

The Top Ten Estate Planning and Estate Tax Developments of 2022

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Preface by Steve Akers:

Ron Aucutt has provided the estate planning professional community his “Top Ten Estate Planning and Estate Tax Developments” of the year over each of the last 12 years. Each year we have come to anticipate Ron’s Top Ten selections and reading his analysis of the background and particular significance of each of the developments. We have all turned to Ron over the years for historical perspective about a wide variety of estate planning issues, and we look forward to continuing to do that. But after this year Ron is stepping back from this annual project, and this is his last Top Ten. Ron has outdone himself this year with especially in-depth insight and analysis of the background of the top developments and their practical significance to planners. This is literally the “end of an era.” We celebrate and savor this year’s Top Ten from Ron, knowing that it will be his last. **We all thank you, Ron.**

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In an annual tradition, Ron Aucutt, Senior Fiduciary Counsel, has identified the following as the top ten estate planning and estate tax developments of 2022. Ron is a past president of The American College of Trust and Estate Counsel; he has been an observer and frequent participant in the formation of tax policy and regulatory and interpretive guidance in Washington, D.C.; and he is the editor of the Recent Developments materials that are presented each year at the Heckerling Institute on Estate Planning.

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This summary is for your general information. The discussion of any estate planning alternatives and other observations herein are not intended as legal or tax advice and do not take into account the particular estate planning objectives, financial situation or needs of individual clients. This summary is based upon information obtained from various sources that Bessemer believes to be reliable, but Bessemer makes no representation or warranty with respect to the accuracy or completeness of such information and disclaims any liability in connection with the use of this information. Views expressed herein are current only as of the date indicated, and are subject to change without notice. Forecasts may not be realized due to a variety of factors, including changes in law, regulation, interest rates, and inflation.

Introduction

Since 2011, I have written a summary of what seemed to me could be the “Top Ten” developments of the year affecting estate planning. (The most recent can be found at <https://www.bessemertrust.com/for-professional-partners/advisor-insights>.) I say “could be” because this is a subjective selection, and it is impossible to be dogmatic about the choices. Different observers might understandably choose different developments or might put them in a different order. I myself might not treat them the same way if I were starting over. Nevertheless, I have offered these annual observations in the hope that some of them might help some readers at least a little bit to understand the challenges of constant legislative, administrative, and judicial change.

I anticipate that this “Top Ten” will be the last in this series. Partly for that reason, both the selections and my comments about the selections might be more reflective and more prone to highlight long-term developments historically and their long-term significance prospectively. But some of those comments are also very subjective.

I greatly appreciate the support and input over the years of my wife Nancy Roush, Steve Akers and my other colleagues at Bessemer Trust, and my colleagues at McGuireWoods.

Number Ten: Intergenerational Split-Dollar Life Insurance (*Levine*)

Highlights. The use of intergenerational split-dollar life insurance arrangements is a specialized technique that may not be very widely used. Nevertheless, it has been the subject of three interesting cases producing four Tax Court opinions. Two of those were “regular” Tax Court opinions (“T.C.,” not “T.C. Memo.”), including the *Levine* opinion in 2022. Those opinions have implications for many other types of estate planning as well, especially regarding the retention of rights that produce inclusion in the gross estate and the role of fiduciary duty in analyzing such retained rights.

Background. Split-dollar life insurance has been in use a long time and was the subject of Treasury regulations in 2003. T.D. 9092 (Sept. 11, 2003); Reg. §§1.61-22, 1.83-3(e), 1.83-6(a)(5), 1.301-1(q) & 1.7872-15. Simply put, a split-dollar arrangement is an arrangement by which the cost of life insurance is split between the insured and another party. In a common early use, the payor was the employer of the insured. Then split-dollar arrangements began to be used by shareholders and their corporations, and within families for estate planning purposes. A recent variation, the subject of the *Cahill*, *Morrisette*, and *Levine* cases, involves the payment of premiums by a member of one generation for insurance on the life or lives of members of a younger generation – intergenerational split-dollar arrangements.

In each of these cases a revocable trust, which of course became irrevocable when the grantor died, made payments toward premiums on life insurance owned by irrevocable trusts created by the same grantor and insuring lives of family members in the next generation. (That revocable trust is often called the “premium-paying trust” and that irrevocable trust is often called the “policy-owning trust.”) In each of the decided cases, upon the death of an insured a portion of the death benefit equal to the greater of the total premiums paid or the cash surrender value of the policy immediately before the insured’s death would be payable to the premium-paying trust. Herein lies one perceived benefit of intergenerational split-dollar arrangements: because the insureds are members of the next generation, their deaths are actuarially likely to occur a significant amount of time after the grantor’s death, and this reimbursement right of the premium-paying (now irrevocable) trust is valued for estate tax purposes at a significant discount reflecting the time-value of money.

Each split-dollar agreement in the first two cases – *Cahill* and *Morrisette* – provided that it could be terminated during the insured’s life by the mutual agreement of the trustees of the premium-paying trust and the policy-owning trust. If one of the split-dollar agreements were terminated during the insured’s life, the policy-owning trust could opt to retain the policy. In that case the policy-owning trust would be obligated to pay the premium-paying trust the greater of the total premiums the premium-paying trust had paid on the policy or the policy’s current cash surrender value.

In each of the three cases, gift tax returns reported the cost of the life insurance protection as gifts to the policy-owning trusts, in accordance with the presumably favorable “economic benefit regime” for the taxation

of split-dollar arrangements under the 2003 regulations, Reg. §1.61-22. In each case the Tax Court agreed that the economic benefit regime was appropriate because the policy-owning trusts received no additional economic benefit beyond the current life insurance protection, as explained in the first Tax Court opinion, *Estate of Morrisette v. Commissioner*, 146 T.C. 171 (2016) ("*Morrisette I*"). But that still left open the determination of the amount includable in the grantors' gross estates with respect to the arrangements, which in turn required examination of the basis for inclusion.

***Estate of Cahill v. Commissioner*, T.C. Memo. 2018-84 (June 18, 2018, Judge Thornton)**

In the *Cahill* case, the decedent's son Patrick, a resident of the State of Washington, was the trustee of the premium-paying trust and, acting on his father Richard's behalf pursuant to a power of attorney, created the policy-owning trust to own policies on his and his wife's life, with his cousin and business partner as the trustee. The purpose of this policy-owning trust was to take ownership of three whole life insurance policies, one on Patrick's life and two on the life of Patrick's wife. The premiums were \$10 million (financed by a loan from an independent lender), the total death benefit was \$79.8 million, and the aggregate cash surrender value at the date of Richard's death 15 months later was \$9,611,624. As executor, Patrick valued the premium-paying trust's right to recover death benefits at \$183,700, reflecting the deferral of that recovery to the deaths of Patrick and his wife. The IRS asserted that the value should be the cash surrender value at the time of Richard's death, \$9,611,624.

Judge Thornton denied the estate's motion for summary judgment that sections 2036, 2038, and 2703 did not apply in valuing the decedent's interests in the split-dollar arrangements and in the premium-paying trust. Citing *Estate of Strangi v. Commissioner*, T.C. Memo. 2003-145, *aff'd*, 417 F.3d 468 (5th Cir. 2005), and *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017) (reviewed by the Court), the opinion viewed the power of the decedent, through the revocable premium-paying trust, to terminate the split-dollar agreement and recover at least the cash surrender value as "clearly rights ... both to designate the persons who would possess or enjoy the transferred property under section 2036(a)(2) and to alter, amend, revoke, or terminate the transfer under section 2038(a)(1)." Judge Thornton was not impressed with the estate's argument that the premium-paying trust could exercise that power of termination only in conjunction with the policy-owning trust because sections 2036(a)(2) and 2038(a)(1) explicitly use the phrases "in conjunction with any person" and "in conjunction with any other person." For purposes of the summary judgment motion, he found many disputed facts regarding whether the decedent's son stood on both sides of the transaction so as to prevent it from being a "bona fide sale" for purposes of sections 2036(a)(2) and 2038(a)(1), but on the subject of adequate and full consideration, Judge Thornton noted that the premium-paying trust would admittedly have received value less than 2 percent of what it had paid. The same reasoning led him to find that the "at a price less than the fair market value" requirement of section 2703(a)(1) was met. In addition, the policy-owning trust's right to veto any termination of the split-dollar agreement was a "restriction on the right to sell or use such property" that therefore met the requirement of section 2703(a)(2). He did not consider the exception for a "bona fide business arrangement" under section 2703(b) because the executor and the IRS had not addressed it, although that analysis might have been similar to his analysis of the "bona fide sale" exception in sections 2036(a)(2) and 2038(a)(1).

In a stipulated Decision of December 12, 2018, Judge Thornton approved a settlement of the case by the parties. The Decision states the net outcome of the settlement of all issues, not just the split-dollar issues on which the executor had moved for summary judgment. The executor reportedly accepted the IRS value of \$9,611,624, as well as a 20 percent accuracy-related penalty, and that is consistent with the stipulated Decision. And that is not a surprise, in view of the skepticism about the transaction that was evident in Judge Thornton's opinion.

***Estate of Morrisette v. Commissioner*, T.C. Memo. 2021-60 (May 13, 2021, Judge Goeke) ("*Morrisette II*")**

In the *Morrisette* case, Clara Morrisette was the grantor of the trusts, including a revocable trust that she had established in 1994 with herself as the initial trustee, funded with all her shares in a group of family-owned moving and logistics companies with a history going back to 1943. In August 2006, a court appointed a company employee as the conservator of Clara's estate for a two-month term. Shortly thereafter, Clara's three

sons, who were active in the business, became co-trustees of Clara's revocable trust, and the conservator established three irrevocable multigenerational trusts, one for each of Clara's sons and their families. All those trusts, Clara's sons, and other trusts holding interests in the business executed a shareholders' agreement providing, among other things, that upon the death of any of the sons the surviving sons and their respective trusts would purchase the stock held by or for the benefit of the deceased son. On October 4, 2006, the three new irrevocable trusts became the policy-owning trusts by purchasing universal life insurance policies on the lives of the two other sons to fund the trusts' purchases of stock under the shareholders' agreement. On October 31, 2006, Clara's revocable trust became the premium-paying trust by forming two split-dollar arrangements with each policy-owning trust and transferring a combined \$29.9 million to those trusts, which the trusts used to make the lump-sum premium payments to buy the life insurance policies. At that time, the sons' life expectancies ranged from 14.6 to 18.6 years. Contemporaneously with these transactions, the revocable trust agreement was amended to authorize the trustees, upon Clara's death, to distribute the revocable trust's rights and receivables under the split-dollar arrangement to the three multigenerational trusts, respectively, that owned the policies.

Clara died almost three years after the split-dollar transactions. Her executors, who were her three sons, reported on the estate tax return a total appraised value of \$7,479,000 for the split-dollar receivables, which they later conceded should be \$10,449,000 because of an error in the appraiser's original calculations. The executors moved for partial summary judgment that section 2703 did not apply to the split-dollar receivables, but three days after the similar summary judgment motion was denied in *Cahill*, Judge Goeke, citing *Cahill*, denied the motion. After a trial, Judge Goeke held that the "bona fide sale for an adequate and full consideration in money or money's worth" exceptions in sections 2036(a) and 2038(a)(1) and the "bona fide business arrangement ... [that] is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth ... [and that has] terms ... comparable to similar arrangements entered into by persons in an arms' length transaction" exception in section 2703(b) were satisfied and therefore those sections did not apply. These were unequivocal taxpayer victories, notably reflecting the fact that the planning had centered around a 75-year-old family-owned operating business, in contrast to *Cahill*, which as Judge Goeke put it, "did not involve active business operations with related financial considerations such as management efficiency and succession, capital accumulation and long-held grudges that put those financial considerations at risk." His analysis of the bona fide business arrangement, testamentary device, and comparability with arm's-length transactions prongs of the exception in section 2703(b) was a rare exposition of Chapter 14, more than three decades after Chapter 14 took effect in 1990.

Regarding valuation, Judge Goeke was more sympathetic with the IRS. Most significantly, he accepted the IRS's appraiser's lower discount rates from yields that were specific to the life insurance industry and the particular insurance companies involved, and he agreed that the assumed maturity date used in that present value calculation should be December 31, 2013, not the life expectancies of the sons as the executors' experts had used. He noted emails between one of the executors and the advisors that had been involved in the planning that "discuss the possibility of canceling certain policies," including one advisor's response "that he insisted that the policies not be canceled until the three-year period of limitations on the estate return had expired." The estate tax return had been filed on December 10, 2010, a couple weeks before the extended due date, which, applying the three-year statute of limitations, forms the basis for an assumed cancellation (maturity) date of December 31, 2013.

On December 13, 2021, Judge Goeke entered a Decision, based on calculations implementing his opinion to which the parties had agreed, determining an estate tax deficiency of \$12,575,459.24 and an accuracy-related penalty of \$3,232,339.89 (even though the executors had relied on appraisals), both subject to interest. That indicates estate tax values of the reimbursement rights significantly higher than those asserted by the executors. But the deficiency is significantly less than the approximately \$39.4 million the opinion states the IRS had asserted in its notice of deficiency, and, to that extent, the case might also be viewed as a taxpayer victory (even despite the penalties).

***Estate of Levine v. Commissioner*, 158 T.C. No. 2 (Feb. 28, 2022, Judge Holmes)**

Facts. Marion Levine, a resident of Minnesota, and her first husband George Levine, who died in 1974, had opened a supermarket in 1950, which grew into a 27-store supermarket chain, and in 1959 they had built the

successful and profitable Penn Lake Shopping Center. Marion sold the supermarket chain in 1981 and used the sale proceeds to invest in other real estate ventures (including real estate lending businesses), several mobile-home parks, two Renaissance fairs (in Arizona and North Carolina), and a stock portfolio she had started in the early 1960s.

Marion had a daughter and a son, who were each married with children of their own. She developed a trusting relationship with Bob Larson, an accountant whom she met when he and his wife, who was Marion's hairdresser, were invited to and attended Marion's daughter's wedding. Bob became the overseer of the accounting and tax work for Marion's companies and, with Marion's son and son-in-law, managed the day-to-day business of the properties.

Marion created a revocable trust in 1988 with herself as trustee. She named her children and Bob as successor trustees, promoted them to co-trustees in 1996, and resigned and made them sole trustees in 2005. At about the same time she appointed Bob the third attorney-in-fact, with her two children, under a statutory power of attorney, which provided that disagreements would be decided by majority vote because her children did not always agree.

In 2007, Marion engaged an estate planning attorney who began by reviewing and updating her business documents, in some cases restructuring her businesses, and placing some of her real estate assets in a grantor retained annuity trust (GRAT) and a qualified personal residence trust (QPRT) to simplify succession and save taxes. Because many of Marion's assets were illiquid, the attorney suggested life insurance as a way to help pay estate tax, and, when it became evident that Marion's children had no estate plans of their own, he suggested intergenerational split-dollar life insurance as a way to give them a head-start on their estate planning. He had experience with split-dollar life insurance, but not in an intergenerational context. Judge Holmes' opinion notes that the attorney "wasn't looking to do anything radical" and makes it clear that he paid attention to details and to the need to tailor the planning to Marion's specific circumstances and objectives. The attorney explained the arrangement to Marion, her children, and Bob in a detailed letter and also in a helpful discussion with them.

