in the gross estate of the individual under either or both of §2036(a)(2) and §2038 because of the retained power that caused the gift to be incomplete, but the assets of the FLP or LLC should not be. The individual is not the owner of the trust under state law principles. (That is to be contrasted with a revocable trust, which might be viewed as being owned by the individual who can revoke it and obtain all its assets.)

Even if the IRS makes a step transaction argument, the individual has never owned or retained anything with respect to the FLP or LLC. Any distributions from the FLP or LLC would pass to the trust, not to the individual. As discussed above, the individual is not the "owner" of the trust and the trust's interest cannot be attributed as ownership by the individual (unless the individual has "de facto" control over the trustee). (The IRS has had little success in make a de facto control argument. *E.g.*, *McCabe v. United States*, 475 F.2d 1142 (Ct. Cl. 1973) (no estate inclusion even though trustee ignored interests of beneficiaries other than settlor); *Estate of Goodwyn v. Commissioner*, T.C. Memo. 1973-153 (grantor at all times, with the acquiescence of two attorneys serving as trustees, made all decisions regarding the administration of the trust, including distributions; court based its reasoning largely on *Byrum* in which the Supreme Court held that the term "right" as used in §2036(a)(2) refers to "an ascertainable and legally enforceable power").)

The same arguments presumably could be made even for deathbed transfers.

Query whether the IRS might raise a lack of economic substance, substance over form, or sham transaction argument? But unless the IRS could succeed in arguing that the individual really has control over the FLP or LLC under a de facto trustee argument, there really is economic substance to the transaction. The individual is not a recipient of any interest in the FLP or LLC; the trust is, and it is a separate state law entity not owned by the individual.

If the individual is a discretionary beneficiary of the trust, preferably the trust should be sitused in a "domestic asset protection trust" jurisdiction that does not give the individual's creditors access to the trust assets to satisfy the individual's debts merely because she is a discretionary beneficiary. Otherwise, the IRS might make the argument that the individual should be treated as the "owner" of the trust (because the individual could incur debts to be satisfied by the trust). The IRS might attempt (under a step transaction or substance over form argument) to treat the individual's deemed "ownership" of the trust as attributing the trust's contribution to and interest in the FLP or LLC as if the individual had made the contribution to the FLP or LLC while retaining the tax sensitive interest or power.

24. FLP and LLC Planning; Donor Retained Rights and Powers That Trigger §2036(a)(2) Inclusion; Management Rights of LLC; Mere Retention of Majority interest in the Entity Does Not Necessarily Trigger Inclusion

For corporate stock, Rev. Rul. 81-15, issued following the Supreme Court's decision in *U.S. v. Byrum*, 408 U.S. 125 (1972), makes clear that a donor can give nonvoting stock and retain voting stock without risking inclusion of the nonvoting stock in the estate under §2036(b). *Byrum* and Rev. Rul. 81-15 do not apply directly, however, to FLPs or LLCs. For example, shareholders, unlike members of LLCs and members of partnerships, do not typically have the right to vote directly on liquidation. The liquidation of a corporation must first by proposed by the board of directors who have fiduciary obligations to all shareholders. Indeed,

the case law developments regarding partnerships and LLCs are more complicated than merely applying concepts from *Byrum* and Rev. Rul. 81-15.

a. **Early IRS Rulings.** The concept of Rev. Rul. 81-15 regarding voting and nonvoting stock was extended to noncorporate entities in a variety of private letter rulings and Technical Advice Memoranda in the 1990s. The rulings dealing with limited partnerships concluded that a senior family member could retain investment and distribution authority over partnership assets as general partner because of the general partner's fiduciary position. *See* Tech. Adv. Memo. 9131006; Letter Rulings 9415007, 9332006, 9131006.

b. ***Strangi* and Its Analysis Distinguishing *Byrum*.** That rather black and white position started to change with *Estate of Strangi v. Commissioner*, T.C. Memo. 2003-145, *aff'd*, 417 F.3d 468 (5th Cir. 2005) (not addressing the §2036(a)(2) issue). *Strangi* held that §2036(a)(1) applied to assets contributed to a limited partnership, but surprisingly also held that §2036(a)(2) applied because the decedent, in conjunction with others, had powers over distributions and the power to dissolve the partnership. (The decedent owned 47% of the corporation that was the general partner.)

The *Strangi* court distinguished *U.S. v. Byrum*, 408 U.S. 125 (1972), which held that the decedent's right to vote shares of stock in three corporations that he had transferred to a trust for the benefit of his children did not cause the value of those shares to be included in the value of his estate under §2036(a)(2). The Court rejected the government's argument that the decedent's ability to vote the transferred shares gave the decedent the power to impact the corporation's dividend policy and thus the trust's income (or the trust beneficiaries' ability to enjoy the income). The Court noted that the "right" ascribed to the decedent

> was the power to use his majority position and influence over the corporate directors to "regulate the flow of dividends" to the trust. That "right" was neither ascertainable nor legally enforceable and hence was not a right in any normal sense of that term.

Among other things, *Byrum* noted that the decedent, as the controlling shareholder of each corporation, owed fiduciary duties to the minority shareholders that circumscribed his influence over the corporations' dividend policies.

Strangi pointed to various additional constraints upon the "rights to designate" in *Byrum.* These included: (1) the existence of an independent trustee with sole authority to pay or withhold income *Byrum* (in *Strangi*, distribution decisions were made by the general partner); (2) economic and business realities of small businesses that impact earnings and dividends; and (3) fiduciary duties were owed to unrelated minority shareholders in *Byrum*.

c. **Section 2036(a)(2) Cases Prior to *Powell*.** Few cases latched onto the §2036(a)(2) analysis in *Strangi* until recently. Eight years after *Strangi*, *Estate of Turner v. Commissioner*, T.C. Memo. 2011-209, applied §2036(a)(2) in part because of the general partner's sole discretion to make distributions and to make distributions in kind and amend the partnership agreement (decedent and his wife were the co-general partners).

The §2036(a)(2) issue is infrequently addressed by the courts; it has only been applied with any significant analysis in four prior cases (*Kimbell* and *Mirowski* [holding that §2036(a)(2) did not apply], and *Strangi* and *Turner* [holding that §2036(a)(2) did apply]). In both *Strangi* and *Turner*, the decedent was a general partner (or owned a substantial interest in the corporate general partner).

d. ***Estate of Powell*; Broad Application of "In Conjunction With" Analysis Under §2036(a)(2).** Fourteen years after *Strangi*, the §2036(a)(2) issue was highlighted by the Tax Court in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017) (reviewed opinion). The majority opinion reasoned (1) that the decedent, in conjunction with all the other partners, could dissolve the partnership, and (2) that the decedent, through her son as the GP and as her agent, could control the amount and timing of distributions. The opinion adopted the analysis in *Strangi* as to why the "fiduciary duty" analysis in the *Byrum* case does not apply to avoid inclusion under §2036(a)(2) because any such fiduciary duty in *Powell* is "illusory." *Powell* was the first case to apply §2036(a)(2) when the decedent merely owned a limited partnership interest. (However, the court also looked to the powers of the general

partner which the court viewed the decedent as holding in conjunction with her agent who was the general partner.)

Section 2036(a)(2) and the "alone or in conjunction with" analysis has been a major focus of advisors in the last several years following the *Powell* case. The senior family member's retention of distribution authority as general partner or the ability to act with others to dissolve a partnership or LLC may trigger §2036(a)(2) according to *Powell*. However, that result may not apply regarding partnership interests owned by trusts with an independent trustee who makes decisions about distributions of any amounts received from the partnership or LLC.

A concern with *Powell*'s "in conjunction with" analysis is that it could be applied broadly to cover almost any transfers to entities if the transferor retains any interest, because all owners could always agree to amend the governing documents in a way that would leave the transferor with tax sensitive powers. Fortunately, the Tax Court acknowledged limits on the broad application of the "in conjunction with" analysis in *Estate of Levine v. Commissioner*, 158 T.C. 58 (2022). That case addressed whether assets in an irrevocable life insurance trust involving a split-dollar arrangement were included in the decedent's gross estate. The court stated that the decedent does not hold a §2036(a)(2) or §2038 power merely because of the ability to amend the split-dollar agreement under general contract law principles. *See also Helvering v. Helmholz*, 296 U.S. 93 (1935) (ability of the settlor of a trust with the consent of its beneficiaries to terminate the trust and revest the transferred property in the donor did not cause estate inclusion under §2036(a)(2) or §2038); *Estate of Tully v. United States*, 528 F.2d 1401 (Ct. Cl. 1976) (ability of decedent and the other 50% shareholder to cause a corporation to agree with the decedent to change the beneficiary under a death benefit contract did not trigger estate inclusion under 2036 or §2038). For a discussion of *Powell* and *Levine* regarding the §2036(a)(2) issue, see Item 17 of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

e. **Overview of Planning Alternatives Following *Powell*.** Planning alternatives for avoiding inclusion under §2036 (and in particular, §2036(a)(2) in light of *Powell* include the following:

- No revocable transfers;
- Avoid transfers under a power of attorney;
- Satisfy the bona fide sale for full consideration exception;
- Transfer all voting rights, including power to amend or revoke the agreement;
- Eliminate unanimous partner approval requirement for dissolution (which was present in *Powell* and *Fields*);
- Avoid having the decedent or decedent's agent as general partner of an FLP;
- If the decedent will have some input into distribution decisions, apply "cognizable limits on the exercise of discretion," see *Estate of Cohen v. Commissioner*, 79 T.C. 1015 (1982);
- Provide for slicing and dicing of voting rights and manager powers (discussed in more detail below);
- If the client insists on retaining as much control as possible, for corporations give non-voting stock while keeping the voting stock. *See* Rev. Rul. 81-15, 1981-1 C.B. 457 (revoking Rev. Rul. 67-54, which had held that transferring nonvoting stock, while retaining voting stock, would result in the transferred nonvoting stock being included in the estate under §2036(a)(2));
- For noncorporate entities, cases such as *Strangi*, *Powell,* and *Fields* suggest that the ability to control distributions or to cause dissolution of the entity (or make amendments to the entity agreement regarding those issues) may trigger estate inclusion; for clients who want to keep as much control as possible, the planner may want to start with the client having control of

investment and possibly distribution decisions for entities owned by the trust, but eventually give up control over distribution decisions (more than three years before death);

- No participation in removal of managers unless replacement must be not related or subordinate to the donor;
- Use trusts as owners of entity interests with an independent trustee;
- Transfer all interests during life; and
- "Claim victory" and dissolve the FLP/LLC following prior successful transfers.

If the donor retains any voting rights, the planner would be wise to create classes of voting rights. For example, Class A limited partners and members would possess full voting rights normally provided to limited partners or members, and Class B limited partners or members (including the donor) could vote on all matters other than (a) the liquidation or dissolution of the entity, (b) distributions from the entity, (c) the right to approve a proposed transfer of an interest in the entity, or (d) the amendment of the entity agreement in a way that would alter any of those restrictions.

For a more detailed discussion of these and other planning steps in light of *Powell*, see Item 19.d. of Estate Planning Current Developments and Hot Topics (December 2020) found **here**, Item 15.g. of the Current Developments and Hot Topics Summary (December 2017) found **here**, and Item 8.c-e of Estate Planning Current Developments and Hot Topics for 2022 (December 2022) found **here**, all available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

f. **Transfers While Retaining Interests in the Partnership or LLC (Even Majority Interest).** The fact that the senior family member also retains some interest in the partnership or LLC (or even a majority interest) should not necessarily require estate inclusion under §2036(a)(2). What is problematic is the ability, alone or in conjunction with others, to control distributions or to cause dissolution of the entity (or make amendments to the entity agreement regarding those issues). Several courts have attributed powers held by an agent to the principal, so avoid having any of those problematic powers held by either the transferor or the transferor's agent.

g. **Planning Considerations for Clients Who Want to Keep Some Investment or Distribution Powers as Manager of LLC or as General Partner of Limited Partnership.**

(1) **Relinquish Control More Than Three Years Prior to Death.** For the client who insists on retaining broad control of investments and possibly distribution decisions for entities owned by the trust, eventually give up control over distribution decisions and tax sensitive investment decisions (see Item 24.g(3) below) more than three years before death to avoid §2035(a).

(2) **Distribution Decisions.** If the donor will continue to (i) be a general partner, (ii) hold an interest in a general partner, or (iii) be the manager of an LLC, limit the donor from having the right to participate in any distribution decisions. For example, use a separate "distribution general partner" or "distribution manager" who has exclusive authority over decisions about when the entity may make distributions to its owners.

If the donor insists on participating in distribution decisions, §2036 and §2038 should not apply if distributions decisions are subject to a definite standard that is specific enough that it can be enforced by a court (based on old cases under §2036 and §2038). Consider providing that Class A limited partners or a "special general partner" or "special manager" (other than the donor) must consent to establishing reasonable reserves (at least for more than a baseline established in a budget that is approved from time to time by all the partners).

