BESSEMER TRUST

2020-2021 Treasury-IRS Priority Guidance Plan

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The Treasury Department and the IRS released their Priority Guidance Plan for the 12 months from July 2020 through June 2021 on November 17, 2020. As usual, the introduction stated: "The 2020-2021 Priority Guidance Plan contains guidance projects that will be the focus of efforts during the 12-month period from July 1, 2020, through June 30, 2021 (referred to as the plan year)." "Focus" does not necessarily mean finish, of course. Except for the section 7520 actuarial tables discussed in this Capital Letter, we might see no published action by June on any of the items in the Plan. But whatever published guidance we do see by June is likely to come from the lists of projects in the Plan.

IMPLEMENTATION OF THE 2017 TAX ACT

Part 1 of the Plan, titled "Implementation of Tax Cuts and Jobs Act (TCJA)," contains 38 items, compared to 51 items in the Updated 2019-2020 Plan, reflecting progress in completing guidance under the 2017 Tax Act. Two items are of particular interest to estate planners.

Deduction of Estate and Trust Expenses

Item 4 of Part 1 is titled "Regulations clarifying the deductibility of certain expenses described in §67(b) and (e) that are incurred by estates and non-grantor trusts. Notice 2018-61 was published on July 30, 2018 and proposed regulations were published on May 11, 2020." This item first appeared in the 2018-2019 Priority Guidance Plan.

Notice 2018-61, 2018-31 I.R.B. 278, stated that "[t]he Treasury Department and the IRS intend to issue regulations clarifying that estates and non-grantor trusts may continue to deduct expenses described in section 67(e)(1)" despite the eight-year "suspension" of section 67(a) in the 2017 Tax Act by new section 67(g). The IRS received comments from the public agreeing with that statement and confirmed it in an amendment to Reg. §1.67-4(a)(1) proposed in REG-113295-18, 85 Fed. Reg. 27693 (May 11, 2020), and finalized by T.D. 9918, 85 Fed. Reg. 66219 (Oct. 19, 2020).

Deductibility, however, continues to be limited by the harsh treatment in Reg. §1.67-4(b)(4) and (c)(2) of fees for investment advice, including the portion of a "bundled" fiduciary fee attributable to investment advice (which now will mean total disallowance, not just the application of a 2-percent floor). Reg. §1.67-4(a)(1)(i)(A) & 4(a)(2). Notice 2018-61 had stated flatly that "nothing in section 67(g) impacts the determination of what expenses are described in section 67(e)(1)." In addition, the new regulations do not address the treatment of deductions for purposes of the alternative minimum tax, and the preambles to both the proposed and final regulations state that such treatment "is outside the scope of these [proposed] regulations."

Notice 2018-61 also indicated that regulations would address the availability of "excess deductions" to individual beneficiaries under section 642(h)(2) on termination of a trust or estate, including the treatment of those deductions as miscellaneous itemized deductions (and therefore entirely nondeductible through 2025) as current Reg. §1.642(h)-2 implies, and the Notice asked for comments on those issues. Public comments urged relief on those points, noting, as the preamble to the proposed regulations put it, "that the regulations under §1.642(h)-2 were written before the concept of miscellaneous itemized deductions was added to the Code and need to be updated." The regulations affirm the availability to beneficiaries of such excess deductions and affirm, as comments recommended, that "[e]ach deduction comprising the excess deductions under section 642(h)(2) retains, in the hands of the beneficiary, its character (specifically, as allowable in arriving at adjusted gross income, as a non-miscellaneous itemized deduction, or as a miscellaneous itemized deduction) while in the estate or trust." Reg. §1.642(h)-2(b)(1). The final regulations include helpful clarifications of the allocation of expenses among items of income, including the fiduciary's discretion to make those allocations, that had been recommended by public comments on the proposed regulations, including ACTEC's comments of June 22, 2020. The 2020 "Instructions for Schedule K-1 (Form 1041) for a Beneficiary Filing Form 1040 or 1040-SR" (released Oct. 21, 2020), citing the final regulations, clarify and elaborate previous versions in explanations titled "Box 11, Code A—Excess Deductions on Termination - Section 67(e) Expenses" and "Box 11, Code B—Excess Deductions on Termination - Non-Miscellaneous Itemized Deductions."

It is common for an estate or trust to have extra expenses related to its wind-up and final distributions in its final taxable year, as well as the catch-up payments of some expenses that have been deferred, at the same time the income of the estate or trust has declined because of its sales or distributions of income-producing assets. An eight-year suspension of the ability of fiduciaries to pass through those final-year excess deductions would have created pressure to artificially time the payment of expenses, the distribution of assets, and the termination of the trust or estate in ways that could be unfair and frustrating to both fiduciaries and beneficiaries. Thus, these regulations provide very important relief.