The attorney settled the irrevocable insurance trust in 2008 in South Dakota with a South Dakota trustee because South Dakota "has no rule against perpetuities, but does have a taxpayer-friendly state income tax and a favorable premium tax." The trust was a directed trust under South Dakota law, with an "investment committee" consisting of one member, Bob Larson. As Judge Holmes described it:

Levine picked Larson for this role because he had long been very close to the Levine family yet was not a part of it. Levine knew the relationship between her children was fraught. She wanted someone she could trust to manage not just the trust but the relationship – and her children understood this.

Because Marion's son had a medical condition that would have made him uninsurable at a reasonable price, Marion, her children, and Bob agreed that the insurance trust would buy last-to-die policies on the lives of Marion's daughter and son-in-law. Marion approved the transaction but limited the amount to be invested in the policies to \$6.5 million, not the \$10 million that her attorney had assumed in illustrating the proposal. In what Judge Holmes described as "an investment decision made by Levine and her children," the premiums were paid largely from short-term (one-year or five-year) loans made to Marion's businesses and secured by properties of those businesses, with the largest loan made to Penn Lake Shopping Center. Under the split-dollar arrangement, as in *Cahill* and *Morrisette*, upon the death of the last to die of the insureds or upon the earlier termination of the arrangement, the policy-owning insurance trust would pay to the premium-paying revocable trust the greater of the advance (\$6.5 million) or the then cash surrender value of the policies. But in stark contrast to *Cahill* and *Morrisette*, termination of the arrangement could be directed only by the policy-owning trust, acting alone (in other words, by Bob as the trust investment director), and if the policy-owning trust did terminate the arrangement it would receive nothing. The premium-paying revocable trust could not terminate the arrangement or participate in the termination of the arrangement.

Issue. The issue was whether Marion's gross estate included the \$6,153,478 cash surrender value of the policies at Marion's death (under section 2036, 2038, or 2703), as the IRS asserted, or only \$2,282,195, which the estate and the IRS had stipulated was the value of the reimbursement right, as the estate argued. The IRS also asserted that a 40 percent gross undervaluation penalty should apply.

The Opinion’s Style. Judge Holmes often makes his opinions readable and interesting, frequently including details of both background and analysis that might not be found in other opinions, and his opinions are often very witty. The *Levine* opinion is no exception. Noting that Marion’s investments included two Renaissance fairs, Judge Holmes freely made use of Renaissance images and metaphors to illustrate elements of his analysis. For example, he introduces his summary of the estate tax audit by remarking that “[t]he Commissioner issued his challenge, and the joust between the IRS and the Estate began.”

Sections 2036 and 2038: The Arrangement Itself. Judge Holmes determined that section 2036(a)(1) did not apply because Marion could not surrender the policies or terminate the split-dollar arrangement and therefore did not retain anything. Although Bob, who as the sole member of the investment committee had the power to terminate the arrangement, was also a co-agent under Marion’s power of attorney, he could not terminate the arrangement and surrender the policies as attorney-in-fact on Marion’s behalf because Marion had no power to do that herself. Therefore, Marion did “not retain any right to possession or enjoyment of the property transferred.” As Judge Holmes put it, “[u]nlike what we saw in *Morrisette II* and *Estate of Cahill*, we see here a carefully drafted arrangement that expressly gives the power to terminate **only** to the Insurance Trust” (emphasis is the court’s).

General Contract Principles. Noting what he called the IRS’s “first pass at the Estate in this part of their joust,” which had argued that under general contract principles all of the parties to a contract could amend it at any time, Judge Holmes viewed that as insufficient to cause the decedent to have a right “in conjunction with” another to designate who could enjoy the property under section 2036(a)(2) or to alter, amend, or terminate the arrangement under section 2038. Relying on *Helvering v. Helmholtz*, 296 U.S. 93 (1935), and *Estate of Tully v. United States*, 528 F.2d 1401 (Ct. Cl. 1976), and also citing the more contemporary analogy of conservation easements addressed in *Pine Mountain Pres. LLLP v. Commissioner*, 151 T.C. 247, 282 (2018), *rev’d in part, aff’d in part, vacated and remanded*, 978 F.3d 1200 (11th Cir. 2020), he concluded that rights to modify contracts under general default rules of contract are not rights held “either alone or in conjunction with any other person” under section 2036(a)(2) or 2038.

Bob Larson’s Fiduciary Duties. The IRS also argued that Marion, through her agent, Bob Larson, “stood on both sides of these transactions and therefore could unwind the split-dollar transactions at will.” Although Judge Holmes might have dismissed this contention more summarily in light of his previous analysis, he lived up to his reputation for detail while maintaining his Renaissance allusions. Although he did “conclude that the Commissioner doesn’t win as a matter of law here” he nevertheless went along with the IRS’s urging to look more granularly at the factual context of Bob Larson’s fiduciary roles, stating:

But we do think he’s correct that we also must avoid being so blinded by any formal gleam from the Estate’s armor that we overlook some practical chinks that deals like this may have: Can the Commissioner dismount from purely legal or theoretical arguments and start wielding shorter, sharper weapons forged from the particular facts of particular cases?

Judge Holmes then looked to *United States v. Byrum*, 408 U.S. 125 (1972), which had held that the fiduciary duties of a donor-shareholder to minority shareholders prevented a decedent’s retained right to vote transferred stock from causing inclusion in the gross estate under section 2036(a)(2). *Strangi* and *Powell* (which Judge Thornton had cited in *Cahill*) had both distinguished *Byrum* on the ground that in *Byrum* the decedent held fiduciary duties to other shareholders. In *Strangi* the potential fiduciary duties were owed “essentially to himself” because the decedent could act with others to dissolve a partnership and, through his son-in-law who was his agent under a power of attorney and general partner, could determine the amount and timing of distributions. Similarly, in *Powell*, the duties were “owed almost exclusively to decedent herself,” and the partners could act unanimously to dissolve the partnership. In contrast to *Strangi* and *Powell*, Bob’s power to terminate did not, in effect, give Marion rights over the cash surrender values because he also had conflicting fiduciary duties to other beneficiaries. Judge Holmes noted that Bob owed fiduciary duties to Marion’s grandchildren, who were beneficiaries of the life insurance trust in addition to decedent’s children, and those grandchildren would have received nothing if Bob had terminated the arrangement early.

Judge Holmes concluded with this analysis:

We therefore find it more likely than not that the fiduciary duties that limit Larson’s ability to cancel the life-insurance policies were not “illusory”. It also persuades us that we cannot characterize his ability to unload the policies and

realize their cash-surrender values as a right retained by Levine, either alone or in conjunction with Larson, to designate who shall possess or enjoy the property transferred or the income from it.

We conclude that this precludes the inclusion of the cash-surrender values of the life-insurance policies in Levine's estate under section 2036(a)(2).

In short, maybe Judge Holmes viewed the resolution of this issue as very fact-specific, turning on the particular status of Marion's grandchildren as beneficiaries of the insurance trust. Or maybe this is just an example of Judge Holmes being Judge Holmes, meticulously answering the *Strangi/Powell* argument the IRS chose to make while also dignifying the significance of the grandchildren as beneficiaries that the estate chose to emphasize (the estate's "blunt parry" to the IRS's "subtle thrust," in Judge Holmes' entertaining Renaissance vocabulary). In any event, it undoubtedly strengthened the estate's case and facilitated Judge Holmes' analysis that (1) the decedent, Marion (either by herself or through an agent acting on her behalf), could not participate in a decision to terminate the split-dollar arrangement, and (2) the person with that power, Bob, was not a family member or a beneficiary of any trust involved.

Judge Holmes held – but without repetition or elaboration – that the same reasons prevented section 2038 from applying.

Section 2703. Judge Holmes held that section 2703 did not apply to cause the reimbursement right to be valued at the current cash surrender value of the policies. Section 2703(a)(2) requires the determination of "the value of any property ... without regard to ... any restriction on the right to sell or use such property." In a refreshingly simple and straightforward section 2703 analysis, Judge Holmes noted that the "property" referred to is "property of an estate, not some other entity's property." Therefore, "property" could not refer to the life insurance policies that were owned by the life insurance trust and were never owned by the decedent. (And, in contrast to *Cahill* and *Morrisette*, "property" could not even refer to the termination right, because the termination right was also held exclusively by the insurance trust.) Judge Holmes simply concluded that the inability to cause the immediate surrender of the policies and payment of the cash surrender value to the estate was not a restriction on what was owned by the estate, which was the receivable itself (the value of which had been stipulated).

Gift Tax. Previously, in a companion gift tax case, Judge Holmes had granted summary judgment in favor of Marion's estate, following the affirmation in *Morrisette I* that the rules of Reg. §1.61-22(d)(1), (2)(i), and (3) applicable to the "economic benefit regime" defined in Reg. §1.61-22(c)(1)(ii)(A)(2) applied, making the annual gifts equal to the "cost of current life insurance protection." *Estate of Levine v. Commissioner*, Order, Docket No. 9345-15 (July 13, 2016). Significantly, in the summary of the tax reporting in his estate tax opinion, Judge Holmes remarked:

[T]he value of gifts made in bargain sales is usually measured as the difference between the fair market value of what is given and what is received. ... Not so here. The Secretary, for whatever reason, has issued regulations that provide a different measure of value when split-dollar life insurance is involved. See Treas. Reg. § 1.61-22(d)(2).

Then he concluded his opinion with this observation (citation omitted):

If there is a weakness in this transaction, it lies in the calculation of the value of the gift between Levine and the Insurance Trust – the difference between the value that her Revocable Trust gave to the Insurance Trust and what it got in return. But the gift-tax case is not this estate-tax case.

And the problem there is traceable to the valuation rule in the regulations. No one has suggested that this rule is compelled by the Code and, if it isn't, the solution lies with the regulation writers and not the courts.

Penalty. Needless to say, Judge Holmes summarily concluded that "[t]he Estate having almost entirely prevailed [that is, having conceded only a slight increase in the stipulated value of the receivable from "about \$2 million" to \$2,282,195], no accuracy-related penalties apply."

Takeaways: Comparisons and Contrasts with the Previous Cases

Purpose and Method. In *Levine*, while perpetuation of the operating businesses might have been a factor, as in *Morrisette*, the principal objective that influenced the structure may have been Marion's desire to encourage and enable her children's own estate planning. In a footnote, Judge Holmes commented:

While [Marion's attorney] created the Insurance Trust to own the life-insurance policies taken out as part of the split-dollar transaction, we find him credible when he said that he also viewed the Insurance Trust as something [Marion's children] could use in their own eventual estate planning.

Having a purpose – ideally a “legitimate and significant nontax reason” as in *Estate of Bongard v. Commissioner*, 124 T.C. 95, 118 (2005) – is important. And having careful and balanced professional advice, tailored to the circumstances and needs of the particular client, obviously impressed Judge Holmes.

Health, Competence, and Involvement. In *Morrisette* and *Cahill* (and previously in *Powell*), the relevant estate planning decisions had been made not by the decedent but by the decedent's agent – a son of the decedent acting under a power of attorney in *Powell* and *Cahill* and an employee of the family business appointed by a court as a temporary conservator in *Morrisette*. In contrast, Marion Levine made or, as appropriate, participated with her children in making the decisions, although her children and Bob Larson, acting under her power of attorney, executed documents needed to implement those decisions.

The opinion reports that Marion (who was born in 1920) suffered a stroke in 2003, lost her driver's license in 2004 or 2005 after her children arranged for her to take a driver's test, and began to show signs of dementia in 2008, but, as Judge Holmes put it “even as she neared 90, Levine still wanted to know what was going on.” For example, as noted, it was Marion who made the decision to limit the premium payment to \$6.5 million.

Again with a Renaissance flair, Judge Holmes places Marion's physical and mental deterioration in context this way:

With the split-dollar deal done, [the attorney] had finished hammering into place the paper armor he had designed to protect as many of Levine's assets from tax as he legally could. He was just in time; within months, Levine's physical and mental health began to deteriorate more rapidly. She became more forgetful and began to not recognize her family and friends. At the start of 2009, she became bedridden. On January 22 she died.

It is unquestionably better, if possible, that the principal actually participates, so that “this is what Mom wanted” has substance.

Status. The *Levine* opinion is a “regular” (or “published”) Tax Court opinion, not a “memorandum opinion,” implying an element of “law-making” that every Tax Court judge is obliged to follow and not just the application of law to particular facts. Thus, for example, when Judge Holmes responded to the IRS's contention that Bob Larson's agency relationship with Marion Levine meant that Marion “stood on both sides of these transactions” by “conclud[ing] that the Commissioner doesn't win as a matter of law here,” the “regular T.C.” status of the opinion gives him the right to reach that conclusion.

Care in Choosing Fiduciaries. Nevertheless, care is appropriate in selecting fiduciaries to serve in more than one capacity (even though it is entirely understandable that a person trusted by a client in one role would also be trusted in other roles). In *Levine*, despite Judge Holmes' assurance that “the Commissioner doesn't win as a matter of law here,” can we really be sure that the result would have been the same if Judge Holmes were not also able to point out that as director of the policy-owning trust Bob owed fiduciary duties to Marion's grandchildren (not just to her children, who were the beneficiaries of her revocable trust after her death)?

Loans. While the financing of the insurance premiums by a loan might have been off-putting to Judge Thornton in *Cahill*, Judge Holmes characterized the loans in *Levine* as “an investment decision made by Levine and her children” and added in a footnote that “Larson credibly testified that they could have paid all the premiums in cash if they had decided to take that route.” With the short-term (one-year and five-year) business loans as the immediate source of the cash, the businesses were liable for repayment, making the premiums funded, in effect, by distributions on Marion's account from her various business entities.

Stipulation. The satisfactory result for the *Levine* estate reflected a stipulated value for the discounted present value of the receivable that was only slightly higher than the value reported on the estate tax return. This is in contrast to *Cahill* and *Morrisette* and may not be a concession the IRS will be eager to make in other cases.

Mathematical Balancing. “Economic benefit” intergenerational split-dollar life insurance remains a challenge, requiring balancing of a number of factors. For example, in all the decided cases, the senior-generation premium-payer died relatively soon after the arrangement was created – 15 months in *Cahill*, just under three

years in *Morrisette*, and less than a year in *Levine*. Had they lived longer, there would not only have been more reportable gifts in more years, but the “cost of current life insurance protection” used to measure those gifts would presumably increase because the insured younger-generation family members were growing older. For the same reason, the present-value discounts available for valuing the receivables would be based on lower remaining life expectancies, tending to produce higher estate tax values. Indeed, in the *Morrisette* case, one of Clara Morrisette’s sons died while her estate tax case was still pending.

Moreover, Marion’s estate emphasized that discounting the value of the reimbursement right may merely result in a deferral of taxes. The basis of the reimbursement right would be the finally determined discounted estate tax value, and when the reimbursement right is satisfied the difference between the amount received and the basis of the reimbursement right would be income. (The income might be ordinary income; *see, e.g.*, sections 1271-1276 relating to original issue discount and *Hudson v. Commissioner*, 20 T.C. 734 (1953) (reviewed by the Court), *aff’d sub. nom. Ogilvie v. Commissioner*, 216 F.2d 748 (6th Cir. 1954); *but cf.* section 1278(a)(1)(D)(i) relating to the settlement of a judgment.)