(3) **Investment and Management Decisions.** There are strong arguments that investment and administrative powers held by the donor as a general partner (or manager of an LLC) should not trigger estate inclusion under §2036 or §2038. Citations of various cases are in Item 9.d(2) of Estate Planning Current Developments (Mar. 16, 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

Even if the interest in the entity is owned by a trust with an independent trustee, if the donor serves as a manager of or in some other management position with the entity, the IRS could possibly argue under *Powell* that the donor's authorities "in conjunction with others" could impact beneficial enjoyment of the transferred assets.

Because of these concerns, if the donor makes a gift of an interest in the entity, some respected planners structure the entity to avoid having the donor as a general partner or manager or limit the donor's authority as manager or other management position to participate in "tax-sensitive" activities. Diana Zeydel (Miami, Florida) has noted the possibility of limiting the donor's authority as manager with respect to decisions, approvals, or consents relating to various potentially tax sensitive activities such as distributions, allocations to reserves, determining the fair market value of interests, making loans to or guarantees of loans of any entity owner, withdrawal or resignation of any owner, dissolution or liquidation of the entity, any incident of ownership in any life insurance policy on the life of any entity owner, voting the stock of any "controlled corporation" as described in §2036(b), or an amendment of the governing instruments with respect to any of those matters.

If the donor merely makes a sale of an interest in an entity (and does not make a gift), planners may still encourage the appointment of a distribution officer and a liquidation officer to be safe and let the donor just manage the assets.

Other respected planners are not as concerned with the donor serving as the manager of an LLC with authority over LLC investments, especially if the owners of the entity are family trusts with independent trustees. They believe that only the independent trustee of the trust can control the beneficiary's enjoyment of the gifted asset, and the LLC manager has a fiduciary duty to the LLC members a la the Supreme Court's fiduciary duty analysis in *United States v. Byrum*; therefore, it is the trustee of the trust and not the grantor as manager who controls the income and distribution spigot to the recipients of the gifted property.

25. Does Mere Inclusion of Swap Power in GRAT Trigger the Section 16(b) Short-Swing Profits Rule?, *Nosirrah Management, LLC v. AutoZone, Inc.*, (W.D. Tenn. Nev. 15, 2024)

a. **Case Synopsis.** William Rhodes III (Defendant) created a GRAT that gave him a power of substitution for fair consideration (generally referred to as a swap power). The plaintiff alleged that Defendant was a company insider who received distributions of stock from the GRAT in satisfaction of a required annuity payment and subsequently sold stock in the company within six months for a profit, so the profit should be disgorged under Section 16(b) of the Securities Exchange Act of 1934. A difficulty with plaintiff's argument is that a prior SEC No-Action Letter (*Peter J. Kight* SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 77,403 (Oct. 16, 1997)) ruled that the creation of a GRAT and subsequent return of stock to the settlor in satisfaction of annuity payments satisfied a "mere change of form and no change in pecuniary interest" exception to what constitutes a "purchase" under Section 16(b) where the individual was the settlor, trustee, and beneficiary. Defendant filed a motion to dismiss arguing that he was the settlor, trustee, and beneficiary of the GRAT and should therefore satisfy the "mere change of form and no change in pecuniary interest" exception as in the *Peter J. Kight* SEC No Action Letter. The plaintiff responded that a distinction was that the Defendant held a swap power, and it is not clear whether the individual in the *Peter J. Kight* SEC No-Action Letter also held a swap power. The court denied the motion to dismiss, reasoning that the Defendant had not submitted evidence that he was the settlor, trustee, and beneficiary, and therefore could not establish that the "mere change of form and no change in pecuniary interest" exception applied. However, the opinion also has language suggesting that the exception might not apply because of the mere existence of the swap power in the GRAT, even if the swap power is not exercised, and could somehow cause the distribution in satisfaction of the annuity to become a purchase that could trigger the short-swing profits rule.

The case is problematic for planners because most planners have assumed that the mere existence of a swap power (without exercising it) would not cause a GRAT annuity distribution to a settlor, trustee, and beneficiary to be a "purchase" under Section 16(b).

Nosirrah Management, LLC v. AutoZone, Inc., Case No. 2:24-cv-2167 (W.D. Tenn. Nov. 15, 2024).

b. **General Background Regarding Effect of Insider Trading Restrictions on GRAT Planning.** Section 16(b) of the Securities Exchange Act of 1934 permits recovery by a corporation of insider trading profits made within a 6-month period. Under the §16(b) "short-swing profits" rule, profits must be disgorged if any sales and purchases by an insider occur within six months of each other. A contribution to a GRAT is arguably a "sale," and a distribution of insider stock in satisfaction of the annuity payment is arguably a "purchase" by the grantor. If a corporate insider funds a GRAT with the corporation's stock, will the return of some of the stock to the grantor (in satisfaction of an annuity payment) trigger a 6-month insider trading test period? A 1997 SEC No-Action Letter held that the creation of a GRAT and subsequent return of stock to the grantor in satisfaction of annuity payments will "effect only a change in the form of beneficial ownership without changing a person's pecuniary interest in the subject equity securities." Mr. Kight was the settlor, trustee, and beneficiary of the GRAT during the annuity period of the GRAT. Accordingly, such a transaction would be ignored for §16(b) purposes under that No-Action Letter. *Peter J. Kight*, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 77,403 (Oct. 16, 1997).

If the grantor/corporate insider **exercises** a power to substitute property of equal value for some of the stock in a GRAT during its term, one court held that the substitution constitutes a "purchase" for §16(b) purposes, thus creating a six-month period during which any profits from subsequent sales of such stock would have to be disgorged to the corporation. *Morales v. Quintiles Transnational Corp.*, 25 F. Supp. 2d 369 (S.D.N.Y. 1998). The case was appealed to the Second Circuit Court of Appeals, but was settled prior to hearing, and the appeal was withdrawn.

In *Donoghue v. Smith*, 2022 U.S. Dist. LEXIS 76071; 2022 WL 1225338 (S.D. N.Y. April 26, 2022), a company insider created a GRAT, exercised a swap power to acquire company stock, and sold company stock within six months. The insider was not the trustee or beneficiary of the GRAT (perhaps the annuity term had ended). The "mere change of form and no change in pecuniary interest" exception did not apply, and the insider was forced to disgorge the profits on the short-swing sale.

In *Dreiling v. Kellett*, 281 F. Supp. 2d 1215, 1244 (W.D. Wash. 2003), the court imposed a $247 million damage award, as a result of determining that distributions from a GRAT constituted a "sale." *See generally* Ellen Harrison, *Case Studies – Implementing Bright Ideas*, 38th ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING ¶1902.5 (2004).

No prior case has held that the **mere existence** of a swap power would cause the "mere change of form and no change in pecuniary interest" exception not to apply

c. **Evidentiary Issue.** The court's refusal to dismiss the action could be based on the absence of evidence in the proceeding up to that point that the insider was the trustee and beneficiary of the GRAT.

> [T]the Court considers Defendant's citation to the Complaint and finds it does not support his statement regarding his grantor, trustee, and beneficiary status. … There is, however, no support in the Complaint regarding Defendant's trustee or beneficiary status.
>
> Nor is Defendant's statement regarding his trustee or beneficiary status supported by any exhibits, public records, or other attachments.
>
> …
>
> … Defendant did not provide any proof of his trustee or beneficiary status. Defendant's argument regarding his pecuniary interest status, a key element of the Rule 16a-13 exemption.
>
> …
>
> However, Defendant cannot show he had a pecuniary interest in the AutoZone stock when it was in the GRATs, as his statement regarding his trustee and beneficiary status cannot be considered.
>
> …
>
> Defendant's beneficial ownership argument fails for the same reason as its pecuniary interest argument-it is based on his status as the "grantor, trustee, and sole lifetime beneficiary of the GRATs."

d. **Mere Existence of Swap Power.** There is also language in the opinion suggesting that the mere existence of the swap power somehow also causes the exemption not to apply. In its attempt to distinguish the *Peter J. Kight* SEC No Action Letter, the court stated:

> Here, however, "the 'opportunity' existed for [Defendant] to abuse inside information by substituting property of equal value to get the GRAT shares back just before the shares appreciated drastically," *[quoting Morales v. Quintiles Transnat'l Corp.)*, because there is a reasonable inference that Defendant could exercise his discretion by substituting the stock in the GRATs with other property of equal value.

In distinguishing *Morales* (which involved the actual exercise of a substitution power and subsequent sale of stock within six months), the court noted:

> Defendant is mistaken, as the *Quintiles* court based its conclusion on the opportunity to exercise substitution, not the exercising of substitution itself: "Therefore, the 'opportunity' existed for Smith to abuse inside information by substituting property of equal value to get the GRAT shares back just before the shares appreciated drastically. The Kight letter is therefore inapplicable here." (quoting the *Morales* opinion)

Those were rather short references to the mere existence of the swap power, compared to the much more lengthy discussion in the opinion about the lack of evidentiary evidence to establish the applicability of the exception.

e. **Significance of *Nosirrah Management* for GRAT Planning.** *Nosirrah Management* is merely the denial of Defendant's motion to dismiss the case at an early stage of the proceeding, and the decision is primarily based on the lack of evidence that had been produced up to that point in the proceeding about whether the Defendant was trustee and (more importantly) the sole beneficiary of the GRAT during the period of the annuity term. Even so, in planning a GRAT for a company insider, consider using powers other than a swap power to confer grantor trust status on the GRAT. Another planning possibility is to transfer company stock to an LLC and to transfer interests in the LLC to the GRAT. While the transfer to the LLC would be reportable to the SEC, perhaps the transfer of member interests to the GRAT and from the GRAT as annuity payments would not be reportable. The 2025 Heckerling Recent Developments paper makes this observation: "Carlyn McCaffrey notes that the gist of the Rule 16a-13 exemption is that an insider's economic position has not changed when the insider is the sole beneficiary of the GRAT and stock is used to satisfy the insider's annuity interest. A power of substitution would not have any bearing on this central question."

f. **Other Resources.** For further discussion of the securities laws implications for GRAT planning see Item 25 of Estate Planning Current Developments and Hot Topics for 2022 (December 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** For excellent discussions of securities laws issues impacting estate planning issues, see Anna Pinedo, Jay Waxenberg, Daniel Hatten, *Securities Law Considerations for Estate Planners*, 48 ESTATE PLANNING 3 (Nov. 2021); Arlene Osterhoudt & Ivan Taback, *Securities Law Considerations for Estates and Estates Advisors: Part I (Accredited Investors and Qualified Purchasers),* TRUSTS & ESTATES 19 (July 2016); Arlene Osterhoudt & Ivan Taback, *Securities Law Considerations for Estates and Estates Advisors: Part II (Reporting and Short-Swing Profit Rules Applicable to Insiders)*, TRUSTS & ESTATES 24 (Mar. 2017).

Items 26-34 (as well as Item 19) summarize comments from various presentations at the 59th Heckerling Institute on Estate Planning.

26. Purpose Trusts: New Approaches to Business Succession Planning

The Lloyd Leva Plaine Distinguished Lecture, by Ellen Harrison and Natalie Reitman-White, addressed the growing use of purpose trusts, including both the tax and planning implications as well as practical questions of why and how business owners are using them to achieve their goals.

a. **What is a Purpose Trust?** A purpose trust is a trust for state law purposes that has no ascertainable beneficiaries but instead a purpose that the trustee has the duty to implement. Some well-known examples are pet trusts or cemetery maintenance trusts. At common law, trusts without ascertainable human beneficiaries were met with confusion; some were enforced and some were declared invalid. Today, many states have enacted statutes recognizing and legalizing them. Section

409 of the UTC is a brief statute that recognizes the validity of non-charitable purpose trusts, but it has very little guidance about who can enforce them or any other details.

b. **Purpose Trusts as Alternative for Ownership of Business.** Purpose trusts can be used for steward ownership of a business, meaning placing the control of a business in the hands of people involved in the business or in the community. Using a purpose trust as a business succession planning vehicle could be the right fit for business owners who have not found the desired structure within the toolkit of other common options. Other available succession planning options may or may not be the ideal choice for a business owner.

(1) **Family Ownership.** Continuing the business within the family is often what the business owner desires, but often no family member may be willing or qualified to take over. Sixty-four percent of business owners doubt their children's ability to run the company. Business owners also struggle with the potential for family conflict when multiple members are involved in the business—which one will be selected as CEO?

(2) **Internal Sale.** Business owners often think this could be a good way to reward and create wealth for hard working employees. However, a management buyout is often out of reach if the company is highly valuable. ESOPs can seem like a good option too, until they are in place and the company is required to buy back the stock every time an employee leaves, creating a continuous cycle of buybacks that creates strains on the operational cash flow of the company. More and more owners are starting to question the lasting impact of an internal sale, as it is more and more common to see these employee-owned companies selling. The business owner invests time and effort into transitioning the company only to see the employees sell it at a later date.