Opportunity Zones and Grantor Trusts

Item 33 of Part 1 is titled "Guidance under §§1400Z–1 and 1400Z–2 concerning Opportunity Zones, including census tract changes. Proposed regulations were published on October 29, 2018 and May 1, 2019. Final regulations were issued on January 13, 2020. Notice 2020-39 was published on June 22, 2020."

Although not published in the Federal Register until January 2020, a relevant set of regulations regarding Opportunity Zones was originally released in December 2019 and thereby became recognized as development Number Ten in the Top Ten Estate Planning and Estate Tax Developments of 2019, Capital Letter Number 49. Among other things, as noted in Capital Letter Number 49, if the regulations are read carefully in context, they provide significant reinforcement for the proposition that the death of the grantor does not by itself cause the recognition of gain with respect to appreciated assets held in a grantor trust.

BURDEN REDUCTION

In response to Executive Order 13789 of April 21, 2017, which directed the identification of tax regulations issued after 2015 that impose an undue burden on taxpayers, Treasury and the IRS stated in the original 2017-2018 Priority Guidance Plan that "Part 2 [now Part 3] of the plan describes certain projects that we have identified as burden reducing." Like Part 1, Part 3 of the 2020-2021 Plan contains two items of particular interest to estate planners.

Basis Consistency

Item 14 of Part 3 is titled "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."

As noted in Capital Letter Number 44, the appearance of this subject under the heading of "Burden Reduction" offers hope that the final regulations would relax one or two or all of the following very burdensome requirements of the proposed regulations published in March 2016:

- The requirement of Proposed Reg. §1.6035-1(c)(3) that within 30 days of filing the estate tax return each beneficiary must be told on a Schedule A of Form 8971 the initial basis (that is, the value reported for estate tax purposes) of each asset that beneficiary **might ever receive** even though the statutory requirement of section 6035(a)(1) itself attaches only "to each person **acquiring** any interest in property."
- The requirement of Proposed Reg. §1.1014-10(c)(3) that property that is after-discovered or otherwise omitted from the estate tax return in good faith is given an initial basis of zero even though such property is neither "property the final value of which has been determined for purposes of the [estate] tax" within the meaning of section 1014(f)(1)(A) nor property "with respect to which a statement has been furnished under section 6035(a)" within the meaning of section 1014(f)(1)(B) and therefore the special consistent basis rule in section 1014(f) by its terms does not apply.
- The seemingly open-ended requirement of Proposed Reg. §1.6035-1(f) that a recipient of a Schedule A must in turn file a Schedule A when making any gift or other retransfer of the property that results wholly or partly in a carryover basis for the transferee, regardless of the size of the estate of that transferor and even though section 6035 imposes the reporting requirement only on an "executor," not on a donor.

Those and other issues were discussed in ACTEC's comments on the proposed regulations and Lora Davis's, Gregg Simon's, and my statements at the public hearing on the proposed regulations.

Relief Regarding GST Exemption Allocations and Elections

Item 18 of Part 3 is titled "Final regulations under §2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption."

Like the basis consistency regulations, as also noted in Capital Letter Number 44, the continued appearance of this subject under the heading of "Burden Reduction" offers hope that the final regulations would relax, for example, the burdensome requirement of Proposed Reg. §26.2642-7(h)(3)(i)(D) for "detailed affidavits" from "[e]ach tax professional who advised or was consulted by the transferor or the executor of the transferor's estate with regard to **any aspect** of the transfer, the trust, the allocation of GST exemption, and/or the election under section 2632(b)(3) or (c)(5)."

GENERAL GUIDANCE

There are five items under the heading of "Gifts and Estates and Trusts" in Part 6 of the 2020-2021 Plan, titled "General Guidance."

"1. Guidance on basis of grantor trust assets at death under §1014"

This project was new in 2015.

In Letter Ruling 200434012 (April 23, 2004), involving a sale from one grantor trust to another, the IRS included the caveat (emphasis added) that "when either Trust 1 or Trust 2 ceases to be treated as a trust owned by A under § 671 by reason of A's death or the waiver or release of any power under § 675, no opinion is expressed or implied concerning whether the termination of such grantor trust treatment results in a sale or disposition of any property within the meaning of § 1001(a), a change in the basis of any property under § 1012 or § 1014, or any deductible administration expense under § 2053."

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

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

The current guidance project may somehow be related to the analytical gymnastics found in those authorities.