Against all this mathematical backdrop, the drama of IRS challenges, taxpayers’ responses, and courts’ reactions may continue to play out. Or, as Judge Holmes might say, let the jousts continue.

And that may be another reason to acknowledge that intergenerational split-dollar life insurance is not for everyone.

Number Nine: “Sprinkling” CRUTs (CCA 202233014)

Highlights. The IRS will sometimes reach helpful and common-sense conclusions in letter rulings, even when the statute is challenging. But other times it will choose a more literal and inflexible outcome. That was the case this year when it reversed its position and allowed neither a charitable deduction nor a marital deduction for a charitable remainder unitrust interest that the trustee may “sprinkle” between the grantor’s spouse and charity, even though all of the unitrust payment is sure to go to either the spouse or the charity in some combination and the spouse’s share will not be de minimis.

The IRS’s Prior Position (2007-2018). With respect to a charitable remainder unitrust (CRUT), section 664(d)(2) requires that at least a 5 percent unitrust amount be paid at least annually “to one or more persons (at least one of which is not an organization described in section 170(c))” – that is, a charity. The IRS has previously allowed full estate and gift tax marital deductions for the unitrust interest where some portion of the unitrust amount – more than “de minimis” – was payable to the spouse of the grantor or decedent and the remaining portion of the unitrust amount was distributed each year between the spouse and a charity in the trustee’s discretion. Letter Rulings 200813006 (issued Nov. 21, 2007; released March 28, 2008), 200832017 (issued March 21, 2008; released Aug. 8, 2008), 201117005 (issued Jan. 5, 2011; released April 29, 2011), and 201845014 (issued Aug. 9, 2018; released Nov. 9, 2018). The IRS looked to the legislative history of section 2056(b)(8), which provides that if the surviving spouse of a decedent is the only noncharitable beneficiary of a CRT, the terminable interest rule of section 2056(b)(1) shall not apply to any interest that passes from the decedent to the surviving spouse. In the legislative history to the Economic Recovery Tax Act of 1981, the House Ways and Means Committee stated (emphasis added):

If an individual transfers property outright to charity, no transfer taxes generally are imposed. Similarly, under the unlimited marital deduction provided in the committee bill, no tax generally will be imposed on an outright gift to the decedent’s spouse. As a result, **the committee finds no justification for imposing transfer taxes on a transfer split between a spouse and a qualifying charity.** Accordingly, the bill provides a special rule for transfers of interests in the same property to a spouse and a qualifying charity.

Under the bill, if an individual creates a qualified charitable remainder annuity trust or a qualified charitable remainder unitrust, and the only noncharitable beneficiaries are donor and his spouse, the disallowance rule for terminable interests does not apply. Therefore, the individual will receive a charitable deduction (under sec. 2055 or 2522) for the amount of the remainder interest and a marital deduction (under sec. 2056 or 2523) for the value of the annuity or unitrust interest; no transfer tax will be imposed.

H.R. REPT. NO. 97-201, 97TH CONG., 1ST SESS. 162 (July 24, 1981).

Even though the portion of the unitrust amount that would be paid to the spouse is uncertain because some of the unitrust amount could be distributed to either the spouse or a charity in the trustee's discretion, an estate tax marital deduction for the full value of the unitrust interest was allowed in these rulings. The two most recent of the rulings, Letter Rulings 201117005 and 201845014, quoted those two paragraphs from the 1981 Ways and Means Committee report. Then, here is the reasoning as articulated in Letter Ruling 201845014:

In light of the legislative history noted above, we conclude that under these facts, where X's spouse is the only noncharitable beneficiary of the survivor unitrust interest, the estate tax marital deduction under § 2056(a) will completely offset the value of the assets of [the CRUT] included in the gross estate of X after deducting the value of the remainder interest of [the CRUT] qualifying for a charitable deduction under § 2055(a).

The reasoning in Letter Ruling 201117005 was similar:

In light of the legislative history noted above and based on the facts provided and representations made, we conclude that where Taxpayer establishes a testamentary charitable remainder unitrust for one measuring life in which the surviving spouse is the only noncharitable beneficiary, the estate tax marital deduction under § 2056(a) will completely offset the value of the assets distributed to CRUT as of Taxpayer's date of death, after deducting the value of the remainder interest qualifying for a charitable deduction under § 2055(a).

The New Position (2022-____?): Chief Counsel Advice 202233014 (issued July 12, 2022; released Aug. 19, 2022). Chief Counsel Advice 202233014 involved amounts passing from a decedent's estate to a CRUT providing that 25 percent of the 5 percent unitrust interest must be paid to the decedent's spouse, and the remaining 75 percent could be paid either to a designated charity or to the spouse in the trustee's complete discretion. The CCA reasons that no estate tax charitable deduction is allowed for any portion of the unitrust amount that might be distributed to the charity in the trustee's discretion "because Charity's interest is not in the form of a fixed unitrust amount to be distributed annually and no part of the unitrust interest is ascertainable or severable from Spouse's noncharitable interest. See § 2055(e)(2)(B) and § 20.2055-2(a)." Similarly, no estate tax marital deduction was allowed for that portion of the unitrust amount that could be distributed either to the spouse or charity. The CCA stated:

[T]he extent of Spouse's interest in the remaining 75 percent portion of the unitrust amount cannot be established as of Decedent's date of death and, therefore, is not considered to pass from Decedent to Spouse as beneficial owner for purposes of § 2056(a). The extent of Spouse's interest cannot be established because the amount to be distributed to Spouse annually is within the sole and complete discretion of the trustee. It is not possible to ascertain as of the date of death whether spouse will receive any of the 75 percent portion of the unitrust amount each year since all of such portion of the unitrust interest may be distributed to charity. Because the interest is not treated as passing to Spouse for purposes of § 2056(a), Decedent's estate may not claim an estate tax marital deduction for the value of this interest under § 2056(a). See § 20.2056(c)-2(a). See also *Estate of Turner v. Commissioner*, 138 T.C. 306, 316 (2012) ("property that passed to a person other than a surviving spouse cannot also be considered as passing to the surviving spouse").

Nothing in the CCA questions that all of the unitrust amount must be paid to either a charity or the spouse. But because the portion of the unitrust amount passing to charity is not ascertainable no charitable deduction is allowed with respect to the unitrust amount, and because the portion passing to the spouse is not ascertainable no marital deduction is allowed. It is as simple as that, according to the IRS's reversed position.

The CCA makes it clear in a footnote that it has changed its position from the prior letter rulings:

The analysis and conclusion would be the same under § 2523 for a completed gift transfer to a CRUT with similar terms. In PLR 200813006, PLR 200832017, PLR 201117005, and PLR 201845014, this office ruled that taxpayers were entitled to an estate tax marital deduction under § 2056 or a gift tax marital deduction under § 2523 for a unitrust interest in a CRUT that can be distributed between charity and spouse at the trustee's discretion. The position in these earlier rulings no longer reflects the position of this office.

Before the issuance of CCA 202233014, sections 5.01(16) and 5.01(20) of Rev. Proc. 2022-3, 2022-1 I.R.B. 144, published January 3, 2022, added this sprinkling charitable remainder trust issue for both estate and gift tax purposes 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 could have meant that the IRS believed that something with the authority of, say, a regulation was necessary to support the position of the four previous letter rulings. But, in hindsight, it appears more likely to have meant only that the IRS was planning to reverse its position in what turned out to be CCA

202233014 – not a revenue ruling, revenue procedure, or regulation, but apparently the “otherwise” manner the IRS found convenient. The CCA bears a file number of 120392-21, with the last two digits indicating that the case addressed by the CCA had reached the Chief Counsel’s Office in 2021. Following the release of the CCA, the Treasury-IRS 2022-2023 Priority Guidance Plan, published November 4, 2022, included nothing on this subject, and then Rev. Proc. 2023-3, 2023-1 I.R.B. 144, published January 3, 2023, omitted those two items from the 2023 no-ruling list.

Takeaways. The flaw that developments like CCA 202233014 uncover is that the present Tax Code was never designed on purpose. It has developed in increments (some would say “piecemeal”) since the approval of the Sixteenth Amendment in 1913 and the re-establishment of a federal income tax in the Revenue Act of 1913, reflected at first in periodic “Revenue Acts” and then in the Internal Revenue Code of 1939, reorganized in 1954 and renamed in 1986.

For example – relevant to the issue in CCA 202233014 – section 664, defining and governing charitable remainder trusts, was added to the Code by the Tax Reform Act of 1969 to prevent “the trust assets [from being] invested in a manner so as to maximize the income interest with the result that there is little relation between the interest assumptions used in calculating present values and the amount received by the charity.” H.R. REPT. NO. 91-413 (PART 1), 91ST CONG., 1ST SESS. 58 (Aug. 2, 1969). Section 2056(b)(8) was added to the Code by the Economic Recovery Tax Act of 1981 as part of the removal of the limitation of the estate tax marital deduction to the greater of \$250,000 or one-half of the adjusted gross estate. In particular, it provided that “[i]f the surviving spouse of the decedent is the only noncharitable beneficiary of a qualified charitable remainder trust, paragraph (1) [the terminable interest rule] shall not apply to any interest in such trust which passes or has passed from the decedent to such surviving spouse,” and it defined “charitable remainder trust” simply by reference to section 664. (A reference to “an ESOP beneficiary,” added in 1997, is not relevant to this analysis.) Section 2523(g), applicable to the gift tax, is similar.

Thus, even though we know – and before 2022 the IRS apparently knew – what the Ways and Means Committee must have envisioned in 1981 when it found “no justification for imposing transfer taxes on a transfer split between a spouse and a qualifying charity,” it admittedly is hard to point to that in the Code, where the marital and charitable deductions have evolved on separate paths. There is no unified or multi-purpose charitable/marital deduction. The Code has no section 2055½.

Meanwhile, the estate and gift tax charitable deductions for a charitable remainder trust themselves arguably were created (or at least acknowledged) by Reg. §§20.2055-2(e)(2)(v) and 25.2522(c)-3(c)(2)(v), added in 1974 in response to the Tax Reform Act of 1969 (T.D. 7318, 39 FED. REG. 25451 (July 11, 1974)), with cross-references to section 664 and the section 664 regulations. Although that might have lent credibility to the suggestion above that the IRS’s 2007-2018 ruling position could be embraced by a clarifying regulation, it now seems more likely that the IRS has intended CCA 202233014 to be its last word on the subject.

Number Eight: Proposed Exceptions from Anti-Clawback Rules (Prop. Reg. §20.2010-1(c)(3))

Highlights. Like the estate and gift taxation of charitable remainder trusts, the “clawback” issue is another demonstration of how the Tax Code has developed over the decades. For gifts made during the eight years (2018-2025) of the doubled basic exclusion amount enacted in 2017, the reason there is a prospect of an unfair loss of the benefits of the doubled exclusion in the calculation of the estate tax – *i.e.*, “clawback” – when the donor dies after 2025 is that the Tax Reform Act of 1976 replaced the historic separate exemptions (\$30,000 for the gift tax and \$60,000 for the estate tax) with a single unified “exemption equivalent” applying over time for purposes of both taxes. And fixing the clawback problem is made more complicated because of the choice in 1976 to convert that “exemption equivalent” to a “unified credit” because “a tax credit tends to confer more tax savings on small- and medium-sized estates” and therefore “would be more equitable” (H.R. REP. NO. 94-1380, 94TH CONG., 2D SESS. 15 (1976)). With that “exemption equivalent” (or “exclusion amount,” which has evolved into a “basic exclusion amount” to accommodate a portability add-on) increasing to levels unforeseen in 1976, estate and gift taxes are now imposed in effect at a flat rate, and with “small- and medium-sized estates” therefore now exempt, that decision by Congress in 1976 adds little equity but considerable complexity in tax return preparation and, as seen with “clawback,” in statutory drafting.

Nevertheless, to undo that history and to go back to a simple “exemption” would itself introduce the perhaps worse complexity of transitional rules for living donors who had already filed some gift tax returns employing the credit.

But even the fix for clawback in Reg. §20.2010-1(c) (proposed in 2018 and finalized in 2019) inadvertently went too far and reversed the intended clawback effect of certain gross estate inclusion rules like section 2036 (which originated in the 1930s) and special rules in Chapter 14 (which was enacted in 1990).

Now the question might be whether the proposed exception from the anti-clawback rule to prevent that reversal will go too far the other way to impose tax consequences on actions that never were taxable before.

And while the current clawback potential applies to gifts during only eight years, these issues still make the Top Ten (ironically – not by design – as Number Eight) in part because of the interest in that possible overreach and also because, as drafted, both the statutory basis for these rules (section 2001(g)) and the final and proposed regulations would again apply during any future period when Congress might choose to enact another reduction of rates or increase in exemptions that proves to be only temporary, because of either an imbedded “sunset” provision (as in 2017) or simply a change in the Congress.

The Proposed “Anti-Abuse” Exceptions. The preamble to the 2019 final regulations added:

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

The current proposal is REG-118913-21, 87 FED. REG. 24918 (April 27, 2022). To do what the 2019 preamble foretold, it would add a new subparagraph (3) to the anti-clawback paragraph (c) that was added to Reg. §20.2010-1 in 2019. The new subparagraph (3) provides exceptions from the anti-clawback rules of paragraph (c) for “transfers includible in the gross estate, or treated as includible in the gross estate for purposes of section 2001(b).” It elaborates such transfers as “including without limitation” four specific types of transfers in four clauses (A) through (D):

“(A) Transfers includible in the gross estate pursuant to section 2035, 2036, 2037, 2038, or 2042, regardless of whether all or any part of the transfer was deductible pursuant to section 2522 or 2523”

This is as forecast in the 2019 preamble. It would simply preserve the “clawback,” in effect, that provisions like section 2036 (and their predecessors) have been designed to achieve since at least the 1930s.

To illustrate, assume that an unmarried individual made a \$9 million gift (the donor’s only lifetime gift) in 2019 when the indexed basic exclusion amount (BEA) was \$11.4 million. With no change in the law, the donor dies in 2026 with a taxable estate of \$20 million. Assume further that the 2026 \$5 million BEA (indexed) is \$6.8 million. (\$9 million, \$11.4 million, and \$6.8 million are the same numbers that are used in the examples in both the 2019 regulations and the 2022 proposed addition to the regulations.) With a 40 percent rate and the BEA used up, the intuitively correct estate tax is 40 percent of \$20 million, or \$8 million. But, as illustrated in the table below, without anti-clawback relief the estate tax turns out to be \$8,880,000, producing a “clawback penalty” of \$880,000.

Other ways to look at this \$880,000 million are:

- 40 percent of the amount by which the \$9 million gift exceeded the \$6.8 million date-of-death BEA; or
- the gift tax on the gift if the gift had been made in 2026; or
- the additional estate tax on a taxable estate of \$29 million if the gift had not been made at all.