(3) **External Sale.** Selling the company to a private equity fund, selling to a strategic buyer, or going public may result in the largest payout, but some business owners are concerned that the wealth will not stay in the local community, an undesired change in operations and employees may result, and they may end up regretting the sale.

(4) **Gift to Foundation.** Some business owners who want their company to benefit the community consider gifting it to a private foundation. However, the excess business holdings rule makes this a challenge as well as the requirement that the foundation give away five percent of its asset value each year. This requirement often makes it harder for the business to reinvest in innovation and talent, and there is a concern about the longevity of the business.

(5) **When Other Succession Alternatives Are Not Ideal.** Natalie Reitman-White indicates that many of her clients have considered all these options for years or even tried some of them and then later work with her to unwind and try again, utilizing a purpose trust as a better fit. The purpose trust is for those business owners who are starting to rethink the role that business should play in society and believe that maybe it should exist for something greater than just shareholder value maximization. Instead, maybe it should create a long-lasting impact on the community and benefit employees.

(6) **Does the Business Fit the Purpose Trust Construct?** Not only is this mentality required for a purpose trust to be a feasible option, the business itself needs to fit within the right criteria. Does the business have a strong foundation for its value proposition and who it exists to serve? Are the leaders just as passionate as the owner about carrying on that purpose? Are the company and industry stable, with long-term viability? Is the company consistently profitable, with little debt, and able to support a buyout period? Natalie made it clear that purpose trusts are not the right fit for all companies and there are many attributes that must be present for it to make sense. Purpose trusts do not make sense if the business owner's primary focus is to maximize exit value or if the owner desires to adhere to a strict exit timeline or payment structure.

c. **Choosing State Law**. There are three primary considerations in selecting the optimal state law for a purpose trust.

(1) **Duration**. Many states impose a maximum duration on non-charitable purpose trusts of twenty-one years, which is not ideal for the long-term management of a business. Most business owners choose a jurisdiction that allows a perpetual or very long-term purpose trust.

(2) **Funding Reduction**. Many states grant the courts the ability to reduce the funding of a purpose trust, which is not ideal for a trust that needs to have adequate reserves.

(3) **Trust Modification**. Some states allow the court the ability to modify a purpose trust, similar to cy pres with charitable trusts, which can be a helpful tool if circumstances change in the future.

(4) **State Chart.** The materials for this presentation include a very helpful comparison chart that addresses each state, naming the applicable statute and maximum duration of purpose trusts in that state.

d. **Structuring the Purpose Trust**. Many issues need to be considered and addressed within the purpose trust and/or the governing documents of the company. No individual beneficiary with an interest will exist to ensure the purpose trust serves its purposes, so great care needs to be taken to include mechanisms to prevent mission drift, resolve conflicts, evolve with changing circumstances, and satisfy capital needs of the business.

(1) **Control and Governance**. Sometimes all the stock is owned by the purpose trust, but that is often not the case. In a typical ownership structure, there will be voting and non-voting stock. The purpose trust owns the voting stock with all control rights, replacing the human owner with a trust that serves as the steward owner of the company. The non-voting stock can be owned by any number of other investors, such as family members, other trusts, or nonprofits.

Who determines the leadership of the company? Typically, there is a Trust Stewardship Committee that replaces the human shareholder. The Trust Stewardship Committee is responsible for appointing the Board of Directors and developing a process to evaluate the Board of Directors and its ability to run the company for the stated purposes of the trust.

The business retains its structure with a Board of Directors, officers, executives, etc. The Board is still responsible for company leadership, strategic business decisions, budgeting, risk management, etc., all with the goal of furthering the purpose. The purpose trust replaces the shareholders, not those running the company.

The business owner will also need to select a trustee domiciled in the state in which the business owner desires to create the purpose trust. The role of the trustee is to hold the stock and administer dividends, if any, in accordance with the directions in the trust agreement. The trustee usually holds a directed administrative role.

The trust can also appoint a Trust Enforcer who can step in like a beneficiary and take legal action in the event the Trust Stewardship Committee is not managing the company in line with the purpose. This role can be held by any number of individuals, such as a former shareholder, a former leader, a nonprofit, or a legal or other advisor.

Note that Oregon is the only state currently with a statute that includes specifics on governance requirements. See ORS §130.193.

(2) **Define the Purpose.** Not all companies have an inherent purpose, but defining the purpose is key to the success of the purpose trust. The purpose can be many things, such as pursuing a social or environmental benefit, supporting the employees, or remaining headquartered in a certain location to support a small community long-term. Natalie suggested that when guiding the business owner to develop a purpose, encourage the owner to think about the need for the company to be free to evolve and focus on the bigger picture. If the owner came back fifty years from now, what would she want to still be true? Being in the same business as today is probably not important to the owner, but there are some aspects of what the company does that the owner will want to continue indefinitely.

(3) **Use of Profits**. The purpose trust will never need to create liquidity again or be prepared for another buyer; the trust can hold the stock in perpetuity. The only true need for trust income will

be to cover administration expenses. So where does the money go that the business generates? The trust agreement and/or the governing documents for the company will need to address whether profits will be spent at the company level to benefit the purpose or if they will be distributed to the trust to support the purpose or to other owners if the purpose trust does not hold all the ownership interests (for example, if it just holds voting stock). In some situations, the profits support charitable causes. In others, the profits are reinvested in the company or the employees in the form of profit-sharing programs.

e. **Funding the Purpose Trust**. Even though it is now clear that purpose trusts are valid under most state laws, it is not clear that they are recognized as trusts under federal law. The regulations define a trust as "an arrangement…whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts." Reg. §301.7701-4(a). The American Institute of Certified Public Accountants wrote a letter to Treasury pleading for guidance about whether a purpose trust is a trust for federal tax purposes, but the IRS has provided no guidance. If it isn't a trust, it cannot be a grantor trust with disregarded sales under Revenue Ruling 85-13. If it isn't a trust, it cannot be an ESBT and could disqualify an S corporation. This lack of clarity means that there is some uncertainty surrounding the funding of the purpose trust, even if it uses typical funding techniques commonly used in a traditional trust context.

An important consideration in choosing the proper funding structure for the purpose trust to acquire the stock that will be held by the trust is determining the funding that the company can support. While it is possible for the funding to be completed pursuant to a gift to the trust, it more commonly involves a sale of stock to the trust. Financial modeling needs to be completed to determine if the company can afford to distribute enough revenue to the trust to fund the purchase by the trust or if outside resources will be needed.

Some funding options are summarized.

(1) **Taxable Gift to Purpose Trust**. One of the most famous uses of a purpose trust was Yvon Chouinard's gift of the voting stock of Patagonia to a purpose trust (triggering an estimated gift tax of $17.5 million). However, Natalie shared that in her experience, business owners more often receive payment for their interest in the company.

i. Note that Chouinard also gifted the non-voting stock to Holdfast Collective, a §501(c)(4) organization. This part of the transaction was not subject to gift tax, but he also did not receive an income tax deduction as he would have if the organization were §501(c)(3) organization. One of the great benefits of the §501(c)(4) structure is that it is not subject to the private foundation rules, such as self-dealing or excess business holdings. There is also no required minimum distribution. Because of these issues, it is not usually practical to use a §501(c)(3) in these transactions. However, the main trap with the §501(c)(4) structure is that if the donor retains control (business owners typically want to), §2036 will cause estate inclusion. This is a huge issue because there is no estate tax charitable deduction for transfers to §501(c)(4) entities like there would be with a §501(c)(3) entity, in the event the interests are pulled back into the donor's estate under Code §2036. For a discussion of the tax issues involving the use of §501(c)(4) entities (including alternatives to address the estate tax issue), see Item 16 of LOOKING AHEAD – Estate Planning in 2024 & Current Developments (Including Observations from Heckerling 2024) (April 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

(2) **Sale to Grantor Trust**. As mentioned above, a technical hurdle is whether this sale will avoid triggering gain—if it isn't a trust, how can it be a grantor trust? Several alternatives may assist in managing that problem. First, create an "interim" traditional grantor trust and effectuate the sale. Once the sale is completed, including all payments from the trust, the interim trust would pour the remaining assets into the purpose trust (which would have to be authorized in the trust agreement for the interim grantor trust). A second option is to try to make the trust a quasi-purpose trust that has beneficiaries that are not ascertainable. Grant the trustee full discretion to make distributions to a class of people, most likely nonprofits (again, utilizing at least one

§501(c)(4) to eliminate the risk of an argument that the trust should be subject to the private foundation rules). Structuring the trust this way could meet the state law definition of a purpose trust while also satisfying the federal definition for a trust.

(3) **Nominal Funding; Redemption**. This is the most popular method used to fund purpose trusts. The company nominally funds the trust by issuing a few shares to the trust and then redeems the shares from the individual business owner. (If the purpose trust will merely own voting shares, with the nonvoting shares owned by other parties, the company would redeem the business owner's remaining voting shares.) The few shares issued by the company to the trust may be "golden or veto shares" that have no rights other than to block a sale of the company to a third-party purchaser. Consider several important factors.

First, consider whether a gift is made when the company issues the shares to the purpose trust. The gift tax does not apply to companies, but it does apply to individuals, whether the gift is made directly or indirectly. When the company issues a few shares to the purpose trust, it could be deemed a gratuitous transfer, and therefore an indirect gift, from the shareholders.

Second, note that the redemption from the individual business owner will not be tax-free; the owner will have tax consequences when receiving payment for the shares. One question will be whether Code §305 will treat a portion of that redemption as a dividend, rather than a sale transaction.

Third, if the value of the business owner's interest in the company declines not only because of the issuance of new shares to the purpose trust but also because of new restrictions placed on the shares, the IRS may disregard the restrictions for purposes of gift tax valuation under Code §2703 if it determines the restrictions were not related to a bona fide business arrangement.

f. **Examples.** The materials include several specific real-life examples with flowcharts of successful implementations of purpose trusts. Each one was executed with a customized structure that met the goals of the owner, making it clear that many ways are available to thread the needle when it comes to utilizing purpose trusts in business succession planning. Natalie has also recently started a nonprofit to assist others in creating purpose trusts and plans to provide forms for trust agreements as well as corporate governance.

27. Disposition of Human Remains

This summary is primarily from comments by Tanya D. Marsh (Wake Forest School of Law).

a. **Brief History of Human Remains Disposition in United States.** The United States historically adopted the common law of England, but the disposition and protection of human remains was governed by English ecclesiastical law, which was not adopted in the United States. Therefore, for many years the United States had no law regarding human remains, and individuals followed cultural practices.

Burial was the only legal method to dispose of remains until about the 1880s, when cremation started to become legal (though uncommon). In 1831, the U.S. Supreme Court in *Beatty v. Kurtz*, 27 U.S. 566 (1829), held that courts of equity have jurisdiction over cemeteries and remains. The development of a right to control the disposition of human remains arose in an 1851 case, which gave the right to the next of kin. The court simply made that up. Thus, America made up the right for relatives to dispose of remains; before then, churches and religious organizations had the responsibility and authority over human remains and the responsibility to protect them after death.

The United States is unusual in having perpetual burial sites. Most countries do not recognize the concept of a perpetual burial site. In Europe, burial sites are recycled every 50 years.

b. **Statutory Provisions About Disposition of Remains.** Every state now recognizes a "right of sepulcher" (who can make decisions regarding remains). The priority list is generally similar to intestacy lists. In addition, statutes in nearly every state provide that an individual can leave binding documentation regarding funeral and disposition of remains preferences or can appoint an agent to supersede the priority list.

There is no uniformity. The mechanical manner in which preferences are designated varies from state to state. Some states have statutory forms that must be used. Some states require two witnesses. Some states require a notary. Tanya attempted to prepare a form that would work in all states, and it was 22 pages long; she thinks it works in all states. She has urged the development of a uniform law regarding the disposition of remains.

c. **Law of Place Where Remains Are Located Controls.** The disposition of human remains is controlled by the law of where the remains are located, not the law of the residence of the individual. Unless an individual never leaves the state of domicile, the individual cannot sign anything that assures the disposition of remains wherever the individual might die in the United States (short of signing a 22-page document that Tanya thinks works in all states). The best that an individual can do is sign a document with funeral directions, directions regarding disposition of remains, and designation of an agent, and use two witnesses and a notary. That will be recognized in about 30 states.

d. **Some Interesting Cultural Traditions.** New Orleans jazz funerals begin very somberly at the funeral home and become more joyful as the parade continues. In South Korea, when burial sites are recycled after 60 years, the exhumed remains are cremated and turned into beautiful colored beads. In Ghana, elaborate "fantasy coffins" are custom made to fit a particular body and reflect something about that person. They don't look like what we think of as coffins but look like beautiful sculptures of commonplace things. (Google "Ghana fantasy coffins." You won't believe the pictures.)

e. **Old and New Methods of Remains Disposition.**

(1) **Burial and Entombment; Embalming.** Burial and entombment were the only method of disposing of remains for centuries. The traditional method of disposing of remains was with a steel or hardwood casket.