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

Rev. Proc. 2015-37, 2015-26 I.R.B. 1196, added "[w]hether the assets in a grantor trust receive a section 1014 basis adjustment at the death of the deemed owner of the trust for income tax purposes when those assets are not includible in the gross estate of that owner under chapter 11 of subtitle B of the Internal Revenue Code" to the list of "areas under study in which rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, a revenue procedure, regulations, or otherwise." That designation was continued in section 5.01(12) of Rev. Proc. 2016-3, 2016-1 I.R.B. 126, section 5.01(10) of Rev. Proc. 2017-3, 2017-1 I.R.B. 130, section 5.01(8) of Rev. Proc. 2018-3, 2018-1 I.R.B. 130, section 5.01(8) of Rev. Proc. 2019-3, 2019-1 I.R.B. 130, and section 5.01(9) of Rev. Proc. 2020-3, 2020-1 I.R.B. 131.

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

It is hard to believe that it is a coincidence that Rev. Proc. 2015-37 was published in the Internal Revenue Bulletin on June 29, 2015, **the day before** Letter Ruling 201544002 was issued. If those two contemporaneous events are related, then the no-rule position of Rev. Procs. 2015-37, 2016-3, 2017-3, 2018-3, 2019-3, and 2020-3 might have been aimed only at foreign trusts, and so might this proposal first announced in the 2015-2016 Priority Guidance Plan a month later on July 31, 2015. It is also possible that, even if the project originally had such a narrow focus, it has since been expanded in the Trump Administration. But this item apparently is not mentioned in the Office of Management and Budget's Spring 2020 Unified Agenda of Regulatory and Deregulatory Actions, which was released on June 30, 2020.

"2. Guidance on user fee for estate tax closing letters under §2001."

This project is new in the 2020-2021 Plan, although there was a preview of it in the Office of Management and Budget's Spring 2020 Unified Agenda of Regulatory and Deregulatory Actions, which was released on June 30, 2020.

Before June 1, 2015, the IRS routinely issued a closing letter (not the same as a formal "closing agreement") when the examination of an estate tax return was closed, except returns that were not required for estate tax purposes but were filed solely to elect portability. The "Frequently Asked Questions on Estate Taxes" on the IRS website was updated on June 16, 2015, to state that for such returns filed on or after June 1, 2015, closing letters would be issued only upon request. Notice 2017-12, 2017-5 I.R.B. 742, confirmed that, and also confirmed informal reports that an estate tax account transcript that includes the transaction code "421" and the explanation "Closed examination of tax return" can, as the Notice put it, "serve as the functional equivalent of an estate tax closing letter."

Many estate planning professionals have been frustrated with efforts to obtain such transcripts and in any event have not found that a transcript has the same dignity as a closing letter for purposes of documenting the propriety of making distributions, closing accounts, and taking other actions. While it has been suggested that the IRS abandoned automatic closing letters for budgetary reasons, that explanation has been hard to understand, because presumably a closing letter is (or could be) computer-generated from the same computer records that support transcripts, and it requires the same diligence to generate the transaction code "421" anyway. If this user fee project comes to fruition, it might lay to rest whatever real budgetary concerns there might have been.

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

This project first appeared in the 2007-2008 Plan.

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

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

California law. The conservation agreement reduced the value of the ranch by 88 percent. Since that reduced value was the value of the ranch at the alternate valuation date (which until 1971 was one year after death), the executor elected alternate valuation and reported the ranch at that value. Citing the Depression-era legislative history to the effect that alternate valuation was intended to protect decedents' estates against "many of the hardships which were experienced after 1929 when market values decreased very materially between the period from the date of death and the date of distribution to the beneficiaries," the court held that "the value reducing result of the post mortem act of the surviving trustee" may not be considered in applying alternate valuation.

The second of these cases was *Kohler v. Commissioner*, T.C. Memo. 2006-152, *nonacq.*, 2008-9 I.R.B. 481, involving the estate of a shareholder of the well-known family-owned plumbing fixture manufacturer. The executor had received stock in a tax-free corporate reorganization that had been under consideration for about two years before the decedent's death but was not completed until about two months after the decedent's death. The court rejected the IRS's attempt to base the estate tax on the value of the stock **surrendered** in the reorganization (which had been subject to fewer restrictions on transferability), on the ground that Reg. §20.2032-1(c)(1) prevents that result by specifically refusing to treat stock surrendered in a tax-free reorganization as "otherwise disposed of" for purposes of section 2032(a)(1). The court also noted that the exchange of stock must have been for equal value or the reorganization would not have been tax-free as the parties had stipulated (although, ironically, the executor's own appraiser had determined a value of the pre-reorganization shares of $50.115 million and a value of the post-reorganization shares of $47.010 million – a difference of about 6.2 percent). The court distinguished *Flanders*, where the post-death transaction itself reduced the value by 88 percent. The Tax Court in *Kohler* viewed the 1935 legislative history relied on in *Flanders* as irrelevant, because Reg. §20.2032-1(c)(1) (promulgated in 1958) was clear and unambiguous and because "the legislative history describes the general purpose of the statute, not the specific meaning of 'otherwise disposed of' in the context of tax-free reorganizations."