In other words, all the benefit the 2017 Tax Act apparently promised this donor for making a gift before the sunset would be wiped out by the sunset.

The approach of the 2019 regulations to fix that problem is to provide that if the total BEA used for lifetime gifts is greater than the BEA otherwise applicable at the date of death (as in this illustration), then that larger total BEA (instead of the smaller BEA otherwise applicable) shall be used to compute the estate tax. Thus, in this illustration, because \$9 million of BEA used for the 2019 gift (the only post-1976 lifetime gift) is greater than the \$6.8 million BEA otherwise allowable in computing the 2026 estate tax, that larger amount of \$9 million is used for estate tax purposes instead of \$6.8 million to calculate the credit for estate tax purposes. The elimination of the clawback penalty under that rule is illustrated in the following table, by changing the entry on line 9a from \$6.8 million (the assumed 2026 BEA) to \$9 million (the amount of the 2019 BEA used for computing the gift tax):

Calculation of the Estate Tax With and Without Clawback Using the Estate Tax Return, Form 706 (August 2019) as a Template			
Line		Before 2019 Regulations	Under 2019 Regulations
3c	Taxable estate (in 2026)	20,000,000	20,000,000
4	Adjusted taxable gifts (\$9,000,000 gift made in 2019)	9,000,000	9,000,000
5	Add lines 3c and 4	29,000,000	29,000,000
6	Tentative tax on the amount on line 5	11,545,800	11,545,800
7	Total gift tax paid or payable	0	0
8	Gross estate tax (subtract line 7 from line 6)	11,545,800	11,545,800
9a	Basic exclusion amount [BEA]	6,800,000	* 9,000,000
9b	DSUE amount [not applicable]	0	0
9c	Restored exclusion amount [not applicable]	0	0
9d	Applicable exclusion amount (add lines 9a, 9b, and 9c)	6,800,000	9,000,000
9e	Allowable credit amount (tentative tax on line 9d)	2,665,800	3,545,800
10	Adjustment [not applicable]	0	0
11	Allowable applicable credit amount (line 9e minus line 10)	2,665,800	3,545,800
12	Subtract line 11 from line 8	8,880,000	8,000,000
16	Net estate tax [same as line 12 in this case]	8,880,000	8,000,000
* The greater of the 2026 BEA or the BEA intuitively correct tax		8,000,000	8,000,000
used to calculate the credit in 2019		Clawback penalty	880,000
			0

Now consider the same example, except that the \$9 million gift in 2019 is of such nature that the value of the property is included in the donor's gross estate under, for example, section 2036, thereby making the taxable estate (line 3c of the estate tax return) \$29 million (assuming no intervening change in value), while the gift itself is excluded from "adjusted taxable gifts" (line 4 of the estate tax return) under the last phrase of section 2001(b). In that case, the intuitively correct estate tax seems to be the tax on a taxable estate of \$29 million, which is \$8,880,000. Two ways of looking at that \$8,880,000 are:

- \$11,545,800 (the tax on \$29,000,000 under the section 2001(c) rate schedule) minus \$2,665,800 (the applicable credit amount, which is the tax on the BEA of \$6,800,000 under the section 2001(c) rate schedule) = \$8,880,000, or
- 40 percent times (the taxable estate of \$29,000,000 minus the BEA of \$6,800,000) = $0.4 \times \$22,200,000 = \$8,880,000$.

Thus, application of the anti-clawback calculation in this case would not eliminate an \$880,000 clawback penalty; instead, it would in effect produce an \$880,000 anti-clawback bonus, as the following table indicates:

**Same Comparison, Except That the 2019 \$9,000,000 Gift is a “String Gift”
Again Using the Estate Tax Return, Form 706 (August 2019) as a Template**

Line	Before 2019 Regulations	Under 2019 Regulations
3c Taxable estate (in 2026, including \$9,000,000 string gift)	29,000,000	29,000,000
4 Adjusted taxable gifts (string gift omitted under §2001(b))	0	0
5 Add lines 3c and 4	29,000,000	29,000,000
6 Tentative tax on the amount on line 5	11,545,800	11,545,800
7 Total gift tax paid or payable	0	0
8 Gross estate tax (subtract line 7 from line 6)	11,545,800	11,545,800
9a Basic exclusion amount	6,800,000	* 9,000,000
9b DSUE amount [not applicable]	0	0
9c Restored exclusion amount [not applicable]	0	0
9d Applicable exclusion amount (add lines 9a, 9b, and 9c)	6,800,000	9,000,000
9e Allowable credit amount (tentative tax on line 9d)	2,665,800	3,545,800
10 Adjustment [not applicable]	0	0
11 Allowable applicable credit amount (line 9e minus line 10)	2,665,800	3,545,800
12 Subtract line 11 from line 8	8,880,000	8,000,000
16 Net estate tax [same as line 12 in this case]	8,880,000	8,000,000
* The greater of 2026 BEA or BEA used in 2019	Intuitively correct tax 8,880,000	8,880,000
	Unintended anti-clawback bonus 0	880,000

That “bonus” is undoubtedly what prompted the IRS and Treasury to consider an “anti-abuse provision” and is what the 2022 proposed regulations would understandably eliminate.

“(B) Transfers made by enforceable promise to the extent they remain unsatisfied as of the date of death”

Such transfers were not explicitly targeted in the 2019 preamble. But, because the donor/promisor keeps the enjoyment of the property until the promise is satisfied, there certainly is a resemblance to section 2036. As the 2022 preamble observes, such transfers have been excluded from adjusted taxable gifts under Rev. Rul. 84-25, 1984-1 C.B. 191.

But, as some comments have noted, the proposal, as written, is not limited to promises that give rise to a current gift that would invite clawback (in addition to being merely “enforceable”). As an example, such a promise should be explicitly excluded to the extent the promisor/decedent received consideration.

“(C) Transfers described in §25.2701-5(a)(4) or §25.2702-6(a)(1) of this chapter”

This fulfills the explicit attention of the 2019 preamble to “certain transfers within the purview of chapter 14 of subtitle B of the Code.” The 2022 preamble explains why Treasury and the IRS did not consider it necessary to also amend Reg. §25.2701-5 (as the comments had recommended) or, similarly, Reg. §25.2702-6(b).

But, while the Chapter 14 regulations have some provisions (like those cited) that operate similarly to section 2036, they are not identical. As a result, the reference to those regulations might be too abrupt and vague. They might at least be helped by some examples.

“(D) Transfers that would have been described in ... (A), (B), or (C) ... but for the transfer, relinquishment, or elimination of an interest, power, or property, effectuated within 18 months of the date of the decedent’s death by the decedent alone, by the decedent in conjunction with any other person, or by any other person”

This new 18-month rule has probably received the most attention. “New” rules do that. Many comments have noted how it overlaps with the current three-year “clawback” in the “relinquishment” clause of section 2035(a). But it should also be noted that it resembles, perhaps more meaningfully, the 18-month “not terminally ill” (that is, non-deathbed) valuation presumption in Reg. §§1.7520-3(b)(3), 20.7520-3(b)(3)(i), and 25.7520-3(b)(3), except that it is not rebuttable in either direction. In other words, unlike those section 7520 regulations, the IRS cannot rebut the taxpayer-friendly presumption if the decedent survives for 18 months after the action, but the executor cannot rebut the presumption if the decedent dies within 18 months after the action taken, even, for example, if the decedent dies in an accident and not from any preexisting illness or other foreseeable cause. The final regulations (or at least the preamble) need to address that scenario.

This provision also needs clarification for cases where no other “string” provision applies. To say that clawback should be allowed because Congress has intended some “string” clawback to apply since the 1930s is meaningless unless there is such a “string” provision that otherwise would have applied. One example of that, as in the case of an “enforceable promise,” is where there was partial or full consideration in the original transaction.

By its terms as proposed, the 18-month rule would not apply to the transfer, relinquishment, or elimination of an interest, power, or property that is “effectuated by the termination of the durational period described in the original instrument of transfer by either the mere passage of time or the death of any person” (Proposed Reg. §20.2010-1(c)(3)(ii)(B)). This could make it more desirable to draft such original instruments with such durational triggers, rather than depending on someone’s discretion. But the trade-off could be a forfeiture of flexibility that would make such a choice inadvisable in some cases.

While similar to the existing three-year rule of section 2035, this provision not only applies to actions “by the decedent alone” or “by the decedent in conjunction with any other person,” but is conspicuously extended to affirmative actions “by any other person.” Recalling the court’s analysis in the *Levine* case discussed as Number Ten, this could be a very significant broadening of the reach of this proposed “clawback,” even though it is for only half of the current three-year period. On the other hand, the inclusion of this addition might be an admission (even if unintended) that the position the IRS was arguing in *Levine* is not achievable in the absence of an explicit regulation. In any event, the triggering of this 18-month period solely by the action of “any other person” might be an example of how the 18-month rule prevents the exception from clawback to operate when there is no other affirmative clawback rule to protect.

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

Takeaways. Of course, the phrase “including without limitation” in introducing these four scenarios leaves open the possibility that other scenarios would also be excepted from the anti-clawback rules. The description “includible in the gross estate, or treated as includible in the gross estate for purposes of section 2001(b)” ought to be quite objective and easy to apply in most cases. But some elaboration in the final regulations might be helpful.

The proposed addition to the regulations also includes seven reasonably helpful, but not particularly surprising, examples, illustrating the treatment of various combinations and amounts of gifts of cash and promissory notes, gifts to GRATs (with very untypically large gift values, by the way) and GRITs, and use of DSUE

amounts. Among other things, the examples confirm the results of the examples in the 2019 regulations that in the case of a portability election the DSUE amount is not lost and is applied before the surviving spouse's BEA.

The contemplated addition to the regulations would apply only prospectively – that is, only to the estates of decedents dying on or after April 27, 2022, the date the proposed addition was published in the Federal Register. But it should be noted that it would apply to the calculation of the future estate tax, even if the gift includible, or treated as includible, in the gross estate was made before April 27, 2022. Thus, it should be expected to first apply to the estate of someone who dies after December 31, 2025, when the “sunset” enacted in 2017 occurs, which the preamble to the proposed addition acknowledges. In that way, it would achieve the “anti-abuse” outcome described above with respect to gifts made and other lifetime actions taken since 2017 that result in estate includability, even if those lifetime actions were taken before April 27, 2022 – indeed, as early as January 1, 2018.

Number Seven: IRS Rulemaking and the Example of Syndicated Conservation Easements

Highlights. Five of these 2022 Top Ten Developments involve proposed regulations published in 2022. That is typical. So it is fitting that at least one of those discussions – this one – should include a look at the regulation process itself.

The recent flurry of litigation regarding syndicated conservation easements, including at least two important 2022 Tax Court decisions, is a fascinating context in which to examine the rulemaking process. Consider the following:

- It is obvious that what concerns (or riles) the IRS about syndicated conservation easements is its perception of extreme over-valuations. For example, recent legislative proposals to deny charitable deductions, as well as legislation itself enacted at the end of 2022 (discussed below), have been aimed at cases in which the claimed amount of a contribution by a multi-family partnership within three years after acquiring the property is greater than 2.5 times the sum of all partners' relevant bases in the partnership.
- But instead of disputing the values, the IRS approach has seemed focused on finding a technical violation of a technical requirement – often the “proceeds regulation” (Reg. §1.170A-14(g)(6)(ii)).
- And the partnerships and their partners respond with the technical argument that the proceeds regulation was promulgated in violation of the Administrative Procedure Act (APA) because the rulemaking did not “consider and respond to significant comments.” And so far that argument wins in the Eleventh Circuit, but not in the Sixth Circuit and not in the Tax Court in cases not appealable to the Eleventh Circuit.
- Meanwhile, to affirm its irritation, the IRS raised the stakes of reporting burdens and potential penalties by designating these easement transactions “listed transactions” in Notice 2017-10.
- So taxpayers argue that Notice 2017-10 was promulgated in violation of the APA too because it did not comply with the APA's notice-and-comment requirements. And this argument wins in the Tax Court.
- But the IRS comes back with the accusation that, in effect, even the Tax Court didn't consider and respond to every significant argument.

The Code. In December 1980, as part of a year-end “extenders” ritual, Congress passed Public Law 96-541, an otherwise unnamed Act captioned “An Act To extend certain temporary tax provisions, and for other purposes.” One of the six provisions of the Act made permanent a couple very limited conservation provisions that had been temporarily enacted in 1976 and 1977, and also added to the Code (permanently) most of what is now section 170(h), including section 170(h)(2)(C), which includes in the definition of a “qualified conservation contribution” the requirement of “a restriction (granted in perpetuity) on the use which may be made of the real property,” and section 170(h)(5)(A), which requires that “[a] contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.”

The Proceeds Regulation. Regulations were proposed in May 1983 and finalized in January 1986. They included Reg. §1.170A-14(g) (titled “Enforceable in perpetuity”), which elaborates those statutory mandates. Realistically and helpfully, Reg. §1.170A-14(g)(6) (titled “Extinguishment”) acknowledges, in clause (i), that sometimes “a subsequent unexpected change in the conditions surrounding the property ... can make impossible or impractical the continued use of the property for conservation purposes.” It goes on to provide a way to protect the conservation purpose in perpetuity “if the restrictions are extinguished by judicial proceeding” and upon a subsequent sale or exchange of the property the donee organization uses its share of the proceeds “in a manner consistent with the conservation purposes of the original contribution.” Reg. §1.170A-14(g)(6)(ii) – the “proceeds regulation” – provides that in the case of a donation made after February 13, 1986, the parties must agree that the donee organization’s share of the proceeds for that purpose will be no less than the same proportion of the proceeds as the value of the perpetual conservation easement restriction at the time of the gift bears to the value of the property as a whole at the time of the gift. But the regulation goes on to add that “[f]or purposes of this paragraph (g)(6)(ii), that proportionate value of the donee’s property rights shall remain constant.” In other words, for example, the donor may not adjust that proportion to reflect any improvement in the property that the donor might have made in the meantime. That requirement may not be intuitive, and it may be contrary to how typical co-ownership agreements treat improvements made by one of the co-owners. Thus, it is understandable that such a requirement might be omitted from a typical contract, including a conservation easement agreement. On the other hand, it might be reasonable to view the conservation purpose as introducing a public interest in the contract that makes it appropriate to ignore an improvement by the donor, particularly since it is likely that the donor would not have made the improvement without expecting to derive tangible or intangible benefit from it, which may not necessarily benefit the donee organization or serve the public interest in conservation.

The Administrative Procedure Act. The Supreme Court has interpreted section 4 of the APA (5 U.S. Code §553) as prescribing a three-step procedure for “notice-and-comment” rulemaking. *Perez v. Mortg. Bankers Ass’n*, 575 U.S. 92, 96 (2015). First, “[g]eneral notice of proposed rulemaking shall be published in the Federal Register” (5 U.S. Code §553(b)). Second, “the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments” (*id.* §553(c)), which in *Perez* the Supreme Court interpreted to require the agency to “**consider and respond to significant comments received during the period for public comment.**” Third, in promulgating the final rule, “the agency shall incorporate in the rules adopted a concise general statement of its basis and purpose” (5 U.S.C. §553(c)). Ultimately – perhaps ironically – in the context of syndicated conservation easements the Supreme Court’s embellishment of responding to comments, not the statutory wording itself, has become paramount.