Embalming was popularized after the Civil War, and only in the mid-1900s did it become commonly used.

(2) **Cremation.** Cremation was illegal until the 1880s but was not commonly used until recently. Cremation rates remained in the single digits until 1972. As of 2023, the cremation rate is almost 61% and is expected to rise to a plateau of about 80%. (That varies by country; Greece does not have a single crematory.) The increased use of cremation is destabilizing to the funeral and cemetery industries.

Melissa Willms (Houston, Texas) has noted creative ways people are disposing of cremains. Examples are incorporating them into a manmade reef in the ocean, shooting them into space, or having them made into a vinyl record (see **https://www.andvinyly.com/**).

(3) **Green Burial.** Burial without embalming and without a casket is becoming more common. The body can be placed in a shroud or a biodegradable container. Caskets or vaults are not required by law in any state, but they may be required by the cemetery. The Green Burial Council website has a state-by-state list of providers.

(4) **Water Cremation.** With water cremation, or alkaline hydrolysis, the body is heated and pressurized in an alkaline solution until the body is liquified and bones are soft. The bones are ground to a powder finer than ashes.

(5) **Natural Organic Reduction.** Natural organic reduction (NOR) was invented about 10 years ago and has only been legal for about 4 years (in some states). The body is placed in a container with organic materials and microorganisms (no, not worms). "No, you cannot compost people in your backyard."

f. **Survey of Preferences.** Tanya conducted a broad survey to determine the knowledge of various methods of remains disposition, preferences, and openness to particular disposition methods. The survey was recently published. Tanya D. Marsh & Quincey J. Pratt, *Maybe It's Time to Let the Old Ways Die: New Data and Consumer Preferences in Death Care*, 59 WAKE FOREST L. REV. 909 (2024).

People were surveyed about six choices: (1) Cremation, (2) Casket Burial, (3) Donation to science, (4) Green burial (no casket), (5) Natural organic reduction, and (6) Water cremation. The results are rather surprising.

Almost everyone was aware of cremation, casket burial and donation to science, about 40% were aware of green burial and NOR, and only 13% were aware of water cremation. But after being made aware of these various methods., 40% to 50% of the people were open to considering green burial, NOR, or water cremation. The top choice was cremation – 80% of the respondents would consider cremation for themselves.

The lowest generational group that would consider casket burial and embalming for themselves, quite interestingly, was boomers (60-78) (29.5%); 50-65% of younger generations would consider casket burial and 35%-50% would consider embalming. Casket burial was the last choice for about 26% of those surveyed.

Almost 60% would consider green burial (for most it was their second or third choice).

Tanya concludes that this shift of interest in new disposition methods is an unbelievable cultural change in an incredibly short period of time.

28. Estate Planning Issues for Real Estate Investors and Developers

Comments in this item are from an excellent presentation by Farhad Aghdami (Richmond, Virginia) and a panel discussion by Farhad and Gray Edmondson (Oxford, Mississippi). Their presentation was an outstanding summary of issues particularly (and sometimes uniquely) important for real estate investors (referred to in this Item as "RE investors").

a. **Overview of Important Income Tax Issues.** These issues are also discussed below, but as an overview, RE investors have unique issues and concerns with estate planning transfers.

   (1) **Debt in Excess of Basis or Negative Capital Accounts.** The investor may have debt in excess of basis (because of accelerated depreciation) or may have negative capital (because of refinancings), and transfers could result in gain recognition (other than transfers to grantor trusts).

   (2) **Real Estate Professional.** If the investor qualifies as a real estate professional, real estate losses can be deducted, not limited by the passive loss rules, meaning that the real estate investor may have little or no income tax.

   (3) **Roth IRA Conversions.** Because of large losses, the real estate investor may be able to convert regular IRAs to Roth IRAs. RE investors often have very large Roth IRAs.

b. **Balance Sheet.** The balance sheet is very important to the RE investor to reduce borrowing costs and to qualify for bonding.

   (1) **Balance Sheet vs. Estate Planning Tension.** The RE investor will want to have a large balance sheet for important operating purposes but that may be contrary to estate planning goals (listing assets at appropriate discounted values, etc.)

   (2) **SLATs.** The RE investor will be tempted to include assets in the spouse's SLAT on the investor's balance sheet. One option is to list the income from the SLAT that could be distributed to the spouse in household income, but the investor should not go further than that.

c. **Hurdles to Transfers.**

   (1) **Out of Attorney's Control.** Many of the transfer hurdles for RE investors will be out of the attorney's control (whether lenders or partners will consent to transfers, timing of and cost of appraisals, etc.).

   (2) **Lender Concerns.** Transfers will result in a smaller balance sheet, creating lender concern. Also, lenders will push for the RE investor to keep control of operational activities following the transfer, which can at least raise potential issues with avoiding estate inclusion under §2036(a)(2) and §2038. The failure to obtain necessary consents could result in losing a favorable existing

low-interest loan. Obtaining consents from multiple lenders or for HUD loans can be especially tedious.

d. **Guarantees.** Lenders may want personal guarantees from the RE investor, especially for non-recourse loans (commonly referred to as "bad boy guarantees" in connection with non-recourse loans). Be careful with having the investor's spouse also give guarantees.

e. **Asset Protection for Spouse.** Titling real estate as a tenancy by the entireties may protect assets from creditors of just one of the spouses.

f. **Lack of Diversification.** RE investors are typically very highly concentrated in real estate investments. The investor may cross collateralize deals, creating a risk of falling dominos in the case of a reversal.

The concentration may open possibilities of market absorption valuation discounts when interests are transferred.

g. **Manner in Which Real Estate Investments Are Held.** Each separate real estate investment is typically held in a separate LLC. All investments will often be managed by a management company, of which the investor is the manager. The separate investments pay a management fee to the management company. Outside investors may also own interests in the separate LLCs. All the owners may be required to give personal guarantees. An alternative approach is using a single real estate investment fund (having outside investors) with multiple projects in the fund. The fund would be controlled by a general partner.

h. **Specific Issues for RE Investors That Impact Estate Planning.**

(1) **Leveraged Assets.** Only the net value of leveraged assets is included in the estate value.

(2) **Cash Flow.** Cash flow (for making note payments following sales to grantor trusts) will be impacted by outside debt and required payments to lenders.

(3) **Accelerated Depreciation.** Accelerated depreciation is often permitted for particular assets connected with real estate investments, which can result in the assets having a relatively low basis and can even result in having debt in excess of basis. A later sale may result in depreciation recapture.

(4) **Realization on Transfers.** Refinancings (to borrow money against one deal to provide liquidity to fund other deals) can result in negative basis. Transfers of interests with negative basis or debt in excess of basis may result in income realization (but not if made to a grantor trust).

(5) **Timing Issues.** Timing transfers can be especially important in some real estate transactions. For example, if transfers are made before rezoning has been approved, the valuation may be considerably lower.

(6) **Tax Credits.** Real estate investments may qualify for tax credits (for example, historic property, new markets, low-income housing). Special holding periods may apply to avoid recapture of the credits upon transfer.

(7) **Qualified Opportunity Zone Investment.** These investments were popular in 2018 and 2019. Investments in specified zones allowed two tax benefits: (1) recognition of gain on assets that were sold to be reinvested in the qualified opportunity zone (QOZ) asset would be deferred until January 1, 2026 unless a transfer is made triggering an "inclusion event"; and (2) gain on the QOZ investment will not be recognized when the investment is sold (even if there has been accelerated depreciation) if it is held at least 10 years.

Regulations provide that a transfer to a spouse is an inclusion event (despite §1041), but a transfer to a grantor trust is not an inclusion event. Death is not an inclusion event and a transfer from the estate to a beneficiary is not an inclusion event. (Whether that exception applies to QOZ investments held in a revocable trust even if the trust elects to be treated as part of the probate estate for income tax purposes is unclear.) A transfer from the estate to a trust is not an inclusion event, but a subsequent transfer from that trust to a beneficiary or to another trust is an inclusion

event. (An inclusion event merely triggers the deferred gain prior to January 1, 2026; it does not impact the 10-year rule.)

i. **Grantor Trust Planning.**

(1) **No Gain Recognition on Transfer to Grantor Trust.** A transfer to a grantor trust is not a gain recognition event, even if the transferred assets have debt in excess of basis or have a negative capital account.

(2) **Investor Considered Owner of the Trust for Income Tax Purposes; Real Estate Professional; Material Participation.** The trust can rely on the investor's activities to qualify as a real estate professional, to satisfy material participation requirements (which is important in meeting the real estate professional test as well as the passive versus active rental activity test of 469(c)(1)), and thereby continue to benefit from tax losses generated by the property.

(3) **IRS Guidance Impacting Tax Treatment of Grantor Trusts.**

(a) Notice 2007-73 ("toggling" as a transaction of interest)

(b) Rev. Rul. 2004-64 (grantor's payment of income tax liability of grantor trust not a gift)

(c) Rev. Rul. 2007-13 (grantor trust transactions with insurance policies (where the grantor is the insured) do not trigger transfer for value rules)

(d) Rev. Rul. 2008-22 (substitution power does not cause estate inclusion under §2036 or §2038)

(e) Rev. Rul. 2011-28 (substitution power over life insurance policy does not cause estate inclusion under §2042)

(f) Rev. Rul. 2023-2 (basis of irrevocable trust assets not in gross estate are not adjusted to fair market value on termination of grantor trust status at the death of the grantor)

(g) CCA 202352018 (modification of grantor trust to add discretionary reimbursement clause is considered a gift by the trust beneficiaries)

(4) **Termination of Grantor Trust Status.** The grantor may wish to terminate the grantor trust status of the trust so the grantor is not liable for the tax on trust income (sometimes referred to as the grantor's "phantom" income tax).

(a) **Mechanics of Terminating Grantor Trust Status.** Planning alternatives include structuring the trust to give the grantor or someone else the flexibility to toggle off grantor trust status, structuring automatic expiration of grantor trust status in some circumstances, including powers of appointment giving a holder the power to appoint the assets to a non-grantor trust, or decanting to a non-grantor trust. Terminating grantor trust status may be difficult (if not impossible) with a SLAT if the spouse continues as a discretionary beneficiary, even if the spouse has become an ex-spouse by way of a divorce.

(b) **Ways of Addressing the Concern Over "Phantom" Income Tax.** Planning alternatives include selling additional assets to the trust so note payments to the grantor can resume, which the grantor can use to pay the income tax; swapping other assets into the trust that generate less taxable income; making loans to the grantor from the trust to pay the tax; structuring automatic expiration of grantor trust status in some circumstances; structuring the trust to give the grantor or someone the flexibility to toggle off grantor trust status; making distributions to the grantor's spouse if the spouse is named as beneficiary; having the grantor retain sufficient assets to pay the income tax; or giving the trustee the flexibility to reimburse the grantor for such income taxes (but possible adverse transfer tax consequences with tax reimbursement must be navigated carefully); including powers of appointment giving a holder the power to appoint the assets to a nongrantor trust; or decanting to a nongrantor trust. These alternatives (and more) are discussed in Kristen A. Curatolo & Jennifer E. Smith, *Strategies for Mitigating the 'Burn' of Grantor Trust Status*, 48 BLOOMBERG TAX MGMT. ESTS., GIFTS & TR. J. No. 3 (May 11, 2023). *See also* Jerome M. Hesch & Paul Lee, *The Financial*

Danger of Maximizing Taxable Gifts, LEIMBERG ESTATE PLANNING NEWSLETTER #2035 (Dec. 5, 2012).

(c) **Tax Treatment of Terminating Grantor Trust Status During Grantor's Life.** The conversion of a grantor trust to a non-grantor trust during the grantor's life is treated as a deemed transfer of the assets in the trust to the non-grantor trust at the time of the conversion. *See Madorin v. Commissioner*, 84 T.C. 667 (1985); Reg. §1.1001-2(c), Ex.(5); Rev. Rul. 77-402. For example, if a partnership interest owned by the trust has a negative capital account at that time, the deemed transfer results in a recognized gain.

(d) **Coordinate With Investor's Accountant Before Terminating Grantor Trust Status During Life.** Coordinate with the investor's tax accountant before terminating the grantor trust status of the trust during life so the investor will be aware of adverse income tax consequences (if there is debt in excess of basis or negative capital accounts or if the trust would lose real estate professional or material participation status).