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

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

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

Thus, in contrast to the 2008 approach of ignoring certain intervening events – and thereby potentially valuing assets six months after death on a hypothetical basis – the new approach is to expand the description of intervening events that are regarding as dispositions, triggering alternate valuation as of that date. The expanded list, in Proposed Reg. §20.2032-1(c)(1)(i), includes distributions, exchanges (whether taxable or not), and contributions to capital or other changes to the capital structure or ownership of an entity, including "the dilution of the decedent's ownership interest in the entity due to the issuance of additional ownership interests in the entity." Proposed Reg. §20.2032-1(c)(1)(i)(I)(*1*). But under Proposed Reg. §20.2032-1(c)(1)(ii), an exchange of interests in a corporation, partnership, or other entity is not counted if the fair market values of the interests before and after the exchange differ by no more than 5 percent (which would still subject a 6.2 percent difference as in *Kohler* to the new rules). If the interest involved is only a fraction of the decedent's total interest, an aggregation rule in Proposed Reg. §20.2032-1(c)(1)(iv) values such interests at a pro rata share of the decedent's total interest. The proposed regulations also include special rules for coordinating with annuities and similar payments (§20.2032-1(c)(1)(iii)(B)) and excepting qualified conservation easements (§20.2032-1(c)(4)), and also many more examples (§20.2032-1(c)(5), (e) *Example (2)*, (f)(2)(B) & (f)(3)).

While the 2008 proposed regulations were referred to as the "anti-*Kohler* regulations," the most significant impact of these proposed regulations may fall on efforts to bootstrap an estate into a valuation discount by distributing or otherwise disposing of a minority or other noncontrolling interest within the six-month period after death (valuing it as a minority interest under section 2032(a)(1)) and leaving another minority or noncontrolling interest to be valued six months after death (also valued as a minority interest under section 2032(a)(2)). Examples 7 and 8 of Proposed Reg. §20.2032-1(c)(5) specifically address the discount-bootstrap technique – Example 8 in the context of a limited liability company and Example 7 in the context of real estate – and leave no doubt that changes in value due to "market conditions" do not include the valuation discounts that might appear to be created by partial distributions. Example 1 reaches the same result with respect to the post-death formation of a limited partnership.

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

"4. Regulations under §2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate."

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

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

But it is easy to see how the Treasury Department's and the IRS's "further consideration" of "the appropriate use of present value concepts" could turn their focus to the leveraged benefit in general that can be obtained when a claim or expense is paid long after the due date of the estate tax, but the additional estate tax reduction is credited as of, and earns interest from, that due date. *Graegin* loans (see *Estate of Graegin v. Commissioner*, T.C. Memo. 1988-477) could be an obvious target of such consideration. If this project results in a deduction of only the present value of the payment, as of the due date of the tax, **and** the discount rate used in the calculation of the present value is the same as the rate of interest on the tax refund, **and** the interest is not subject to income tax (or the discount rate is also reduced by the income tax rate), then the invocation of "present value concepts" might make very little difference on paper. But it might require legislation to accomplish all these things. Moreover, because claims or expenses are rarely paid exactly on the due date of the tax, the **precise** application of such principles might be exceedingly complicated.

"5. Regulations under §7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests."

The current mortality tables, based on 2000 census data, became effective May 1, 2009. Previous mortality tables had taken effect on May 1, 1989, and May 1, 1999. Section 7520(c)(2) mandates revision of the tables at least once every ten years. Thus, this project appears to be that routine revision, to reflect 2010 census data and to be effective as of May 1, 2019. It was not completed by that date, although it reportedly is near completion now.

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

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

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

OMISSIONS FROM THE PRIORITY GUIDANCE PLAN

Although the following items that have previously appeared in Priority Guidance Plans and are now omitted may not be a "focus" of Treasury and the IRS for the next seven months, it should not be assumed that they are abandoned or forgotten, or that we will not see action on such items sometime in the future.