The Proceeds Regulation and the Administrative Procedure Act. In *Hewitt v. Commissioner*, 21 F.4th 1336, 128 AFTR 2d 2021-7033 (11th Cir. Dec. 29, 2021), *rev’g and rem’g* T.C. Memo. 2020-89, the Court of Appeals for the Eleventh Circuit (Judge Lagoa) held the judicial extinguishment proceeds regulation invalid because it did not satisfy the procedural requirements of the APA. In particular, Treasury did not “respond to significant comments” regarding the proceeds regulation.

Of 90 comments on the proposed conservation easement regulations, 13 addressed the proceeds regulation, and seven specifically expressed concern that the process under the proceeds regulation “was unworkable, did not reflect the reality of the donee’s interest, or could result in an unfair loss to the property owner and a corresponding windfall for the donee.” The most detailed comment, by the New York Landmarks Conservancy (NYLC), specifically addressed inequities about applying the proposed regulation to post-donation improvements.

The Tax Court (Judge Goeke) had found that the regulation was procedurally valid, relying on its decision in *Oakbrook Land Holdings, LLC v. Commissioner*, 154 T.C. 180 (2020). *Oakbrook* included a detailed analysis of why the regulation was procedurally valid regarding the requirement that a proportionate share of post-donation improvements be shared with the easement holder if the easement was extinguished. Included in that analysis was a statement that “[t]he APA ‘has never been interpreted to require the agency to respond to every comment, or to analyze every issue or alternative raised by the comments, no matter how insubstantial.’” (quoting *Thompson v. Clark*, 741 F.2d 401, 408 (D.C. Cir. 1984)). The *Oakbrook* majority opinion

also observed that “[o]nly one of the 90 commenters” – NYLC – “mentioned donor improvements, and it devoted exactly one paragraph to this subject.”

The Eleventh Circuit observed that Treasury stated that it had “consider[ed] ... all comments regarding the proposed amendments,” but that in the “Summary of Comments” section “Treasury did not discuss or respond to the comments made by NYLC or the other six commenters concerning the extinguishment proceeds regulation,” which the Eleventh Circuit viewed as “significant” (agreeing with the dissenting Tax Court Judges Toro and Holmes). The court elaborated (citations omitted):

Because Treasury, in promulgating the extinguishment proceeds regulation, failed to respond to NYLC’s significant comment concerning the post-donation improvements issue as to proceeds, it violated the APA’s procedural requirements. We thus conclude that the Commissioner’s interpretation of § 1.170A-14(g)(6)(ii), to disallow the subtraction of the value of post-donation improvements to the easement property in the extinguishment proceeds allocated to the donee, is arbitrary and capricious and therefore invalid under the APA’s procedural requirements.

The Justice Department did not seek certiorari from the Supreme Court in *Hewitt*.

In contrast, in *Oakbrook Land Holdings, LLC v. Commissioner*, 28 F.4th 700, 129 AFTR 2d 2022-1031 (6th Cir. March 14, 2022); *aff’g* 154 T.C. 180 (2020) (reviewed by the Court), *pet. for reh’g en banc denied*, 130 AFTR 2d 2022-5017 (6th Cir. July 6, 2022), *petition for cert. filed* (S. Ct. Dkt. No. 22-323, Oct. 4, 2022), the Court of Appeals for the Sixth Circuit (Judge Moore) affirmed the Tax Court and upheld the validity of the “in perpetuity” regulation. The majority agreed with the Tax Court that the very concise statement of basis and purpose of the regulation was sufficient and that the comments, including the comment by the NYLC mentioning donor improvements, did not raise valid concerns about how the regulation served the policy of restricting the conservation easement deduction to cases where the easement’s purpose can be protected forever and “do not qualify as significant,” therefore not requiring a response under the APA. In a concurring opinion, Judge Guy stated his view that “the [in-perpetuity] regulation is procedurally invalid under the APA for substantially the same reasons stated by the Eleventh Circuit in *Hewitt* ... and by the concurring and dissenting opinions in *Oakbrook*,” but he still joined the majority in affirming the Tax Court on the basis that *Oakbrook*’s deed violated the perpetuity requirement of section 170(h)(2)(C) itself.

Oakbrook petitioned for certiorari on October 4, 2022, which the Supreme Court denied on January 9, 2023.

Listed Transactions. Section 6707A, enacted by the American Jobs Creation Act of 2004 (AJCA), in subsection (c)(1), authorizes the identification of a transaction as a “reportable transaction” if “as determined under regulations prescribed under section 6011, such transaction is of a type which the Secretary determines as having a potential for tax avoidance or evasion.” Section 6707A(c)(2) goes on to authorize the identification as a “listed transaction ... a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011.” (Section 6011 is the general statutory authority for the IRS to require the submission of information on returns and statements.) Reg. §1.6011-4(b)(2) states that “[a] listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service (IRS) has determined to be a tax avoidance transaction and **identified by notice, regulation, or other form of published guidance** as a listed transaction” (emphasis added).

Identification as a “listed transaction” means that any taxpayer participating in such a transaction must provide detailed information about that transaction to the IRS under Reg. §1.6011-4(d) (using Form 8886), and “material advisors” with respect to such a transaction, including appraisers, are also required under section 6112 to report to the IRS, including the identification of each person whom they so advised.

Under section 6707A, failure to so report can result in a penalty of 75 percent of the understatement of tax resulting from the transaction, up to a maximum penalty of \$200,000 (\$100,000 in the case of an individual). For a taxpayer required to file periodic reports with the Securities and Exchange Commission, section 6707A(e) also requires reporting of such penalties to the SEC, with an additional penalty for failure to do so.

In addition, for a listed transaction, section 6662A (also enacted by the AJCA) authorizes an additional penalty of 20 percent (30 percent if the required information was not provided) of any understatement of income tax

(calculated by multiplying the “reportable transaction understatement” amount by the highest rate under section 1, rather than the taxpayer’s actual tax rate), with no limit.

Syndicated Conservation Easements as Listed Transactions (Notice 2017-10). On December 23, 2016, the IRS issued Notice 2017-10, 2017-4 I.R.B. 544, identifying as “listed transactions” any transactions on or after January 1, 2010, that are “the same as, or substantially similar to,” the transaction the Notice described this way:

An investor receives promotional materials that offer prospective investors in a pass-through entity the possibility of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor’s investment. The promotional materials may be oral or written. ... The investor purchases an interest, directly or indirectly (through one or more tiers of pass-through entities), in the pass-through entity that holds real property. The pass-through entity that holds the real property contributes a conservation easement encumbering the property to a tax-exempt entity and allocates, directly or through one or more tiers of pass-through entities, a charitable contribution deduction to the investor. Following that contribution, the investor reports on his or her federal income tax return a charitable contribution deduction with respect to the conservation easement.

Notice 2017-10 was not limited to prospective application. For such listed transactions on or after January 1, 2010, for which the return had already been filed but the statute of limitations had not run on assessment (as in the case of the four transactions in *Green Valley Investors* discussed immediately below), the Notice required such reporting by June 21, 2017 (which the IRS later extended to October 2, 2017, by Notice 2017-29, 2017-20 I.R.B. 1243, and to October 31, 2017, by Notice 2017-58, 2017-42 I.R.B. 326).

Notice 2017-10 and the Administrative Procedure Act (*Green Valley Investors*). In *Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5 (Nov. 9, 2022) (reviewed by the Court), the Tax Court held that Notice 2017-10 is invalid for failure to comply with the notice-and-comment requirements of the APA.

In 2014 and 2015 (over a year before the IRS issued Notice 2017-10), four LLCs granted conservation easements to Triangle Land Conservancy (TLC). They deducted charitable contributions ranging from \$22,498,000 to \$22,626,000 on their respective Returns of Partnership Income (Form 1065). There was no dispute that those transactions fit the description of the listed transaction in Notice 2017-10. The IRS asserted the additional reportable transaction penalty under section 6662A, apparently not in its notices of final partnership administrative adjustments but in its answers to the petitions or other pleadings. In cross-motions for summary judgment, the LLCs challenged those penalties on the grounds that Notice 2017-10 was inappropriately retroactive and that its issuance failed to comply with the notice-and-comment requirements of the APA.

In a 15-2 decision, the full Tax Court granted that summary judgment and set aside Notice 2017-10. The majority opinion (Judge Weiler, joined by 10 other judges) relied heavily on *Mann Construction, Inc. v. United States*, 27 F.4th 1138 (6th Cir. March 3, 2022), *rev’g* 539 F. Supp. 3d 745 (E.D. Mich. 2021), in which the Sixth Circuit Court of Appeals had held that Notice 2007-83, 2007-2 C.B. 960 (Oct. 17, 2017), which designated certain employee-benefit plans featuring cash-value life insurance policies as a listed transaction, was issued in violation of the notice-and-comment procedures for legislative rules under the APA and is therefore invalid.

The majority opinion found that “[i]n sum, by its issuance, Notice 2017-10 creates new substantive reporting obligations for taxpayers and material advisors, including petitioner and the LLCs, the violation of which prompts exposure to financial penalties and sanctions – the prototype of a legislative rule” (which is subject to notice-and-comment requirements of the APA). It then rejected the IRS’s argument that in enacting section 6707A Congress authorized the IRS to identify listed transactions without notice-and-comment rulemaking, noting that section 6707A itself includes no such express indication and that the phrase “as determined under regulations prescribed under section 6011” in section 6707A(c)(1) is similarly not an express override, as required by 5 U.S.C. §559 and *Mayo Foundation for Medical Education & Research v. United States*, 562 U.S. 44, 55 (2011) (rejecting the concept of carving out unique treatment for tax law under the APA). Finally, the court found no persuasive evidence of congressional intent to override the APA in the congressional focus on syndicated conservation easements, particularly as reflected in the bipartisan “Syndicated Conservation-Easement Transactions,” STAFF OF SEN. COMM. ON FINANCE, 116TH CONG., S. PRT. 116-44 (COMM. PRINT, Aug. 2020), and its 133 exhibits, which the IRS had cited as support.

Judge Gale dissented, noting that proposed and temporary regulations under section 6011 in 2000 (Proposed Reg. §1.6011-4, 65 FED. REG. 11,269 (March 2, 2000)) had included the authority for the IRS to identify listed transactions “by notice.” See Reg. §1.6011-4(b)(2) (2003), quoted above. He reasoned (rather compellingly):

The reference to identification “by notice” is significant. A “notice” is a long recognized species of written guidance published by the Internal Revenue Service “when the Service determines that a public concern requires a speedy response” and is correspondingly “[i]ssued without public notice and comment.” Stephanie Hunter McMahon, *Classifying Tax Guidance According to End Users*, 73 Tax Law. 245, 256-58 (2020). This type of “notice” is to be distinguished from the notice entailed in notice-and-comment rulemaking enumerated in the APA. See 5 U.S.C. § 553(b).

Noting that “Congress ... cited the temporary and final regulations permitting identification ‘by notice’ in all accompanying committee reports,” he concluded “that Congress intended in section 6707A to displace the APA requirement of notice and comment for the identification of listed transactions.”

Judge Nega dissented with similar reasoning:

I disagree that Congress failed to “expressly” override the application of the APA to the IRS process incorporated into law by the AJCA. The nature of the legislation as well as the legislative history associated with it that the opinion of the Court finds unpersuasive leads me to the conclusion that Congress did not intend to enact the AJCA penalty regime subject to the time-consuming notice-and-comment procedures of the APA. In the light of congressional knowledge of the existence of the APA when enacting the AJCA, I cannot agree that Congress added a penalty regime to enforce the existing IRS rulemaking without addressing an obvious APA vulnerability, at least, to the then-listed transactions.

In footnote 22, at the end of its opinion, the *Green Valley Investors* majority stated: “Although this decision and subsequent order are applicable only to petitioner, the Court intends to apply this decision setting aside Notice 2017-10 to the benefit of all similarly situated taxpayers who come before us.”

Five days later, in *GBX Associates, LLC v. United States*, 130 AFTR 2d 2022-6440 (N.D. Ohio, Nov. 14, 2022), a federal district court in the Sixth Circuit also held Notice 2017-10 invalid but limited the application of its holding only to the party before it, noting that “there is a value in having legal issues ‘percolate’ in the lower courts.” Although five days was probably not enough time for the Tax Court’s ruling to influence the district court’s conclusion, the district court did note the Tax Court decision and quoted its footnote 22.

But the holding and reasoning in *Green Valley Investors* could have an impact far beyond similarly situated syndicated conservation easements. For example, a concurring opinion cites the IRS’s on-line source, “Recognized Abusive and Listed Transactions” (<https://www.irs.gov/businesses/corporations/listed-transactions>), which lists and describes 35 types of transactions the IRS has identified since 1990, six by Revenue Rulings, two by regulations, but most by Notices. There does not appear to be any reason why any of these would be valid under the reasoning of the *Green Valley Investors* majority. (Even the two regulations, Reg. §1.643(a)-8 regarding distributions from charitable remainder trusts and Reg. §1.7701(l)-3 regarding “fast-pay stock,” are simply substantive rules; they do not refer to transactions as “reportable” or “listed,” and they do not mention any penalties.) And the vote of the Tax Court judges – 15 to 2 – was hardly close.

But Wait – One More Thing. On December 9, 2022, a month after the Tax Court’s 15-2 ruling, the IRS filed a Motion for Reconsideration. It turns out that the IRS’s Motion for Partial Summary Judgment had been filed on December 14, 2021, but on October 19, 2022, the IRS sought leave to file a “Supplement to Respondent’s Objection to Petitioner’s Motion for Partial Summary Judgment,” pointing out, among other things, that the Sixth Circuit had decided *Mann Construction* in the meantime. But, said the IRS’s Supplement – not surprisingly – “*Mann Construction* was wrongly decided.” And because *Green Valley Investors* is likely appealable to the Fourth Circuit, *Mann Construction* is not controlling. In particular, the Supplement asserted:

The Sixth Circuit in *Mann Construction* erred in failing to consider statutory text evidencing Congress’s clear intent that such notices need not follow notice-and-comment procedures and failing to appreciate the existence and implications of the dozens of listed-transaction notices that had already been issued without notice-and-comment when the American Jobs Creation Act of 2004 ... (AJCA) [which included the penalty sections 6662A and 6707A] was enacted. ...

The *Mann* court focused exclusively on Section 6707A, but that provision was not the only part of the AJCA enacted to combat abusive tax shelters, nor the only one to endorse the IRS’s identification of listed transactions by notice.

Other provisions in the statute make clear that Congress viewed the listing notices that existed at the time the AJCA was passed – none of which had gone through notice-and-comment – as validly issued. If those notices were invalid, Congress passed dead letters.

Among those other AJCA provisions was Section 6501(c)(10), which ... holds the statute of limitations for assessing a tax deficiency open until one year after the taxpayer's participation in a listed transaction was disclosed. ... If Congress believed the existing notices identifying listed transactions were invalid, then there would have been no listed transaction to which Section 6501(c)(10) could apply when AJCA was enacted.