(e) **Termination of Grantor Trust Status at Death.** The grantor trust status of the trust will automatically terminate at the grantor's death.

i. **Position That Gain Is Not Recognized at Death.** Most planners take the position that the grantor is deemed to make a testamentary transfer at death that does not constitute a gain recognition event under §1001. *See Crane v. Commissioner*, 331 U.S. 1 (1947) (apartment building encumbered by nonrecourse indebtedness equal to the estate tax value of the building passed to surviving spouse; spouse's basis was adjusted to the building's fair market value unreduced by the indebtedness, as property acquired from a decedent, so the disposition of the building to the spouse at the decedent's death was not a taxable event); Rev. Rul. 73-183 (transfer of securities to decedent's estate at death did not generate a loss on the decedent's final income tax return; "the mere passing of property to an executor or administrator on the death of the decedent does not constitute a taxable realization of income" within the meaning of §1001(a)); CCA 200923024 (statement in dicta that "a transfer caused by the death of the owner … is generally not treated as an income tax event); Conference Committee Report to Economic Growth and Tax Relief Reconciliation Act (2001) (in explaining the carryover basis rule in 2010 when there was no estate tax, the report states "The bill clarifies that gain is not recognized at the time of death when the estate or heir acquires from the decedent property subject to a liability that is greater than the decedent's basis in the property").

ii. **Position That Gain Is Recognized at Death.** A minority of planners takes the position that the grantor's death triggers a taxable event as to the grantor trust citing *Madorin v. Commissioner*, 84 T.C. 667 (1985). As discussed above, the termination of grantor trust status during life is treated as a transfer from the grantor to the newly-formed non-grantor trust, which can result in taxable gain. *See also* Reg. §1.1001-2(c) Ex.(5). Paul Lee's presentation at the 2025 Heckerling Institute discussed reasons supporting this minority view. But most planners limit the *Madorin* rationale to a lifetime termination of grantor trust status.

iii. **No Basis Adjustment of Grantor Trust Assets at Grantor Death If Assets Are Not in Grantor's Gross Estate.** Rev. Rul. 2023-2 states that no basis adjustment is allowed under §1014 at the grantor's death for assets gifted to the trust that are not included in the grantor's gross estate. (Rev. Rul 2023-2 does not apply to a trust for which a note exists between the trust and the grantor that has liabilities in excess of basis.) For a detailed discussion of Rev. Rul. 2023-2, see Item 6.c of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

The grantor may exercise a substitution power prior to death to substitute high-basis assets into the grantor trust in return for the trust's low-basis assets, which would be owned by the grantor at death and receive a basis adjustment under §1014.

(5) **Sales to Grantor Trusts; Defined Value Clauses; Reporting on Gift Tax Return.** Sales from grantors to grantor trusts are routinely used as an estate freezing alternative. Traditionally, the trust initially has assets prior to the sale that represent at least 10% of the gross value of the trust assets after the sale (i.e., the debt-equity ratio does not exceed 9-1).

(a) **Model Cash Flow.** The anticipated cash flow must be modeled to determine the ability to pay lenders and to make note payments on the sale. The entire cash flow from the business should not be used to make note payments; that could raise a §2036(a)(1) concern that the sale was impliedly a transfer with retention of the income from the transferred asset.

Having sufficient cash flow to pay lenders and to make note payments (both with higher interest rates than previously) may be more difficult than in the past when rates were much lower.

(b) **Disregarded Entity Valuation Principles.** If the interest that is sold is a member interest in an LLC that is owned entirely by the parent and grantor trusts, it may be treated as a disregarded entity for income tax purposes. Even though the entity is "disregarded" for income tax purposes, property rights associated with the interest are still controlled by state law and are valued as such (i.e., with discounts). *See Pierre v. Commissioner*, 133 T.C. 24 (2009) (with a strong dissent).

(c) **Defined Value Clauses.** Defined value clauses may be used for the sale, to minimize the risk of gift liability as a result of selling at a price the IRS and court eventually determine to be less than fair market value.

A combined *Wandry*/consideration adjustment approach could be used (sometimes referred to as a two-tiered *Wandry* transfer). The client would make a traditional *Wandry* transfer of that number of units of the real estate investment that is anticipated to be worth the desired transfer amount (which could either be a gift or a sale), but with a provision that if those units are finally determined for federal gift tax purposes to be worth a higher value, the shares that were not transferred because of the *Wandry* provision would be sold for a note as of the same date as the *Wandry* gift, with the price being determined by the finally determined gift tax value. *See* Joy Matak, Steven Gorin & Martin Shenkman, *2020 Planning Means a Busy 2021 Gift Tax Return Season*, LEIMBERG ESTATE PLANNING NEWSLETTER Archive #2858 (Feb. 2, 2021) (includes excellent suggested detailed disclosures for reporting a two-tiered *Wandry* transfer on a gift tax return and income tax return, including Schedule K-1 disclosures).

For a more detailed overview of the use of defined value clauses, see Item 12 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

(d) **Reporting on Gift Tax Return.** Sales can be reported on a gift tax return to start the running of the traditional 3-year statute of limitations on additional gift tax assessments. The adequate disclosure regulations have detailed requirements that should be satisfied to assure that the disclosure is sufficient to start the running of the limitations period. Reg. §301.6501(c)-1(f).

In particular, watch out for these points regarding discounts: (1) the donor must affirmatively answer "Yes" to the Question A on Schedule A asking if a discount is being claimed; and (2) the amount of the discount and the basis for applying the discount must be described.

The Tax Court determined that "substantial compliance" with those requirements is sufficient. *Schlapfer v. Commissioner*, T.C. Memo. 2023-65 (2023). However, careful planners will follow the regulatory requirements as closely as possible. For a discussion of *Schlapfer* and planning with the adequate disclosure rules, see Item 14 of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

(6) **SLATs.** A RE investor may consider making the gift to a trust of which the spouse is a discretionary beneficiary in case of "rainy days" needs. The SLAT is a grantor trust. §677(a).

For a detailed discussion of SLATs and "non-reciprocal" SLATs, including a discussion of the §2036 and §2038 issues and creditor issues, see Items 78 and 80 of the ACTEC 2020 Annual Meeting Musings (Mar. 2020) found **here**, Item 10.i. of Estate Planning Current Developments and Hot Topics (December 2019) found **here**, and Item 16 of the Current Developments and Hot Topics Summary (December 2013) found **here**, all available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** For a discussion of potential conflicts of interest between spouses and creditor concerns with SLATs, see Item 10.e of Estate Planning Current Developments (December 2021) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** *See generally* George Karibjanian, *Exploring the "Back-End SLAT" – Mining Valuable Estate Planning Riches or Merely Mining Fool's Gold?*, 47 BLOOMBERG TAX MGMT. ESTS., GIFTS & TR. J. NO. 6 (Nov. 10, 2022).

(7) **GRAT Transfers Not Optimal.** Transfers of real estate investments to GRATs are problematic in various respects. For a classic 2-year GRAT, three appraisals would be needed; one at the initial transfer, a second at the end of year one if part of the asset is distributed in satisfaction of the first-year annuity, and a third at the end of year two. Furthermore, if minority interests are distributed in satisfaction of annuity payments, discounts would apply in determining the value transferred in satisfaction of the pecuniary annuity amount.

j. **Section 754 Elections.** A tax election may be made under §754 for partnerships at a partner's death to adjust the inside basis of the assets in the partnership attributable to the estate's interest to equal the outside basis of the estate's partnership interest (which would be the fair market value of the interest). The advantage is that assets attributable to the estate's interest could be depreciated and sales of those assets would generate less flow-through gain to the estate if the basis adjustment resulted in an upward adjustment of the basis.

Real estate partnerships will often refuse to make the §754 election, though, because they require intricate (and expensive) accounting exercises at each partner's death. Also, marketable and minority discounts could result in the outside basis being less than the estate's pro rata value of the partnership assets, which would result in a step-down of the inside basis of the assets. (That typically would not occur for traditional real estate investments that may have a low inside basis of partnership assets because of depreciation deductions.)

k. **Passive Activity Losses and Material Participation.**

(1) **Passive Activity Losses.** Passive activity losses may not be deducted by individuals, estates, trusts, closely-held C corporations, and personal service corporations. §469(a)(1). A "passive activity" is any activity involving the conduct of a trade or business in which the taxpayer does not materially participate. §469(c)(1).

Any rental activity is considered passive even if the taxpayer materially participates (i.e., it is passive *per se*), §469(c)(2), but an exception for real estate professionals applies (and the rental activity is considered active) if a 2-part test is met: (1) more than one-half the personal services performed by the taxpayer in trades or businesses during the year must be performed in real property trades or businesses in which the taxpayer materially participates; and (2) the taxpayer must perform more than 750 hours of personal services during the year in real property trades or businesses in which the taxpayer materially participates. §469(c)(7).

Material participation requires involvement that is "regular, continuous, and substantial." §469(h)(1).

(2) **Material Participation by Estate of Trust.** The regulations list seven ways for individuals to materially participate)Reg. §1.469-5T(a)) but give no guidance as to how an estate or trust materially participates.

(a) **IRS General Position Based on Legislative History.** The IRS position is that the trustee must be involved directly in the operations of the business on a "regular, continuous, and substantial" basis. The IRS points to the legislative history of §469, which states very simply:

Special rules apply in the case of taxable entities that are subject to the passive loss rule. An estate or trust is treated as materially participating in an activity if an executor or fiduciary, in his capacity as such, is so participating. S. Rep. No. 99-313, at 735.

(b) **Activities by Non-Trustee Employees**. A district court in 2003 concluded that material participation by a trust should be determined by reference to all persons who conducted the business on the trust's behalf, including employees as well as the trustee. *Mattie K. Carter Trust v. U.S.*, 256 F. Supp. 2d 536 (N.D. Tex. 2003).

(c) **Very Strict IRS Position in Private Rulings.** The IRS has taken a strict position in its informal guidance requiring activities by the trustee directly. Tech. Adv. Memo. 201317010 (activities of a "Special Trustee," whose authority as trustee was limited to voting and selling stock, who was president of the business were not counted in determining the trust's material participation because of his limited authority as trustee and because the activities as president were not in the role as fiduciary); Letter Ruling 201029014 (sole means for a trust to materially participate is for the trustee to be involved on a regular, continuous, and substantial basis; taxpayer friendly ruling to the extent it recognized that a trust could materially participate in the activities of a multi-tiered subsidiary through the activities of its trustee even though the trustee had no direct authority to act with respect to the subsidiary's business in its capacity as trustee (because of the remote relationship of the trust to the subsidiary); Tech. Adv. Memo. 201317010 (activities of "Special Trustees" would not be considered in determining the trust's material participation if they did not have the authority to commit the trust to any course of action without approval of the trustees).

(d) ***Frank Aragona Trust v. Commissioner***. In this case of major importance, the Tax Court determined that a trust qualified for the real estate professional exception (which requires material participation by the taxpayer) for rental activities because activities of three of the six co-trustees as employees of the manager of the business are counted in determining material participation by the trust. *Frank Aragona Trust v. Commissioner*, 142 T.C. 2014). All six co-trustees acted as a management board and made all major decisions regarding the trust property. They met every few months to discuss the trust's business. Three of the six were employees of the entity that managed the real estate activities (which constituted full-time participation in the real estate operations).

The *Aragona Trust* case is distinguished from the *Mattie K. Carter Trust* case. In *Aragona Trust*, trustees (half of them) were directly active in the real estate operations, but in *Carter Trust,* only employees of the trust (not trustees) were active in real estate activities. *Aragona Trust* in footnote 15 said that it was not faced with and did not address whether activities by non-trustee employees are considered in determining a trust's material participation.

l. **Valuation; Appraisals.** Valuation discounts often applied to transferred interests. Attaching a qualified appraisal to a gift tax return is often the easiest way of satisfying the adequate disclosure requirements to begin the limitations period on additional assessments. Consider using a "Kovel letter" to document that the attorney engages the appraiser on the client's behalf. Hopefully, the appraisal becomes work product privileged, and if an appraisal is not used on the return, arguably it will not be discoverable.

m. **Co-Ownership.** An entity should typically be used rather than a co-ownership (through a tenancy in common, for example), but co-ownership can be helpful for making sliver gifts of undivided interests in real estate to allow a child to have full-time (but non-exclusive) use of the property without having to pay rent. (A co-owner has a non-exclusive right to occupy property 100% of the time.) See *Stewart v. Commissioner*, 617 F.3d 148 (2d Cir. 2010) (if there is both "continued exclusive possession by the donor and the withholding of possession from the donee," §2036(a)(1) will apply).

A detailed co-ownership agreement should be used to avoid disputes as much as possible. But one planner said it seems sometimes that 20% of his practice is dealing with siblings who have disagreements over the sharing of real estate.

n. **Residences; Vacation Homes.** The parents may want to keep a vacation home in the family in perpetuity (though all children ultimately may not feel the same affinity for the property).

(1) **QPRT.** A qualified personal residence trust (QPRT) is often not ideal for residence transfers. GST exemption cannot be allocated until the end of the ETIP (when the donor's right to use the property ends). If the property is mortgaged, potential gift issues arise each time mortgage payments are made.