Anti-Clawback Regulations

The "clawback" issue was the subject of Capital Letter Number 46. The publication of the final "anti-clawback" regulations was Number Seven in the Top Ten Estate Planning and Estate Tax Developments of 2019, Capital Letter Number 49. That discussion described both the relief from potential "clawback" of large gifts made before 2026 when the doubled basic exclusion amount is currently scheduled to "sunset" and the assurances in the final regulations that portability elections made before that sunset will be fully protected after the sunset. The omission of clawback from the 2020-2021 Priority Guidance Plan is consistent with the fact that the anti-clawback guidance was thereby completed in 2019.

But another issue was identified in the preamble to the final regulations, which stated:

> A commenter recommended consideration of an anti-abuse provision to prevent the application of the special rule to transfers made during the increased BEA period that are not true inter vivos transfers, but rather are treated as testamentary transfers for transfer tax purposes. Examples include transfers subject to a retained life estate or other retained powers or interests, and certain transfers within the purview of chapter 14 of subtitle B of the Code. The purpose of the special rule is to ensure that bona fide inter vivos transfers are not subject to inconsistent treatment for estate tax purposes. Arguably, the possibility of inconsistent treatment does not arise with regard to transfers that are treated as part of the gross estate for estate tax purposes, rather than as adjusted taxable gifts. An anti-abuse provision could except from the application of the special rule transfers where value is included in the donor's gross estate at death. Although the Treasury Department and the IRS agree that such a provision is within the scope of the regulatory authority granted in section 2001(g)(2), such an anti-abuse provision would benefit from prior notice and comment. Accordingly, this issue will be reserved to allow further consideration of this comment.

The commenter the preamble cited is the Tax Section of the New York State Bar Association, in its February 20, 2019, letter to Treasury and the IRS. It appears that the objective of Treasury's and the IRS's "consideration" is to exclude from the anti-clawback relief those gifts made before the sunset that are brought back into the gross estate under statutes like section 2036 or some of the special rules in chapter 14, thereby ultimately subjecting those transfers to estate tax using the rates and exemptions applicable at the time of the donor's death. That is understandable because arguably the whole purpose of statutes like section 2036 is to "claw back" certain lifetime transfers with strings attached into the gross estate to be subject to the estate tax rules at that time.

With slowdowns and distractions caused by the COVID-19 pandemic, Treasury and the IRS may not be able to return to the subject of "transfers that are treated as part of the gross estate for estate tax purposes" as promptly as they might have hoped when they wrote the preamble. Nothing about it was added to the Second, Third, and Fourth Quarter Updates of the 2019-2020 Priority Guidance Plan, and it does not appear in the 2020-2021 Plan either. Again, the likely inference to be drawn from that omission is that this addition to the anti-clawback regulations is not expected to "be the focus of efforts during the 12-month period from July 1, 2020, through June 30, 2021," not that Treasury and the IRS have abandoned or forgotten it. Indeed, under current law they have until the end of 2025 to complete this project (although there will certainly be some interest in the new Biden Administration to move the sunset earlier or even further reduce the basic exclusion amount.) Moreover, although these anti-abuse regulations are expected to apply only prospectively, that probably means prospectively as to the date of the donor's death, not the date of the relevant gift, meaning that no rush is needed to curb such gifts from being made in the interim.

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

"Guidance on the valuation of promissory notes for transfer tax purposes under §§2031, 2033, 2512, and 7872"

This project first appeared in the 2015-2016 Plan.

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

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

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

98 T.C. at 590. Perhaps this project was intended to resolve that anomaly, probably by regulations. Promissory notes are frequently used in estate planning, and guidance could provide welcome clarity.

"Guidance on the gift tax effect of defined value formula clauses under §§2512 and 2511"

This project was also new in 2015.

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

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

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

In other words, like Judge Hamblen in *Frazee*, the Ninth Circuit appears to have left the door open for Treasury and the IRS to articulate a position in regulations different from the result reached in that case. Maybe, in this guidance project, Treasury was intending to accept that invitation too. Because of the widespread use of defined value formula clauses in estate planning, particularly (as we saw in 2012) to make use of increased exemptions that were about to sunset, guidance could provide needed clarity on this point also.

"Guidance regarding material participation by trusts and estates for purposes of §469"

This project could have shed light on the application to trusts and estates of the 3.8 percent tax on net investment income under section 1411.

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

Even so, the guidance project described as "Guidance regarding material participation by trusts and estates for purposes of §469," which had been in previous Priority Guidance Plans under the heading of "General Tax Issues," was omitted from the 2017-2018 Plan and has not returned.

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