(As noted above, two of the "Recognized Abusive and Listed Transactions" in the IRS on-line source cited above were identified in regulations, not notices, but they do not refer to transactions as "reportable" or "listed," and they do not mention any penalties.)

On November 2, the court granted the IRS's October 19 request for leave to file its Supplement. Then it issued its fully reviewed Opinion just one week later, on November 9, without any mention of the IRS's Supplement or the arguments it contained. The Motion for Reconsideration states:

The lack of any mention in the Opinion of Respondent's Supplement, and the fact that there is no mention of the new arguments in the majority opinion, the two concurring opinions or the two dissents, suggests that Respondent's Supplement may not have been circulated to the entire Court during its consideration of Petitioner's Motion.

...

The Court's Opinion states that it is based on a consideration of "the statutory text before [the Court]." However, the Opinion fails to mention or discuss the additional statutory text highlighted in Respondent's Supplement, making it unclear whether the Court actually did consider all of the statutory text before it and raising a doubt about whether the Court would have reached the same conclusion if it had considered this additional statutory text. This uncertainty about the basis for the Court's conclusion in a fully reviewed decision is unusual and warrants reconsideration by the full Court, especially in light of the Court's stated intent to apply its decision to all similarly situated taxpayers [see the court's footnote 22 quoted above], the large number of docketed cases that will be affected by the Court's opinion, and the fact that the validity of Notice 2017-10, and other notices issued under the authority of I.R.C. §§ 6011 and 6707A and Treas. Reg. § 1.6011-4(b)(2), is a matter of significant importance to the detection and prevention of abusive tax avoidance schemes.

In other words, ironically echoing the Eleventh Circuit's criticism in *Hewitt* that Treasury and the IRS "**did not discuss or respond to** the comments made by NYLC or the other six commenters concerning the extinguishment proceeds regulation," the IRS argues that the Tax Court **did not discuss or respond to** its Supplement. Yet, with only a week intervening, and considering the logistic challenges of a fully reviewed opinion with concurrences and dissents, the IRS seems to have a point. But the real question is whether the arguments in the Supplement would have changed what became a 15-2 decision.

Meanwhile, What About Those Valuations? We are still waiting for a syndicated conservation easement case to address the valuation issue. In 2022, there was one valuation case, *Champions Retreat Golf Founders, LLC v. Commissioner*, T.C. Memo. 2022-106 Oct. 17, 2022), *on remand from* 959 F.3d 1033 (11th Cir. 2020), *vac'g and rem'g* T.C. Memo. 2018-146. The Tax Court (Judge Pugh) determined that the value of the easement was about 75 percent of what the taxpayer had claimed, but that case did not involve a syndicated conservation easement.

Mirroring Notice 2017-10 in Proposed Regulations. On December 6, 2022, the IRS released proposed regulations to identify certain syndicated conservation easements as "listed transactions." Proposed Reg. §1.6011-9, REG-106134-22, 87 FED. REG. 75185 (Dec. 8, 2022). The preamble cites *Mann Construction* and *Green Valley Investors*, affirms that Treasury and the IRS disagree with those decisions, but notes that they are issuing these proposed regulations "to eliminate confusion and ensure consistent enforcement of the tax laws throughout the nation." The description of the subject transaction in Proposed Reg. §1.6011-9(b) is substantially the same as the description in Notice 2017-10. In addition, Proposed Reg. §1.6011-9(d) **strengthens** the application of that description by (1) extending the promotional offer "of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment" in a pass-through entity to include any piece of promotional materials that "suggests or implies" such a deduction, (2) creating a rebuttable presumption that there was such an offer if the claimed charitable deduction in fact exceeds two and one-half times the investment, and (3) applying the calculation

only to the portion of the entity attributable to the real estate in question (thereby preventing avoidance of the test by “stuffing” other assets into the entity).

The 2022-2023 Treasury-IRS Priority Guidance Plan, released November 4, 2022, under the heading of “General Tax Issues,” includes a project described, without further explanation, as “Guidance under §170 regarding conservation easements, including façade easements.” Because this was issued before the Tax Court’s *Green Valley Investors* opinion (albeit by less than a week), and it includes a reference to façade easements, it probably contemplates more general guidance, not the December 6 proposed regulations.

Legislation. The “omnibus” Consolidated Appropriations Act, 2023 that President Biden signed on December 29, 2022, included a provision similar to the bipartisan “Charitable Conservation Easement Program Integrity Act,” most recently introduced June 24, 2021, as S. 2256 by Senator Steve Daines (R-Montana), Senator Debbie Stabenow (D-Michigan), and Senate Finance Committee Chair Ron Wyden (D-Oregon) and former Chair Chuck Grassley (R-Iowa), and as H.R. 4164 by Representatives Mike Thompson (D-California) and Mike Kelly (R-Pennsylvania). (Both bills had gained additional cosponsors from both parties.) It is also similar to a proposal in the Treasury Department’s “General Explanations of the Administration’s Fiscal Year 2023 Revenue Proposals” (popularly called the “Greenbook”) released on March 28, 2022.

This enacted provision denies a partner a deduction that exceeds 2.5 times the applicable portion of that partner’s basis in the partnership for any contribution made within three years of the partnership’s acquisition of the real property or the partner’s acquisition of the interest in the partnership, unless substantially all of the partnership interests are held by the same family. It also provides that, “[e]xcept as may be otherwise provided by the Secretary,” the new rules “shall apply to S corporations and other pass-through entities in the same manner as such rules apply to partnerships.” But the legislation exempts contributions that preserve certified historic structures if the entity making the contribution reports the contribution and provides required information about it on its current return.

The legislation also strengthens the rules on accuracy-related penalties by

- treating any disallowance under these new rules as a “gross valuation misstatement,” which thereby doubles the penalty under section 6662 from 20 percent to 40 percent of the underpayment;
- eliminating any defense based on reasonable cause under section 6664(c); and
- eliminating the requirement for supervisory approval of the penalty assessment under section 6751(b).

And the legislation explicitly provides that the transactions it covers shall be treated as listed transactions for purposes of sections 6501(c)(10) and 6235(c)(6), meaning that that statute of limitations on assessments and on partnership adjustments shall not run until one year after the IRS has been furnished the information it requires regarding listed transactions.

Unlike the “Charitable Conservation Easement Program Integrity Act” and the Greenbook proposal, which tied the effective date to the publication of Notice 2017-10, the enacted legislation applies only to contributions made after December 29, 2022, the date of enactment, although it adds that “[n]o inference is intended as to the appropriate treatment of contributions made in taxable years ending on or before” that date (curiously seeming to skip contributions made between January 1 and December 29, 2022).

The legislation also provides that “[t]he Secretary of the Treasury (or such Secretary’s delegate) shall, within 120 days after the date of enactment of this Act, publish safe harbor deed language for extinguishment clauses and boundary line adjustments,” and that a signed and recorded amendment of an easement deed to add that safe harbor language within 90 days after the safe harbor language is published will be respected if it is treated as effective as of the date of the recording of the original easement deed. That relief is not available, however, for a claimed deduction of 2.5 times basis within three years that is denied by this legislation, or if the contribution is the subject of a case already docketed in the Tax Court or another federal court or for which a penalty has already been determined administratively or judicially. And, interestingly, this relief is not available for any contribution “which (I) is part of a reportable transaction (as defined in section 6707A(c)(1) ...), or (II) is described in Internal Revenue Service Notice 2017-10.”

The staff of the Joint Committee on Taxation estimated that this legislation would raise revenue by \$6.435 billion over 10 fiscal years (2023 through 2032). Interestingly, what might be viewed as the “long-term” effect (in fiscal years 2027-2032) averages about \$527.5 million per fiscal year and increases by a consistent \$11 million each year. The estimated annual revenue increases in fiscal years 2024-2026 average about \$980 million, while the estimated increase in revenue for fiscal year 2023 is \$333 million. (Only a few of the provisions in the Act are estimated to substantially raise revenue in fiscal year 2023, probably because much of the revenue effects would ordinarily not be observed until 2023 returns are filed in 2024.) The striking front-loading of the revenue estimates for the syndicated conservation easement legislation may be attributable to its impact on cases already pending, even though the legislation is generally prospective only and its only retroactive application appears to be the addition of safe harbor language to deeds in non-docketed cases.

Controversy. The issues related to syndicated conservation easements (at least those granted on or before December 29, 2022) continue to produce contrasting reactions – some seeing aggressiveness on the part of the promoters and some seeing aggressiveness on the part of the IRS. For a sampling of the most recent commentaries, see Katherine S. Jordan, “Appraisers as Collateral Damage in the Syndicated Conservation Easement War,” 177 TAX NOTES FEDERAL 837 (Nov. 7, 2022) (*but see* Roger A. Pies, “Conservation Easement Appraisers – A Problem That Needs Treatment,” Letter to the Editor, 177 TAX NOTES FEDERAL 1411 (Dec. 5, 2022)); Hale E. Sheppard, “New Cases Bolster Special Valuation Methods for Conservation Easements,” 177 TAX NOTES FEDERAL 1107 (Nov. 21, 2022); Mitchell A. Kane, “The Dispute Over Perpetual Conservation Easements Just Got Worse,” 177 TAX NOTES FEDERAL 1211 (Nov. 28, 2022) (published after *Green Valley Investors*, but focused on *Oakbrook Land Holdings* and does not mention *Green Valley Investors*). Regarding reactions to the legislation, see Kristen A. Parillo, “Updated Easement Proposal Lands in Omnibus Bill,” 178 TAX NOTES FEDERAL 113 (Jan. 2, 2023).

Takeaways. The now prospectively codified rejection of deductions within three years of acquisition that exceed 2.5 times basis invites some interesting comparisons. It applies, for example, to taxpayers with a basis equal to their investment of \$400,000 who claim a deduction greater than \$1,000,000 for a contribution within three years. Assuming a combined federal and state income tax rate of 40 percent, such a deduction would save such a taxpayer more in taxes than the amount of the investment, thus theoretically leaving the taxpayer without a net expense at all. This example also shows how extreme such a claimed deduction would be. It means not only that the property must have appreciated an astounding 2.5 times (*e.g.*, proportionately from \$400,000 to \$1,000,000), but that it has appreciated so much more that the **difference** between its value before the contribution (without the easement) and its value after the contribution (encumbered by the easement) exceeds 2.5 times the acquisition price. Truly it is not hard to see why such astounding appreciation looks suspicious.

While 2.5 times seems astoundingly high, however, the new rule does not preclude the IRS from challenging valuations that produce contributions that do not exceed 2.5 times basis. But will that work in the other direction? What if, because of dramatic unforeseen events, the purchased property does legitimately appreciate so much, and an easement contribution does reduce the new value so much, that a contribution of more than 2.5 times basis is justified? The legislation does not seem to allow for that; in fact, it seems to even deny “reasonable cause” relief from penalties in such a case. While the occasion for addressing this issue would be very rare indeed, it cannot be said to be impossible, and, if it arises, something has to give.

Meanwhile, with over 425 syndicated conservation easement cases docketed as of last February, Tax Court judges are reportedly considering streamlining options, such as trying cases together, picking out test cases, or assigning clusters of similar cases to particular judges. See Aysha Bagchi, “Tax Court Pondering Three Options for Ballooning Easement Docket,” BLOOMBERG DAILY TAX REPORT (Dec. 16, 2022). Because the 2022 legislation is prospective, it does not specifically apply to these pending cases, except to deny relief for amendments that follow the contemplated deed language. But the arguments in those pending cases can already be imagined:

- See, Congress has affirmed Notice 2017-10 that we are asking the court to apply!
- See, it took a specific Act of Congress to finally affirm Notice 2017-10, but only prospectively, and Congress still has not explicitly waived the APA requirements that applied to the promulgation of Notice 2017-10 in the first place!

So the drama isn't over.

Number Six: Courts Back Off from Allowing Mandatory Arbitration (*Boyle* (VA), *Hekemian* (NJ))

Highlights. Mandatory binding arbitration provisions are specifically authorized in wills and trust instruments in some states by statute, which seems to be the appropriate source of such authority. In 2013, the Texas Supreme Court, in a questionable opinion, perceived such authority in a general arbitration statute not aimed at wills and trusts. Now courts in other states are refusing to indulge such an overreach.

***Rachal* (Texas 2013).** The Texas case was *Rachal v. Reitz*, 403 S.W.3d 840 (Tex. 2013). The lawyer who drafted a revocable trust instrument with an arbitration clause became the successor trustee after the grantor's death. When sued by one of the decedent's children for misappropriation of assets – not the best fact pattern! – he invoked the arbitration clause and moved to compel arbitration. The trial court denied the motion, and the court of appeals affirmed. But the Texas Supreme Court reversed and enforced the arbitration clause, reasoning that the Texas Arbitration Act requires only an “agreement,” not a “contract” to enforce an arbitration clause. To the court, a “contract” requires consideration and meeting of the minds, but an “agreement” requires only mutual assent, which can be achieved through accepting one's rights under the terms of the trust, through the principle of direct benefits estoppel. Thus, as the court saw it, a beneficiary who accepts any benefits under a trust is estopped from challenging the validity of the arbitration clause. What's more, the court discerned that “Federal and state policies favor arbitration,” citing three cases from other jurisdictions. But two of those cases it cited involved commercial transactions (a pooled mortgage trust and a deed of trust rider), and in the third case, the parties had agreed to arbitration, leaving *Rachal* on a very weak foundation indeed.

Rachal's Progeny. In *Ali v. Smith*, 554 S.W.3d 755 (Tx. Ct. App. 2018), a lower Texas appellate court cited *Rachal* as a case “enforcing arbitration provision in a trust based on theory of direct-benefits estoppel” and then distinguished *Rachal* and affirmed the trial court's denial of arbitration because “Ali failed to meet his burden to show the existence of a valid arbitration agreement amongst non-signatories based on a theory of direct-benefits estoppel.”

In *Gibbons v. Anderson*, 575 S.W.3d 144 (Ark. Ct. App. Div. III April 3, 2019), a case involving a claim that an amendment of a revocable trust was invalid because it had been obtained by undue influence, an Arkansas appellate court cited *Rachal* but declined to follow it because it “did not involve a contest over the validity of the trust itself.” Almost seven months later, another division of the Arkansas appellate court cited *Rachal* and reached the same result as *Rachal* in *Bazazzadegan v. Vernon*, 588 S.W. 3d 796 (Ark. Ct. App. Div. IV Oct. 30, 2019), a case involving alleged breach of trust and misappropriation of trust funds.

Other cases that have enforced arbitration clauses in the absence of a specific state statute include *Whipple v. Whipple (In re Kent and Jane Whipple Trust)*, No. 69945, 2017 WL 2813974 (Nev. 2017) (decided two years before Nevada enacted a specific statute, not citing *Rachal*).

Other cases that have refused to compel arbitration include *McArthur v. McArthur*, 224 Cal. App. 4th 651, 168 Cal. Rptr. 3d 785 (2014) (citing *Rachal* but finding no actual or implied consent to arbitration), and *Burgess v. Johnson*, 835 Fed. Appx. 330 (10th Cir. Nov. 4, 2020) (citing *Rachal* but construing an arbitration clause to allow the trustee only to accept arbitration, not to compel others to do so).