(2) **Sale-Leaseback.** The owner may sell the residence and lease the property for the owner's continued use (with fair rental value). Cases have gone both ways regarding whether §2036(a)(1) would apply. Applying §2036 is problematic, because the statute only applies to transfers for less than full and adequate consideration, and the donor would be paying full consideration for the right to use the property. It is ironic that paying rental payments would even further deplete the donor's estate. However, the trend of the cases is not to apply §2036 if adequate rent is paid for the use of the property. *E.g., Estate of Barlow v. Commissioner*, 55 T.C. 666 (1971) (no inclusion under §2036 even though decedent stopped paying rent after two years because of medical problems); *Estate of Giselman v. Commissioner*, T.C. Memo 1988-391; *Estate of Riese v. Commissioner*, T.C. Memo. 2011-60 (following termination of qualified personal residence trust initial term the donor continued to live in the residence for six months until she died unexpectedly without paying rent or executing a written lease, but court found that an agreement existed for the decedent to pay fair market rent; residence not included in estate). The IRS has ruled privately in several different rulings that the donor of a qualified personal residence trust may retain the right in the initial transfer to lease the property for fair rental value at the end of the QPRT term without causing estate inclusion following the end of the QPRT term under §2036. *E.g.,* Letter Ruling 199931028. However, the IRS does not concede that renting property for a fair rental value always avoids application of §2036. *See* Tech. Adv. Memo. 9146002 (*Barlow* distinguished). Most of the cases that have ruled in favor of the IRS have involved situations where the rental that was paid was not adequate. *E.g.*, *Estate of Maxwell v. Commissioner*, 3 F.3d 591 (2d Cir. 1993) (rent payment cancelled out interest payment on note when decedent sold residence to her son and his wife and estate did not pay rent following decedent's death); *Estate of Du Pont v. Commissioner*, 63 T.C. 746 (1975); *Disbrow v. Commissioner*, T.C. Memo 2006-34.

Leaseback transactions should be carefully planned so that the rental amount is the fair rental value for the property. Planners suggest not going over about 10 years on the leaseback arrangement.

(3) **SLATs.** If a residence is transferred to a SLAT with the donor's spouse as a discretionary beneficiary, the trust agreement will likely provide explicitly that the spouse will have the right to occupy the residence rent-free. What if the donor continues living in the residence (as the spouse of the beneficiary)? The IRS concedes that continued co-occupancy for interspousal transfers will not of itself support an inference or understanding as to retained possession or enjoyment by the donor. *E.g., Estate of Gutchess v. Commissioner*, 46 T.C. 554 (1966), *acq.*, 1967-1 C.B. 2; Rev. Rul. 78-409, 1978-2 C.B. 234; Rev. Rul. 70-155, 1970-1 C.B. 89; Letter Ruling 200240020. However, the IRS is not as lenient when the residence is given to family members other than the spouse if the donor continues living in the residence. *See, e.g.*, *Estate of Maxwell v. Commissioner*, 3 F.3d 591 (2d Cir. 1993); *Estate of Trotter v. Commissioner*, T.C. Memo. 2001-250; *Estate of Adler v. Commissioner*, T.C. Memo. 2011-28; Tech. Adv. Memo. 200532049.

Keep in mind, the key word with SLATs is "Spousal." If the donor is no longer married to the beneficiary, issues get very complicated.

o. **Promoter.**

(1) **Typical Arrangement.** An example arrangement could be a client that contributes land worth $5 million and $5 million of cash to an LLC for a 10% Class A interest. An equity investor would contribute $90 million cash for a 90% Class A interest. The client would also receive a Class B "Promote" interest with no invested capital. (Why would the client receive this Class B interest

for no additional investment? For the entrepreneurial risks that passive limited partners are not undertaking and because the client may bear higher risk if she personally guarantees transaction financing.) A separate management company owned by only the client will be the manager of the LLC.

Net cash flow and profits are allocated as follows:

- Class A members up to the first $110 million received (a 10% IRR).
- Next, net cash flow and profits are allocated 25% to the Class B interest and 75% to the Class A interest until the Class A interest has received $120 million (a 20% IRR).
- Afterward, net cash flow and profits are allocated 40% to the Class B interest and 60% to the Class A interest.

Thus, after hurdles are met, the client's Promote interest receives 40% of the cash flow even though the client only invested 10% of the equity.

(2) **Transfer of the Class B "Promote" Interest.** No capital is associated with the Class B interest, and the client might take the position that it has no value initially. Of course, that is not correct, but the initial value of the Class B interest may be relatively low compared to the Class A interests that are backed by $100 million of capital, and the Class B interest receives nothing until the Class A interest has recouped its $100 million investment plus $10 million (representing 10% IRR).

(a) **Section 1061.** The 2017 TCJA generally preserves the capital gain treatment of "carried interests" (the "Promote" interest in the example above; investment funds reference "carried interests" and real estate transactions typically reference "Promote" interests). It renumbered §1061 to §1062 and added a new §1061 that applies to a "carried interest" (which it refers to as an "applicable partnership interest"). The owner of the carried interest must provide substantial services and hold the interest at least three years to qualify for capital gains rates.

(b) **Overview of Risks of Estate Planning Transfers of Promote Interests.** Risks and pitfalls of transferring Promote interests include §2701 (discussed below), §2036 retained interest issues, valuation uncertainties for gift tax purposes, incomplete gift issues for unvested interests, trust and entity attribution rules, and qualified purchaser and accredited investor rules. See N. Todd Angkatavanich, David A. Handler, and Ivan Tabak, *Wealth Transfer Planning with Interests in Private Investment Funds and Other Closely-Held Entities,* 50th Heckerling Inst. On Est. Pl., at Section III.D (2016).

(c) **Section 2701; Carry Derivative Contract.** Section 2701 applies Draconian rules that value "Promote" interests at very high values when they are transferred while retaining the capital interests. One way of avoiding those rules is to make vertical slice gifts; proportionately gift the same portion of the owner's Class B and Class A interests. But often the client wants to transfer just the Class B interests that have a very low initial value compared to amounts that they may receive if (and only if) the real estate transaction is successful.

An alternative approach is the carry derivative contract. The client would sell to the trust the economic rights associated with the Class B interest but not the Class B interest itself, a planning alternative developed by David Handler (Chicago, Illinois). *See* David Handler, *Naked Derivatives and Other Exotic Wealth Transfers*, 50th U. MIAMI HECKERLING INST. ON EST. PLAN. ch. 8 (2016). For a summary of David Handler's comments regarding general planning with private derivatives, see Item 15 of the Current Developments and Hot Topics Summary (December 2016) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

A planner reports that he has employed the carry derivative contract alternative various times, working with David Handler's firm.

29. Potpourri of Planning Tips (and Traps) for Married Couples

This brief overview is based, in part, on comments by Clary Redd, Turney Berry, and Laura Zwicker.

a. **Community Property and Community Property Trusts.** Married clients who do not live in one of the nine community property states still may own community property. In states that have adopted the Uniform Disposition of Community Property on Death Act, community property assets acquired in a community property state retain their character as community property when a couple moves to a common law state for purposes of testamentary dispositions—meaning that a deceased spouse can dispose of one-half of such property—but the Act does not purport to provide that the property continues as "community property" per se. Community property has special characteristics during a marriage, upon a divorce, and upon death, so it needs to be identified and planned for appropriately.

   Care needs to be taken when doing lifetime gift planning with community property. A gift of community property is deemed to be made by both spouses equally (no gift splitting is necessary; this is automatic). It is not possible to opt out of this treatment, so if a different result is desired, the couple would need to take action to alter the classification as community property prior to making any gifts. Married couples with community property have the option of converting it to separate property and vice versa through a written agreement referred to as a partition agreement or transmutation agreement. Note that a gift of community property to a grantor trust will result in both spouses being grantors for income tax purposes, which often causes confusion and complications when one spouse dies.

   If it is important that a gift is made with one spouse's separate property (for example if the other spouse is a beneficiary of an ILIT or a SLAT), the property must be partitioned or transmuted in advance of the gift to avoid estate inclusion for the beneficiary spouse. If done improperly, step transaction issues can arise, resulting in a disastrous outcome for the intended planning. *See Smaldino v. Commissioner*, T.C. Memo 2021-127.

   One of the benefits of community property is that it receives a full basis adjustment on both halves of the assets upon the first spouse's death under §1014(b)(6). In an attempt to replicate this benefit, some states have adopted "community property trust" legislation that classifies assets held in such a trust as community property (this only applies to assets held in the trust and not to all assets owned by the married couple). Alaska, Florida, Kentucky, South Dakota, and Tennessee have enacted such statutes, and other states have proposed similar legislation. To date, no binding precedent exists about whether the IRS will respect the community property classification of assets in these community property trusts for purposes of the full basis adjustment at the first spouse's death. There are, however, some older cases that support the argument that if state law recognizes property as community property, it is recognized as such for federal tax purposes as well.

   For a more detailed discussion of community property concepts, community property trusts, and planning considerations for migrating spouses, see Items 8-11 of ACTEC 2020 Fall Meeting Musings (Mar. 2021) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

b. **Spousal Lifetime Access Trusts.** SLATs can be an ideal technique for couples who have sufficient assets to be concerned about the potential drop in the estate tax exemption but do not feel that they have enough to gift the full exemption amount without retaining some way to access the assets if needed in the future. However, some issues to consider include the step transaction doctrine (depending upon which spouse has the assets and what transfers will need to be made in order to fund the SLAT), the reciprocal trust doctrine, and all ramifications of divorce or untimely death of the beneficiary spouse.

   For other resources with detailed discussions of SLATs and "non-reciprocal" SLATs, see Item 28.i(6) above.

c. **Securing Both Exemptions; Testamentary Planning.** Gift splitting and SLATs are tools that can be used to ensure that both spouses' exemptions are fully utilized with lifetime planning, but there are also many tools available when determining how to best utilize both spouses' exemptions in their

testamentary plans. The pros and cons of relying on portability should be considered, as well as the Clayton QTIP and disclaimer bypass approaches that are sometimes appropriate to secure flexibility to make decisions about the use of exemption after the first spouse has died. For couples whose situation calls for a standard bypass/marital trust structure, consider the implications of the various funding formulas (true pecuniary marital, fractional share marital, fairly representative pecuniary marital, reverse pecuniary, and minimum worth pecuniary marital) and which one is most appropriate for the facts at hand.

For a detailed discussion of planning considerations, including major factors in bypass planning versus portability, methods of structuring plans for a couple to maximize planning flexibilities at the first spouse's death, ways of using the first decedent-spouse's estate exemption during the surviving spouse's life, whether to mandate portability, whether to address who pays filing expenses to make the portability election, state estate tax planning considerations, and the financial impact of portability planning decisions, see Item 5 of the Current Developments and Hot Topics Summary (December 2015) found **here**, Item 8 of the Current Developments and Hot Topics Summary (December 2013) found **here**, and Item 3 of Heckerling Musings 2018 and Estate Planning Current Developments (April 2018) found **here**, all available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

d. **Marital Deduction Mismatch**. Another issue to take care to avoid with a testamentary plan of a married couple is a marital deduction mismatch that could cause unnecessary estate tax to be due at the first spouse's death. This may happen when the value of what is allocated to the marital share (and therefore entitled to the unlimited marital deduction) unintentionally ends up being less than the value of what is included in the estate of the first spouse to die. A very simplified example of this is a home worth $1,000,000 that is bequeathed in undivided one-half interests to the surviving spouse and charity. The gross estate includes $1,000,000 for the home, but the marital and charitable deductions will not equal $1,000,000 because an undivided one-half interest in the home is not worth $500,000. Two recent cases that exemplify the dangers of this mismatch are *Estate of Warne v. Commissioner*, T.C. Memo. 2021-17 (2021) (combined charitable deduction for LLC units passing to two charities less than amount included in gross estate) and *Turner v. Commissioner*, T.C. Memo. 2011-209 (2011) (value of discounted interest passing to spouse may be less than the amount included under §2036).

For a discussion of the *Warne* case and other mismatch cases involving the marital deduction, charitable deduction, and §2036, see Item 34 of Estate Planning Current Developments (December 2021) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

e. **Planning with QTIP Assets**. For some surviving spouses, the majority of wealth is tied up in a QTIP trust that will be subject to estate tax at death. With the potential drop in the estate tax exemption, many clients in this situation are looking to access the assets in the QTIP trust to do planning that would use the surviving spouse's lifetime exemption before half of it may be lost. If the distribution standard is not broad enough to allow for large distributions to enable the surviving spouse to embark on gift planning (and note that this may be a reason to consider such broad distribution language when drafting a QTIP trust), it may be difficult to get the assets out to the surviving spouse to allow the making of gifts. The ideal solution may be to modify, decant, or terminate the QTIP trust early. However, even if all remainder beneficiaries are in agreement as to the plan, this may not be an option because of the possible tax implications. Unfortunately, there have been a number of recent cases and other developments that highlight the negative gift tax consequences that may result. *See Chief Counsel Advice* 202352018; *McDougall v. Commissioner*, 163 T.C. No. 5 (Sept. 17, 2024); and *Estate of Anenberg v. Commissioner*, 162 T.C. No. 9 (May 20, 2024). See Items 14 and 15 above.

f. **Sale of Remainder Interest in Marital Trust (Remainder Purchase Marital Trust)**. This technique involves a donor spouse who makes a gift to a marital trust for the benefit of the beneficiary spouse, who receives an income interest in the trust for her lifetime or a term of years. The donor spouse simultaneously sells the remainder interest in the marital trust to children or a trust for children at its fair market value. The gift to the marital trust will qualify for the unlimited marital deduction, meaning

no gift tax is due. In addition, the trust assets should not be includible in the beneficiary spouse's estate or subject to estate tax. The result is the transfer of assets to children or a trust for children free from gift and estate taxes.