Now *Boyle* (Virginia 2022). *Boyle v. Anderson*, 871 S.E.2d 226 (Va. April 14, 2022), offers a robust rebuke to the notion that an arbitration statute not explicitly focused on wills and trusts can authenticate even an unambiguous arbitration mandate in a trust instrument. Strother Anderson had created an *inter vivos* irrevocable trust that was to be divided into three shares: one for his daughter Sarah Boyle (who was also the successor trustee), one for his son John, and one for the children of his third child Jerry. The trust instrument provided that “[a]ny dispute that is not amicably resolved, by mediation or otherwise, shall be resolved by arbitration.” Linda Anderson, the widow of John Anderson and the ancillary administrator of John's estate, filed a complaint against Sarah, alleging that Sarah had breached her duties as trustee. The complaint sought, among other things, Sarah's removal or, in the alternative, an order that she comply with the terms of the trust. In response, Sarah filed a motion to compel arbitration, which Linda opposed, contending that the trust

was not a contract and that she had not agreed to resolve the dispute by arbitration. The circuit court denied the motion to compel arbitration. Sarah filed an interlocutory appeal.

The Virginia Supreme Court held that the arbitration clause in the trust was not enforceable. The court began its analysis this way:

Access to the courts to seek legal redress is a constitutional right. *See* Va. Const. art I § 12; *see also Mission Residential, L.L.C. v. Triple Net Properties, L.L.C.*, 275 Va. 157, 161 (2008). Like many other constitutional rights, however, the right of access to the courts can be waived. *Id.* Parties can opt out of resolving their disputes in court and choose instead to submit their disputes to resolution through mediation or arbitration. However, “[a] party cannot be compelled to submit to arbitration unless he has first agreed to arbitrate.” *Doyle & Russell, Inc. v. Roanoke Hosp. Ass’n*, 213 Va. 489, 494 (1973).

The court acknowledged that the Virginia Uniform Arbitration Act (VUAA) “establishes a public policy in favor of arbitration” and that it “applies to both a ‘written agreement to submit any existing controversy to arbitration’ and to ‘a provision in a written contract to submit’ a controversy to arbitration” (quoting the statute). But, stated the court, “a trust does not qualify as a contract or agreement. Trusts are generally conceived as donative instruments” creating “a fiduciary relationship with respect to property.” The court elaborated (citations omitted):

Beyond this longstanding conception of trusts, contracts and trusts differ in how they are formed. The existence of the contract depends on actual acceptance of an offer. It is founded on mutual assent. A trust is in the nature of a conveyance of an equitable interest, and its formation is not dependent on the beneficiary’s knowledge or acquiescence. Additionally, trusts differ from contracts in that no consideration is required for the creation of a trust. In fact, most trusts are created by gratuitous transfer. Beneficiaries of a trust generally do not provide any consideration to the settlor of the trust.

Additionally, the duties owed by contracting parties also differ from the fiduciary duties a trustee owes to the beneficiaries of the trust. ... In contrast to the fiduciary duties owed by a trustee, no rule prevents parties to a contract from acting freely for their own interests during the execution of the contract. They have no duty of loyal representation of the opposing party in the relationship. A beneficiary’s action against a trustee is properly brought as a claim for breach of fiduciary duty rather than as a breach of contract.

Third, ownership of property in a trust differs from ownership of property in a contract. One of the major distinguishing characteristics of a trust is divided ownership of property, the trustee usually having legal title and the beneficiary having equitable title. This stands in contrast to the law of contracts, where this element of division of property interest is entirely lacking. Additionally, the rights and duties of parties to a contract generally may be freely transferred. A trustee, on the other hand, cannot assign the trusteeship or delegate the performance of fiduciary duties except as permitted by statute.

... The VUAA does not apply to all arbitration clauses. It applies to “a provision in a written contract.” We conclude for all these reasons that a trust is not a contract.

The VUAA also requires arbitration for “[a] written agreement to submit any existing controversy to arbitration.” An “agreement” is “[a] mutual understanding between two or more persons about their relative rights and duties regarding past or future performances; a manifestation of mutual assent by two or more persons.” Assuming without deciding that a trustee’s obligations might constitute an “agreement” under the VUAA, the beneficiary of a trust is not a party to a “written agreement to submit any existing controversy to arbitration agreement.” If the beneficiary has not agreed to submit the case to arbitration, there is no “agreement” and the VUAA does not compel arbitration for a suit brought by the beneficiary of the trust.

The court similarly disposed of alternative claims under the Federal Arbitration Act (FAA). The *Boyle* opinion did not cite *Rachal*.

And Estate of Hekemian (New Jersey 2022). Meanwhile, in *In re Hekemian*, No. P-479-21 unpublished (Superior Court Feb. 7, 2022) a trial court had reached the same conclusion with respect to a comprehensive arbitration clause in a will, under which several trusts were to be created.

After the will was probated, one of the four sons of the decedent requested “an early distribution, or a loan, or combination of two, from the Trusts.” The co-executors (one of the decedent’s other sons and “a longtime friend, family advisor, and attorney”) denied the request. The beneficiary then sued to enforce his rights as a beneficiary and to compel an accounting. The co-executors moved to compel arbitration of the claims.

The court acknowledged that “[t]he affirmative policy of the state of New Jersey favors arbitration as a mechanism for resolving disputes” and that “there is ample case law that discusses New Jersey’s ‘strong public policy ... favoring arbitration.’” “Moreover,” the court added, “a hallmark principle that guides probate matters in New Jersey is that a decedent’s intentions are to be honored and effectuated.” The court also cited *Rachal*. Nevertheless, the court refused to compel arbitration of the claims, reasoning as follows (citations omitted):

The New Jersey Arbitration Act ... provides “[a]n agreement contained in a record to submit to arbitration any existing or subsequent controversy arising between the parties to the agreement is valid, enforceable, and irrevocable, except upon a ground that exists at law or in equity for the revocation of a contract.” However, the favored status of arbitration “is not without limits.”

Importantly, a court in New Jersey must first apply “state contract-law principles ... [to determine] whether a valid agreement to arbitrate exists.”

As Plaintiff correctly points out, in determining whether an arbitration agreement is enforceable, a New Jersey Court’s initial inquiry must be “whether the agreement to arbitrate all, or any portion of a dispute is the product of mutual assent, as determined under customary principles of contract law.”

Here, there is a lack of mutual assent regarding the ... arbitration clause. The [will] is a statement of testamentary intent, not an instrument that reflects a consensual understanding between parties. In short, a will is not a contract, nor is it an agreement as defined in *Rachal*.

...

New Jersey case law is guided by the principle that unless both parties are signatories to the agreement, one party may not compel the other party to arbitrate unless the benefits of the underlying arbitration agreement have extended to the non-signatory party “based on the traditional principles of contract and agency law.”

Applied to the instant case, Plaintiff cannot be compelled to arbitrate because (1) the will is not a contract between two parties in the traditional sense and (2) the benefits of the will have not extended to the Plaintiff based on the “traditional principles of contract and agency law.” Plaintiff has not agreed to arbitrate disputes concerning the [will] because the [will] is not a contract or an agreement of consensual understanding between two parties.

Number Five: Disqualification of a GRAT Over Valuation Process (CCA 202152018, *Baty*)

Highlights. It might seem that Chief Counsel Advice 202152018 was a 2021 development, not 2022. But it was released on Thursday, December 30, 2021, and it is probably safe to assume that it was not noticed, or at least was not discussed, by many estate planners until 2022. Moreover, it is best understood when read in conjunction with a Tax Court case that was indeed settled in 2022. So this discussion begins with that case.

Background: *Baty* and Chief Counsel Advice 201939002. Chief Counsel Advice (CCA) 201939002 (issued May 28, 2019; released Sept. 27, 2019) concluded that stock on a listed exchange transferred to a GRAT by the co-founder and chairman of the board of the corporation had to be valued for gift tax purposes by taking into consideration an anticipated merger of the underlying company that was expected to increase the value of the stock. On his gift tax return, the donor had valued the shares under Reg. §25.2512-2(b)(1) at the mean between the highest and lowest quoted selling prices on the date of the gift. Reg. §25.2512-2(e) provides that if the value determined from the mean between the high and the low selling prices does not represent the fair market value of the shares, then some reasonable modification of the value shall be considered in determining fair market value. The CCA reasoned:

The principle that the hypothetical willing buyer and seller are presumed to have “reasonable knowledge of relevant facts” affecting the value of property at issue applies even if the relevant facts at issue were unknown to the actual owner of the property. *Estate of Kollsman v. Commissioner*, T.C. Memo. 2017-40, [*aff’d*, 123 AFTR 2d 2019-2296 (9th Cir. June 21, 2019)]. Moreover, both parties are presumed to have made a reasonable investigation of the relevant facts. *Id.* Thus, in addition to facts that are publicly available, reasonable knowledge includes those facts that a reasonable buyer or seller would uncover during the course of negotiations over the purchase price of the property. *Id.* Moreover, a hypothetical willing buyer is presumed to be “reasonably informed” and “prudent” and to have asked the hypothetical willing seller for information that is not publicly available. *Estate of Kollsman*, *supra*.

...

... Under the fair market value standard as articulated in § 25.2512-1, the hypothetical willing buyer and willing seller, as of [the date the GRAT was funded], would be reasonably informed during the course of negotiations over the purchase and sale of Shares and would have knowledge of all relevant facts, including the pending merger. Indeed, to ignore the facts and circumstances of the pending merger would undermine the basic tenets of fair market value and yield a baseless valuation.

The CCA failed to even mention that federal securities laws may have prohibited the donor from disclosing confidential information regarding the merger because he was the chairman of the board of the publicly traded corporation. On the other hand, it is interesting that the CCA focuses on the “hypothetical willing buyer” being “presumed to be reasonably informed.” In fact, it is the hypothetical willing seller who, knowing about the merger discussions, would not have sold at the price used for the GRAT valuation. Of course a hypothetical willing buyer would have bought at that understated price if possible.

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

Chief Counsel Advice 202152018. Chief Counsel Advice 202152018 (issued Oct. 4, 2021; released Dec. 30, 2021) involved the founder of what the CCA described as a “very successful company, Company,” who transferred shares of Company to a two-year GRAT. The required annuity payments, as the CCA described them, were “a fixed percentage of the initial fair market value of the trust property.” The CCA did not specifically state that that was the fair market value as finally determined for federal tax purposes, as described in Reg. §25.2702-3(b)(1)(ii)(B), but it is hard to believe that it wasn’t, when that description of the annuity payments in the CCA immediately follows the description of the GRAT as “a two-year grantor retained annuity trust (GRAT), the terms of which appeared to satisfy the requirements for a qualified interest under § 2702 and the corresponding regulations.”

The value used for the transferred shares was based on an appraisal as of a date about seven months earlier that had been obtained to report the value of a nonqualified deferred compensation plan under section 409A. Prior to the transfer to the GRAT, however, the donor had been negotiating with several corporations about a possible merger and had received offers from five different corporations within two and a half weeks before the transfer to the GRAT. Within three months after the initial offers, four of the corporations had submitted higher offers, and, three months after that, the donor accepted one of the offers, an initial cash tender offer for some of the outstanding shares at an amount that was nearly three times greater than the value used for the GRAT, with an option to purchase the remaining shares under a formula valuation.

Several weeks prior to closing the tender-offer purchase, the donor had given shares to a charitable remainder trust and valued the shares pursuant to a qualified appraisal (under section 170(f)(11)) at an amount equal to the tender-offer value. The charitable remainder trust also took advantage of the tender offer.

About six months after the end of the GRAT’s two-year term, the purchasing corporation purchased the balance of Company’s shares at a price per share almost four times the value used for the GRAT valuation.

CCA 202152018 has analysis very similar to the reasoning in CCA 201939002. Indeed, the following conclusion in CCA 202152018 is almost word for word the same as the corresponding conclusion in CCA 201939002 quoted above, **except for the additional 17 words (emphasis added) at the end:**

Under the fair market value standard as articulated in § 25.2512-1, the hypothetical willing buyer and willing seller, as of [the date the GRAT was funded], would be reasonably informed during the course of negotiations over the purchase and sale of the shares and would have knowledge of all relevant facts, including the pending merger. Indeed, to ignore the facts and circumstances of the pending merger undermines the basic tenets of fair market value and yields a baseless valuation, **and thereby casts more than just doubt upon the bona fides of the transfer to the GRAT.**

That addition is a big further step, which treats the GRAT annuity as not being a qualified interest because of the undervalued appraisal used to determine the annuity amounts that were payable by the GRAT over its two-year term. Accordingly, the donor would be treated as making a gift equal to the full finally determined value of the shares transferred to the GRAT, without any offset for the value of the retained annuity payments, even though those annuity payments would come back to the grantor and be included in the grantor’s gross estate. Much worse than even an outright gift.

The CCA reasoned by analogy to *Atkinson v. Commissioner*, 115 T.C. 26 (2000), *aff'd*, 309 F.3d 1290 (11th Cir. 2002). In *Atkinson*, no annuity payments were actually made from a charitable remainder annuity trust during the two years from the creation of the CRAT until the donor's death. Although the terms of the trust met the statutory requirements for five percent annual distributions, the trust did not operate in accordance with those terms, and the court denied an income tax charitable deduction. On appeal, the taxpayer argued that the deduction was denied because of a "foot fault," or a minor mistake, but the appellate court concluded that the trust had failed to comply with the rules governing CRATs throughout its existence and denied the deduction. The deduction was denied because of the manner in which the trust was operated, even though the trust document itself met the technical requirements for CRATs.

Similarly, CCA 202152018 reasoned that basing the annuity payments on an undervalued appraisal was an "operational failure" that prevented the donor's interest in the GRAT from being a qualified annuity interest under section 2702, apparently even if the GRAT document included a formula, specifically authorized by Reg. §25.2702-3(b)(1)(ii)(B), to adjust the annuity payments to a specified percentage of the initial fair market value of assets contributed to the GRAT, as finally determined for federal tax purposes. Immediately following the conclusion quoted above, which echoes CCA 201939002, the CCA stated (emphasis added):

In addition, although the governing instrument of Trust appears to meet the requirements in § 2702 and the corresponding regulations, **intentionally** basing the fixed amount required by § 2702(b)(1) and § 25.2702-3(b)(1)(i) on an **undervalued** appraisal causes the retained interest to fail to function exclusively as a qualified interest from the creation of the trust. The trustee's failure to satisfy the "fixed amount" requirement under § 2702 and § 25.2702-3(b)(1)(ii)(B) is an operational failure because the trustee paid an amount that had no relation to the initial fair market value of the property transferred to the trust; instead, the amount was based on an outdated and **misleading** appraisal of Company, at a time when Company had received offers in the multi-billion dollar range. When asked about the use of the outdated appraisal, the company that conducted the appraisal stated only that business operations had not materially changed during the 6-month period. In contrast, in valuing the transfer to the charitable trust, the company that conducted the appraisal focused only on the tender offer, and accordingly gave little weight to the business operations for valuation purposes.