For a more detailed summary of remainder purchase marital trusts, see Item 14.w of Heckerling Musings 2012 and Other Current Developments (April 9, 2012) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** The transaction is described in detail in Handler & Dunn, *GRATs and RPM Annuity Trusts: A Comparison*, 20 BLOOMBERG TAX MGMT. ESTS., GIFTS & TR. J. (July 8, 2004); Handler & Dunn, *RPM Trusts: Turning the Tables on Chapter 14*, TRUSTS & ESTATES 31 (July 2000).

30. Defined Value Formula Transfers – Musings

a. **Significance.** For large transfers of hard-to-value assets approaching the client's remaining gift exclusion amount, defined value formula transfers are commonly used in light of inherent valuation uncertainties.

b. **Types of Value Formula Transfers.** There are six basic types of defined value clauses: (1) allocation based on agreement (*McCord*, *Hendrix*); (2) allocation based on finally determined gift tax values (*Christiansen*, *Petter*); (3) assigned value (*Wandry*) or *Wandry* with a formula disclaimer; (4) price adjustment (*King*); (5) subsequent appraisal (*Nelson* – the IRS respects these); and (6) reversions (*Procter* – these do not work). A seventh type, which is a combination, is become more widely used – a combined *Wandry*/*King* approach.

c. **Combined *Wandry*/*King* Approach.** A combined *Wandry*/*King* (consideration adjustment) approach (sometimes referred to as a two-tiered *Wandry* transfer) combines advantages of both *Wandry* and *King* clauses. The client would make a traditional *Wandry* transfer of that number of units that is anticipated to be worth the desired transfer amount (which could either be a gift or a sale), but with a provision that if those units are finally determined for federal gift tax purposes to be worth a higher value, the shares that were not transferred because of the *Wandry* provision would be sold for a note as of the same date as the *Wandry* gift, with the price being determined by the finally determined gift tax value. *See* Joy Matak, Steven Gorin & Martin Shenkman, *2020 Planning Means a Busy 2021 Gift Tax Return Season*, LEIMBERG ESTATE PLANNING NEWSLETTER Archive #2858 (Feb. 2, 2021) (includes excellent suggested detailed disclosures for reporting a two-tiered *Wandry* transfer on a gift tax return and income tax return, including Schedule K-1 disclosures).

   That approach was used in *True v. Commissioner* (Tax Court Docket Nos. 21896-16 & No. 21897-16), which cases were settled on a basis that, as reported in Tax Court filings, appears favorable for the taxpayer. The father made transfers of assets worth well over $160 million under these clauses (any gifts were deemed to be made equally by the spouses under the split gift election). The IRS determined that the transfers resulted in additional gifts by the parents collectively of $94,808,104 resulting in additional combined gift taxes of 35% of that amount, or $33,182,836. The taxpayers avoided that horror show and ended up paying only an additional $4,008,642 (combined) of gift tax under stipulated decisions filed in both cases in July 2018. The taxpayers no doubt viewed an additional current outlay of about $4 million rather than $33 million as a huge victory (even if the audit may have resulted in additional value being included in the parents' estates under revised face amounts of notes). For a discussion of *True v. Commissioner*, see Item 8.c(17) of Aucutt, *Grantor Retained Annuity Trusts (GRATs) and Installment Sales to Grantor Trusts* (Mar. 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

d. **Potpourri of Planning Issues.**

   - The IRS looks at these cases closely, but largely to determine whether the clause was implemented properly. No pre-arrangements should exist.
   - Documentation should be consistent in all respects with the formula transfer. Planning tips can be gleaned from the IRS arguments in *Sorensen v. Commissioner* (settled in 2022) for structuring and documenting the transfer of shares in satisfaction of the formula assignment before the time that a final determination of gift tax value is made, including documentation

regarding the stock ledger, distributions, and the sale to the third party as well as having the donee specifically acknowledge the formula transfer on the stock power. For a detailed discussion of *Sorensen*, see Item 12.d of LOOKING AHEAD – Estate Planning in 2024, Current Developments & Hot Topics (December 2024) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

- With a *Petter* or *Wandry* type of formula (based on values as finally determined for gift tax purposes) it is essential that a gift tax return be filed.
- The recipient trusts should be grantor trusts; if adjustments are made following an audit, no income tax return amendments should be necessary because all of the income is taxed to the grantor in any event.
- Be wary of using *Wandry* transfers if the transferred assets could explode in value. A change in the finally determined gift tax value could result in many of the transferred assets remaining with the donor – and all the appreciation attributable those assets remaining in the donor's gross estate. An alternative to assure that all of a particular block of assets is transferred is to use a combined *Wandry/King* approach.
- Consider using a tenancy in common arrangement for a *Wandry* transfer. The transferred assets would be owned by the donor and irrevocable trust as tenants in common, and a co-ownership agreement would define the percentages owned by each based on values as finally determined for federal gift tax purposes.

e. **Other Resources.** For a detailed discussion of *Sorensen v. Commissioner*, see Item 13.c of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.** For a more detailed discussion of defined value clauses, see Item 14 of the Current Developments and Hot Topics Summary (October 2017) found **here** and Item 8.c. of Aucutt, *Grantor Retained Annuity Trusts (GRATs) and Installment Sales to Grantor Trusts* (Mar. 2024) found **here,** both available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**

31. Business Succession Planning; Key Issues for Advisors

This summary is based on comments from a presentation by Tom Abendroth (Chicago, Illinois).

a. **Key 1—No One Solution.** The advisor should convince the client there is no one solution. Business owners think transactionally, but estate planning is a process, not a transaction.

b. **Key 2—Under the Business.** The advisor needs to understand the business and how it is valued. That probably requires devoting some nonbillable time. For valuation considerations, ask the owner what sale price he or she would require to sell the business. The value for transfer tax purposes will be guided by Rev. Rul. 59-60.

c. **Key 3—Separate Control From Equity.**

(1) **Corporate Voting and Nonvoting Stock.** Using voting and nonvoting stock allows the senior owners to retain control while transferring some or even almost all the equity in the business to trusts for family members. See Rev. Rul. 81-15 (§2036(b) does not apply to nonvoting stock merely because the decedent owned voting stock or because the decedent owned a majority of the stock). Rev. Rul. 81-15 revoked the IRS's prior contrary position in Rev. Rul. 67-54 because of the Supreme Court's decision in *Byrum*.

(2) **Partnerships and LLCs.** The issue for partnerships and LLCs is the application of §2036(a)(2), which requires estate inclusion for transfers in which the decedent retained "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." Following the Tax Court's rather groundbreaking decision in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017), the ability, alone or in conjunction with others, to control distributions or to cause dissolution of the entity (or make amendments to the

entity agreement regarding those issues) may trigger inclusion under §2036(a)(2) of assets contributed to noncorporate entities.

d. **Key 4—Review Buy-Sell Agreements.** In the *Connelly* case, the price under a buy-sell agreement was not recognized for estate tax purposes in part because the parties did not follow the provisions of the agreement in purchasing a decedent's stock. *Connelly v. United States of America, Department of the Treasury, Internal Revenue Service*, 128 AFTR 2d 2021-5955 (E.D. Mo. 2021), *aff'd*, 131 AFTR 2d 2023-1902 (8th Cir. June 2, 2023), *aff'd on other grounds,* 602 U.S. 257 (2024). See Item 16 above for a discussion of *Connelly*. If the client does not want to abide by the mechanics in the buy-sell agreement, the attorney should be a "nice pest." Learning to be blunt in a nice way is a talent. If the client will not follow the agreement, change the agreement.

   Key terms to review in buy-sell agreements are restrictions and notice requirements on transfers, the time period for exercising options, and the valuation of transferred interests.

   Section 2703 ignores certain transfer restrictions for transfer tax purposes that are absolutely enforceable under state law. Section 2703(b) applies exceptions, in which event transfer restrictions will be recognized, but the §2703(b)(3) comparability test has been applied very strictly (and harshly). See Item 17 above for a discussion of *Huffman v. Commissioner*, T.C. Memo. 2024-12.

e. **Key 5—Ground Floor Advice.** Get in on the ground floor when possible. Advise the client in advance before making an acquisition. For example, form an LLC to make the investment, and transfer some interests in the LLC to family trusts before the acquisition. Address how capital calls will be covered. The parent may make loans to the trust or the LLC. Banks lending to the LLC will probably require guarantees by the parent. Consider whether that raises indirect gift concerns if the parent is not paid a fair compensation for giving the guarantee. See Letter Ruling 9113009 (gift by taxpayer who guaranteed loans to corporations owned by his children) (withdrawn in Letter Ruling 9409018).

f. **Key 6—Plan Well In Advance of Sale.** If a potential sale transaction is too far along, obtaining discounts on pre-sale gifts of interests may be difficult (at least, less discounts may be available). But even if a transaction has started, major contingencies to closing the deal may still exist and justify significant valuation discounts. *See* Radd L. Riebe, *Discounts Before The Deal is Done*, TRUSTS & ESTATES, at 37 (Dec. 2007).

g. **Key 7—Do Not Lose Sight of Non-Tax Planning Issues.** Non-tax planning issues can be of paramount importance to the client. Family issues will exist in most closely-held business succession planning matters. What children receive interests in the business or positions in the business? Communication and involvement is key. Non-employee family members will want to feel informed. "Employ them all" is not a solution. Buying out some family members may be possible.

32. Immediate Pre-Mortem and Post-Mortem Planning—Two Weeks Before and Two Weeks After Death

Following are a few brief musings from a presentation by Tom Yates (Fairfax, Virginia) and Shane Kelley (St. Augustine, Florida), including written materials from Ellis Pretlow (New York, York).

a. **Legal Documents; Assets.** Assemble and understand the key legal documents. Get a general understanding of the assets and summarize how they will pass under the key legal documents.

b. **Who Can The Attorney Talk With?** Get authorization from the client to talk with designated persons. Consider a HIPAA release not only for family members but also for the attorney.

c. **Activity Under a Power of Attorney.** In the last weeks or days before death, the client is often incapacitated. Actions can still be taken under powers of attorney. The Uniform Power of Attorney Act has been adopted in 38 states (with variances). Key actions to consider are the completion of funding a revocable trust, making appropriate changes to closely-held business operating documents, and withdrawing money from retirement accounts (which may be helpful for income tax planning if the last return would otherwise have unused deductions or losses or would be in low brackets).

"Hot powers" that must be specifically listed in the power of attorney are making gifts, amending or creating trusts, and changing retirement plan beneficiary designations. The power of attorney should include the authority to deal with cryptocurrency if the individual has any cryptocurrency (and make sure someone has specific "keys" needed to access cryptocurrency).

d. **Access to Digital Assets.** More and more assets are accessed digitally (for example, financial accounts). Confirm that the agent under the power of attorney (or an agent appointed to deal with digital assets) has the power to obtain disclosure of and to obtain access to digital assets. Forty-seven states have enacted some form of the Revised Uniform Fiduciary Access to Digital Assets Act ("RUFADAA"). For a discussion of RUFADAA (and a sample disclosure form), see Item 26 of Heckerling Musings 2016 and Current Developments found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

Many digital assets now require dual authentication. To access digital assets, someone needs to have access to the client's mobile phone (and the password to open it) and email, because authentication notices are often sent to one of those places.

e. **Probate Avoidance.** Confirm ownership and titling of the client's assets. Fund the revocable trust. Review beneficiary designations, transfer on death designations and payable on death designations (and make sure a beneficiary form has been completed and can be located). Avoid ancillary probate by contributing out-of-state real estate to a revocable trust or LLC.

f. **Safe Deposit Box; Loans.** Determine if the client has a safe deposit box. If so, locate the key to access it.

Discuss loans to family members and determine amounts owed on the loans. (Family members after death may say loans had been forgiven.)

g. **Deathbed Transfer Planning Considerations.** A key is "do no harm."

Consider if a basis adjustment under §1014 will be more valuable than estate exclusion.

Be wary of deathbed contributions of assets to a limited partnership or LLC to generate discounts. Those situations are ripe for §2036 attacks, and the estate may be worse off than if nothing had been done. (In *Estate of Fields v. Commissioner*, §2036 applied to assets given to a partnership days before death and a 20% accuracy related penalty was imposed. See Item 22 above.

Consider making "sliver gifts" to slice up assets to create fragmentation discounts. *But see Murphy v. Commissioner*, T.C. Memo. 1990-472 (decedent owned 51.41% of stock and gave 1.76% to children before death, leaving her with 49.65%; discount was not allowed where the control block was briefly fragmented for tax avoidance purposes, citing family control [that reasoning was subsequently rebuked by Rev. Rul. 93-12], lack of economic substance and substance over form); *contrasted with Estate of Frank v. Commissioner*, T.C. Memo. 1995-132 (shares gifted to wife two days before death under power of attorney to reduce decedent's interest from 50.2% to 32.1%; "if tax avoidance was the sole motive, a substantially smaller number of shares could have transferred").

Reconsider whether a "credit shelter" approach or "portability" approach should be used in the testamentary plan if the client is married, taking into account facts known at that time that may have not been available when the testamentary plan was designed previously.

Consider using a QTIP trust rather than an outright bequest to the spouse to create a fragmentation discount; the interests held by the spouse and by the QTIP trust will be valued separately even though the values are all included in the spouse's gross estate. *See Estate of Mellinger v. Commissioner*, 112 T.C. 26, *acq. in result only*, 1999-2 C.B. 763.

Consider possible ways to utilize GST exemption if it will not be used in the testamentary plan.

Consider whether the client holds any lifetime or testamentary powers of appointment that should be exercised or holds a power that should be exercised to change the trustee succession for trusts.

h. **Simple Gifting Techniques.**

Make use of unused gift tax annual exclusions. An unlimited exclusion is available for education and medical expenses. Tech Adv. Memo. 199941013 allowed making gifts of prepaid tuition.

Checks to non-charitable beneficiaries must clear the bank before death. See *Estate of DeMuth v. Commissioner*, T.C. Memo. 2022-72, discussed in Item 26 of Estate Planning Current Developments and Hot Topics for 2022 (December 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

If charitable bequests are in the testamentary plan, consider revising the plan to make the charitable gifts during life (to obtain an income tax deduction).

Do not give low-basis assets. (There could be exceptions, for example if the gift would generate substantial fragmentation discounts for the remaining portion of the asset retained by the decedent).

i. **Basis Planning.**

Minimize valuation discounts.

Consider distributions to the client from trusts to achieve a basis step-up (if estate tax will not be generated).

Swap high-basis assets for low-basis assets in grantor trusts that will not be included in the grantor's gross estate.

Transfers of low-basis assets to the client to obtain a basis step-up at the client's death must navigate §1014(e), which disallows a basis adjustment for property given to an individual within one year of death that passes back to the donor. That limitation does not apply if the asset passes from the decedent to someone other than the donor. Also, perhaps it does not apply if the asset passes to a trust providing the donor with a discretionary beneficial interest. See Item 8.c of the Current Developments and Hot Topics Summary (December 2015) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

A younger family member may want to engage in an "upstream planning" transaction, giving the decedent a general power of appointment over the family member's grantor trust. See Item 12.m of Estate Planning Current Developments and Hot Topics (December 2023) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

j. **End of Life Decisions.** Confirm that that the client has in place healthcare directions, HIPAA waivers, and an advance medical directive. Consider signing the hospital's specific form for DNR instructions.

k. **Discussions After Death But Before Personal Representative Appointed.** The attorney's duty of confidentiality continues after death. The attorney can confirm the decedent was a client, whether the attorney has possession of the decedent's will, and if the attorney is named as a fiduciary. The ACTEC Commentaries on the Model Rules of Professional Conduct state that the attorney can "make appropriate disclosure of client confidential information that would promote the client's estate plan, forestall litigation, preserve assets, and further family understanding of the decedent's intention," but disclosure should be limited to information the lawyer would be required to reveal as a witness.

l. **Immediate Preservation of Assets.** Assure that someone will care for the decedent's pets. Secure the house (expensive artwork or jewelry has a way of "disappearing" soon after death).

m. **Funeral and Burial Instructions.** Family fights may erupt if the client has not given instructions regarding funeral and burial plans. See Item 27 above.

n. **Disclaimers.** Discuss disclaimers with beneficiaries soon after death. Make clear that the attorney is not representing the beneficiary individually (if that is not the case), but warn the beneficiary about accepting assets from the estate before disclaimer decisions have been made.

33. Some Non-U.S. Trust Law Concepts Important for U.S. Attorneys

a. **Understanding Foreign Trust Law.**

(1) **Less Importance of Legislation.** U.S. trust law is based on both common law as well as extensive statutory provisions. Foreign trust law in English-speaking jurisdictions generally follows the English model of common law concepts, with some legislation supplementing those concepts. Trust law in Australia and Canada, like the United States, varies by state, province and territory, whereas countries such as New Zealand, Singapore, Switzerland, France, and Brazil apply national rather than state or provincial concepts.

(2) **Multiple Jurisdictions.** The laws of multiple jurisdictions often apply to trusts, including law of the settlor's domicile, law of the place of administration, and governing law under the trust instrument.

(3) **Hague Convention.** The Hague Convention on the Law Applicable to Trusts and on Their Recognition is a multilateral treaty aimed at ensuring the international recognition of common law trusts and equivalent civil law instruments. It provides generally that a civil law country must recognize a trust that is valid in the country where it was created. About twelve nations have ratified the Hague Convention (but not the United States).

b. **How to Get Information About the Trust.** U.S. trustees provide substantial information to beneficiaries (limitations periods for bringing breach of trust actions often run from when the beneficiary has information about the breach, so trustees have an incentive to provide information to beneficiaries). Advisors can get very frustrated trying to get information about foreign trusts. The trustees are typically professional trustees who give strong deference to privacy and confidentiality concerns. Foreign trustees often give little or no information about their decision-making process. Beneficiaries cannot get access to letters of wishes. An "account" from a foreign trust is more like a balance sheet or statement; it does not include income-principal allocations.

c. **Trustee Discretionary Powers.**

(1) **Delegation of Investment Authority.** Foreign trustees typically delegate investments to an outside manager, often an investment management subsidiary. (That creates "controlled foreign corporation" tax issues in the United States.) Exoneration clauses provide that trustees are not liable for investment decisions by investment managers.

(2) **Broad Discretionary Powers.** Foreign trustees often have broad discretionary powers, such as a power to add new beneficiaries, to exclude beneficiaries (for example, pending the divorce of a beneficiary), and even broad powers in trust deeds to modify trusts.

(3) **Court Approval.** Foreign trustees often will seek court approval of significant decisions. These are referred to as a *Public Trustee v. Cooper* "blessing." (That was a Cayman Islands case approving a proposed plan of liquidation and distribution of trust assets.)

(4) **Setting Aside Trust Transactions: *Hastings-Bass* Rule.** Some foreign countries allow a trustee who realized that a decision had unforeseen consequences to apply for a court order to void the trustee's exercise of discretion. This is the so-called "rule in *Hasting-Bass.*" That could be done in the U.K from 2000 to 2013; the decisions often resulted in a loss of revenue for the U.K. government, and in 2013 the U.K. Supreme Court significantly limited the rule in the U.K. Various other countries still follow the rule, however, and it has been entrenched by legislation in some countries.

d. **Trustee Succession.**

(1) **Changing the Trustee.** Changing the trustee is a complex process for most foreign trusts. The trust may have complex structures with assets around the world.

(2) **Indemnities.** A former trustee's rights to indemnity from the trust assets impact how trustee succession issues are negotiated and managed with foreign trusts. The trust deeds of foreign trusts typically give express indemnities to trustees covering any conduct short of fraud or gross negligence. A resigning or removed trustee will want indemnities for future claims for the next hundred years. The indemnity might even be secured. Indemnities might even be required when

large distributions are made to beneficiaries. Negotiations over indemnities can take months. Chain indemnities are typically required covering all prior trustees.

e. **Trust Modification.** Foreign trust deeds often give the trustee broad power to modify the trust (which might be referred to as a "power of appointment"). The modification power must be exercised in good faith.

34. Jurisdiction Diversification Throughout the World

The summary is from a presentation by Scott Bowman (Washington, D.C.) addressing planning considerations for "preppers" who believe a catastrophic disaster may be looming and make active preparations for it. Individuals may consider a portfolio of jurisdictional diversification, including moving some assets outside the United States and making citizenship and residency changes. Economic concerns in the U.S. include the national debt, inflation, and the ongoing efficacy of the U.S. dollar as the world's dominant currency.

a. **Hazards of Jurisdictional Diversification.**

(1) **Corporate Entities.** Very complex anti-deferral regimes apply to "controlled foreign corporations" (CFCs) and passive foreign investment companies (PFICs).

(2) **Foreign Trusts.** The first question is whether an entity is really a trust or is classified as an association for U.S. tax purposes under Reg. §301.7701-4. A trust must then be classified as either a domestic or foreign trust for U.S. tax purposes. *See* §7701(a)(30)-(31).

A trust classified as a foreign trust faces several tax consequences (designed to prevent the use of trusts for avoidance of U.S. taxes).

First, an exit tax applies. Section 684 requires gain recognition if the foreign trust is not a grantor trust, or if a foreign grantor trust subsequently becomes a non-grantor trust. (If a foreign grantor trust becomes a non-grantor trust by reason of the grantor's death, the trust assets will receive a basis adjustment under §1014 if the trust assets are included in the U.S. grantor's gross estate for estate tax purposes, which would negate gain recognition.)

Second, a draconian throwback tax applies to foreign non-grantor trusts. §§665-668.

(3) **Compliance Complexities.** Myriad compliance complexities face U.S. persons with foreign assets. A sample of the more prominent filings include: Form 1120-F (Income Tax Return of a Foreign Corporation); Form 8832 (Entity Classification Election); Form 8854 (Initial and Annual Expatriation Statement); Form 8858 (Information Return of U.S. Persons With Respect to Foreign Disregarded Entities and Foreign Branches); Form 8865 (Return of U.S. Persons With Respect to Certain Foreign Partnerships); Form 8621 (Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund); Form 5471 (Information Return of U.S. Persons With Respect to Certain Foreign Corporations); Form 5472 (Information Return of a 25 Percent Foreign-Owned U.S. Corporation of a Foreign Corporation Engaged in a U.S. Trade or Business); Form 3520 (Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts); Form 3520-A (Annual Information Return of Foreign Trust With a U.S. Owner); Form 1040 (U.S. Individual Income Tax Return); Form 8938 (Statement of Specified Foreign Financial Assets); and FinCEN Form 114 (Report of Foreign Bank and Financial Accounts (FBAR)).

b. **Go-Bag.** Action items the prepper may want to consider are summarized. These include (1) having some assets outside the U.S. that can be accessed and (2) planning to move citizenship or residency.

(1) **Financial Accounts.** Many foreign financial institutions will not open accounts for U.S. citizens because of reporting requirements under FATCA. Those that will open accounts often require large amount of assets under management (AUM).

(2) **Tangibles.** Fancy jewels, gems, gold, etc. held offshore may provide some jurisdictional diversification, although they may be difficult to access and monetize. Free-port bonded warehouses can hold tangibles without paying a tariff (popular ones are in Luxembourg,

Switzerland, and Singapore). If tangible assets are deposited in a safe deposit box and if the financial institution providing the box has access to the contents and can dispose of contents upon instruction, the contents must be disclosed annually on the FinCEN Form 114 (FBAR).

(3) **Cryptocurrency.** Cryptocurrency may be accessed irrespective of physical location, but be careful with the risks of owning crypto.

(4) **Foreign Real Estate.** Foreign real estate can be difficult to access and to monetize. Sale proceeds must enter the financial system, and opening foreign financial accounts can be difficult.

(5) **Citizenship Changes.** Some individuals may have claims to citizenship by heritage, i.e., by lineage. If not, an individual may be able to purchase citizenship in some countries by paying a hefty fee, depositing substantial investments, or making large charitable donations to the country.

(6) **Residency Changes.** Many jurisdictions offer "golden visa" programs permitting residency at a much lower cost than purchasing a right to citizenship.

c. **Expatriation.**

(1) **Mechanics.** Expatriating involves a multi-step process. There is an initial appointment at a U.S. embassy in which the desire to expatriate is communicated, followed by a required "cooling off" period. In a second appointment several weeks later, the individual consummates the renunciation by surrendering the U.S. passport. About 6-9 months later, the individual receives a certificate of loss of nationality, dated back to the date of the second appointment.

(2) **Tax Consequences**. Provisions were included in the HEART Act of 2008 to remove tax incentives from expatriating. For "covered expatriates," an exit tax applies under §877A, and a special inheritance tax under §2801 applies to any U.S. person who receives a gift or bequest from a covered expatriate (discussed in Item 7 above).

d. **Passport Confiscation.** If an individual has unpaid tax of more than $53,000, §7345 allows the IRS to confiscate a passport or deny the issuance of a passport. (Few people are aware of this provision.)