The operational effect of **deliberately** using an undervalued appraisal is to **artificially** depress the required annual annuity. Thus, in the present case, the **artificial** annuity to be paid was less than 34 cents on the dollar instead of the required amount, allowing the trustee to hold back tens of millions of dollars. The cascading effect produced a **windfall to the remaindermen**. Accordingly, because of this operational failure, Donor did not retain a qualified annuity interest under § 2702. See *Atkinson*.

A "windfall" to the remainder beneficiaries! In a GRAT of all things! Imagine that!

The nature of a CCA, and a frequent challenge in understanding a CCA, is that it arises from a specific audit of a specific case, and therefore possibly with a specific back-story, not revealed in the CCA itself, as well as the motivation of the Chief Counsel's Office to build the strongest possible case for potential litigation. Perhaps the IRS concern in this CCA was not so much with the appraised value but with the process. The donor appears to have used a valuation that the donor knew was seven months out of date, prepared for another purpose, and which substantially undervalued the shares because of intervening events (obviously unknown to the appraiser and perhaps at that time even to the donor), even though the same donor showed the necessary initiative and diligence to obtain a qualified appraisal for the subsequent gift to a charitable remainder trust when the higher value would be beneficial.

In fairness to the donor and the appraiser, however, it should be noted, as the CCA noted, that, when asked to explain, the company that conducted the appraisal stated:

The appraisal used for the GRAT transfer was only six months old, and business operations had not materially changed during the 6-month period ... For the charitable gifts, under the rules for Form 8283, in order to substantiate a charitable deduction greater than \$5,000, a qualified appraisal must be completed. Because of this requirement an appraisal was completed for the donations ... to various charities.

Although there are anecdotal reports of increasingly aggressive IRS audits of GRATs (see Jonathan Curry, "Estate Planners Ponder IRS's 'Overaggressive' GRAT Slapdown," 174 TAX NOTES FEDERAL 1142 (FEB. 21, 2022)), the IRS's extreme reaction in this case, seemingly ignoring even its own regulations about adjusting annuity payments to match redetermined values, may be explained by the perceived lack of any good faith effort whatsoever to determine the initial value, and perhaps by other facts in the case as well.

Takeaways. The obvious generic lesson from CCA 202152018 is to not try to cheat in the hope of getting away with it. There is a big difference between just getting the value of an asset wrong and wrongly not getting the asset valued at all.

But there are also lessons more specific to the design of GRATs and the drafting of GRAT instruments. The first is to include the provision for recalibration of the annuity payment on the basis of finally determined gift tax values that is specifically authorized by Reg. §25.2702-3(b)(1)(ii)(B). The second is to consider keeping the GRAT in existence after the annuity term ends, so that recalibration can be made if necessary and the grantor made whole by the trust. This is especially important for the typical short-term GRAT. It is almost certain, for example, that the gift tax audit will not have produced a final determination of value before the end of a two-year annuity term. The third lesson is to ensure that the trust is a grantor trust, both during the GRAT term (which may be almost automatic) and after the GRAT term has ended (which may have to be intentionally and carefully provided for), in order to both simplify the final annuity payment in kind and also, where income-producing property is involved, allow the recalibration based on finally determined gift tax value without having to amend income tax returns that reflected a different ownership for income tax purposes in the interim.

Number Four: Other Changes and Challenges in the Components of Valuation

Highlights. The year 2022 saw other interesting developments that affect the tools estate planners use in valuations for estate, gift, and income tax purposes. These developments spotlight interest rates, mortality tables, and defined value clauses in ways that invite careful reflection in selecting and designing transfer techniques.

Interest Rates

First, we transition from the discussion of GRATs by noting that estate planners may begin to transition from the use of GRATs, because prevailing interest rates, which determine the “hurdle rate” of growth a GRAT must exceed to be successful, are again rising. Using as a reference the section 7520 rate (which is 120 percent of the monthly federal midterm rate determined under section 1274(d)(1), rounded to the nearest 2/10ths of 1 percent), we started 2022 at 1.6 percent in January and ended 2022 at 5.2 percent in December. It more than tripled in one year. But even the 1.6 percent in January was four times the 0.4 rate we experienced in August through November 2020. The December 2022 rate of 5.2 percent was 13 times that historic low rate. Even so, the 5.2 percent rate was less than half the 10.6 percent rate that was in effect when the GRAT rules of section 2702 were enacted in November 1990. By the way, it has never been that high since November 1990, and it has not even been as high as December’s rate of 5.2 percent since November 2007.

So from one perspective rates have recently been at historic lows. From a longer-term perspective they are relatively high. From an even longer-term perspective they might actually still seem to be low. And to complicate the analysis further, we learned in December that the January 2023 rate was dropping to 4.6 percent (which, except for November and December 2022, is still the highest rate since 2007).

Takeaways. The monthly published federal rates have a very significant, often dispositive, but usually predictable impact on the feasibility of estate planning techniques. Life estates and term interests are more valuable when interest rates are higher, but remainder interests are generally more valuable when interest rates are lower. Thus, lower interest rates are better for GRATs while higher interest rates are better for QPRTs. With lower interest rates, the amount of an annuity required to zero-out a charitable lead annuity trust (CLAT) is lower. But with higher interest rates, the charitable deduction for a charitable remainder annuity trust (CRAT) is higher (because the CRAT has a fixed dollar annuity amount paid currently to non-charitable beneficiaries while the CRAT is assumed to grow before those payments at the higher section 7520 rate, resulting in a larger remainder value). In addition, it is easier to satisfy the at least 10 percent remainder test of section 664(d)(1)(D) and the no greater than 5 percent probability of exhaustion test of Reg. §§20.2055-2(b)(1) and 25.2522(c)-3(b) and Rev. Rul. 70-452, 1970-2 C.B. 199. See Edward Tully & Jim Thomson, “Estate Planning Techniques in a High-Interest-Rate Environment,” BLOOMBERG DAILY TAX REPORT (Dec. 23, 2022).

Applicable federal rates are routinely published in the third week of the preceding month, often early in the week, thereby providing about 10-15 days to compare the next month's rates with the current rate and decide whether to proceed with a transfer that has been under consideration. In calculating a charitable deduction for a portion of a transfer, such as in the case of a charitable lead trust or charitable remainder trust, section 7520(a) allows the choice of the 7520 rate for either the month of the transaction or one of the two preceding months. Thus, in such a case, an estate planner would ordinarily choose either the highest or the lowest of those three monthly rates, depending on which works best for that particular kind of transfer.

Finally, it is important to remember that the interest rate is just one consideration in the selection of an estate planning technique and the timing of its implementation. Many other factors enter into determining what is best for any particular client in any particular situation.

Actuarial Tables: Proposed Regulations

New mortality tables for section 7520 and other purposes, based on 2010 census data, are applied in lengthy proposed regulations released on May 4, 2022. REG-122770-18, 87 FED. REG. 26806 (May 5, 2022). The new tables are available on the IRS website at <https://www.irs.gov/retirement-plans/actuarial-tables>. The 2010 census data on which these new tables are based show significantly increased longevity, especially for older persons, compared to the 2000 census data. Accordingly, these new tables will produce significantly higher values for life interests and significantly lower values for remainder interests following life interests. For any given section 7520 interest rate, this will result, for example, in larger charitable deductions for charitable lead annuity trusts (CLATs) for the life of an individual, but smaller charitable deductions (and more difficulty satisfying the 10 percent remainder test and 5 percent exhaustion test) for charitable remainder annuity trusts (CRATs). Valuations based on a fixed term and not life expectancies (as in term loans and GRATs) are affected only by the monthly section 7520 rate and will not be affected by these new tables. The new tables are proposed to generally take effect on the first day of the month following the month in which the final regulations are published in the Federal Register.

Transitional Rules. The previous mortality tables had taken effect on May 1, 1989 (T.D. 8540), May 1, 1999 (T.D. 8819 and 8886), and May 1, 2009 (T.D. 9448 and 9540). Section 7520(c)(2) mandates revision of the tables at least once every 10 years. Thus, the tables provided by these proposed regulations were due by May 1, 2019. They were delayed in part because the decennial life table data that form the basis for these tables was not compiled and made available by the National Center for Health Statistics of the Centers for Disease Control and Prevention until August 2020. In view of the tardiness of these tables, the proposed regulations include special effective date and transitional rules.

Under Proposed Regs. §20.2031-7(d)(3) and 25.2512-5(d)(3) (other specific proposed regulations have similar provisions), for gifts or dates of death on or after January 1, 2021, and before the effective date, the mortality component of any applicable value, including a charitable deduction, may be determined under either the 2000 tables or these new 2010 tables "at the option of the donor or the decedent's executor." That choice must be the same choice with respect to all valuation elements of the same transfer and, for estate tax purposes, all transfers occurring at death. Specifically, those proposed regulations state:

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

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

Applying the rules already contained in Reg. §1.7520-2(a)(2), 20.7520-2(a)(2), and 25.7520-2(a)(2), the preamble notes that, in the case of a charitable deduction, if the taxpayer elects under section 7520(a) to use the rate for one of the two preceding months, and that elected month is "prior to January 1, 2021" (in other words, it is November 2020 or December 2020), then only the 2000 mortality tables may be used to compute the mortality component.

The Surprise for Pre-2021 Transfers. The proposed regulations say nothing about transfers or deaths on or after May 1, 2019, but before January 1, 2021, thus implying that all valuations in such cases must be made under the 2000 mortality tables.

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

But there is more. Suppose the annuity payment from the CLAT was defined as a percentage of the value of the property transferred to the CLAT (as allowed by Reg. §20.2055-2(e)(2)(vi)(a)), and that percentage was determined by a formula intended to achieve a certain estate or gift tax result – "zeroing out" the CLAT, for example. And, for a pre-2021 transfer, it is likely that the gift or estate tax return has already been filed. The IRS has been wary of attempts to change those kinds of calculations in a manner that looks retroactive, as seen as early as *Commissioner v. Procter*, 142 F.2d 824 (4th Cir. 1944), *rev'g and rem'g* 2 T.C.M. 429 (1943), *cert. denied*, 323 U.S. 756 (1944), and as recently as *Estate of Moore v. Commissioner*, T.C. Memo. 2020-40. Therefore, whether the transition date in the final regulations is May 1, 2019, or January 1, 2021, or something in between, it is essential that the election allowed by the transitional rule relate back to the original transfer date for all purposes, with no possibility of challenge. This could be achieved, for example, by explicitly stating in the regulations that choosing the option provided by the transitional rule will not be treated as a condition subsequent or in any other way that would prevent or limit the application of a formula or other condition in a transfer document intended to determine the amount, value, character, or tax treatment of a transfer in whole or in part with reference to the mortality assumptions, even if a return reporting that transfer has already been filed.

Takeaways. These tables – although they are simply the product of math – are in the Top Ten in 2022 largely because the delay has created such a serious and unprecedented dilemma for the IRS. There are no easy answers. How the IRS solves this dilemma will be interesting to watch. In any event, it seems almost certain that the quicker the regulations are finalized the easier it will be to fix the dilemma.

Settlement of a *Wandry* Defined Value Clause Gift Tax Case (*Sorensen*)

Basic Facts. *Sorensen v. Commissioner*, T.C. Docket 24797-18, 24798-18, 20284-19, 20285-19 (Decision Entered Aug. 22, 2022), involved petitioners Chris and Robin Sorensen. Their father was a firefighter. They loved joining in communal meals at the firehouse, and Robin decided at a young age that one day he would open a restaurant. Eventually, the brothers scrounged \$28,000 in loans from family members and in 1994 started a sandwich shop (because it required the least capital investment compared to other restaurants). They had only one employee, and the family (parents, sisters, spouses, even children) volunteered to provide other labor for the restaurant. Their single sandwich shop eventually turned into a number of Firehouse Subs franchises across the country. Their motto: "Big picture, we love to cook, we love to serve people, we love the hospitality industry. We make sandwiches for a living."

The company succeeded and grew substantially. By 2014, the company owned 27 restaurants, had 823 franchisees, and had over \$550 million of sales system-wide. In late 2014, the brothers decided to make gifts to use their \$5.34 million gift exclusion amounts for fear that the gift exclusion might be reduced in the future. On December 31, 2014, each brother created a grantor trust and made a gift to the trust of nonvoting shares of Firehouse stock having a value of \$5,000,000 as finally determined for federal gift tax purposes. (This approach had been approved two years earlier in *Wandry v. Commissioner*, T.C. Memo. 2012-88.) They signed Irrevocable Stock Powers transferring

[a] specific number of nonvoting shares in FIREHOUSE RESTAURANT GROUP, INC., a Florida corporation (the "Company"), that have a fair market value as finally determined for federal gift tax purposes equal to exactly \$5,000,000. The precise number of shares transferred in accordance with the preceding sentence shall be determined

based on all relevant information as of the date of transfer in accordance with a valuation report that will be prepared by the Dixon Hughes Goodman, LLP (“DHG”), Jacksonville, Florida, an independent third-party professional organization that is experienced in such matters and appropriately qualified to make such a determination. However, the determination of fair market value is subject to challenge by the Internal Revenue Service (“IRS”). While the parties intend to initially rely upon and be bound by the valuation report prepared by DHG, if the IRS challenges the valuation and a final determination of a different fair market value is made by the IRS or a court of law, the number shares [sic] transferred from the transferor to the transferee shall be adjusted accordingly so that the transferred shares have a value exactly equal to \$5,000,000, in the same manner as a federal estate tax formula marital deduction amount would be adjusted for a valuation redetermination by the IRS and/or court of law.

An appraisal valued the nonvoting shares at \$532.79 per share as of December 31, 2014, and \$5,000,000 worth of shares was 9,384.56 shares. The attorney recommended treating the transfer as exactly that number of shares, but the brothers rounded the number of initially transferred shares to 9,385, which represented about 30 percent of each brother’s nonvoting shares. They later decided to transfer a total of up to about 50 percent of their shares, and on March 31, 2015, each brother sold to his respective trust 5,365 nonvoting shares in exchange for a \$2,858,418 secured promissory note (using the \$532.79 per share value in the appraisal as of December 31, 2014). (The sales were not defined value transfers.)

The brothers’ 2014 gift tax returns reported the defined value formula transfers, described the number of shares determined to have a value of \$5,000,000 based on an appraisal (attached on one brother’s gift tax return but not on the other brother’s return), and further explained:

Therefore based on the formula set forth above and the value as determined by the Valuation Report, the donor transferred 9,385 non-voting shares in Firehouse’s stock ... with a value equal to \$5,000,000, and the precise number of shares transferred cannot be finally determined until the value of such shares are finally determined for federal gift tax purposes.

The 2015 gift tax returns did not report the sale of shares in 2015 as a non-gift transaction.

In a gift tax audit, the IRS’s expert appraised the shares at \$1,923.56 per share, later adjusted to \$2,076.86 per share. The Notices of Deficiency were confusing because of confusion by the IRS as to how many shares had been transferred in 2014 and 2015, but the amount of gift tax ultimately in dispute for each brother (according to their pretrial memorandum) was about \$8.95 million for 2014 and \$4.62 million for 2015, totaling about \$13.57 million. In addition, penalties in dispute for each brother were about \$3.58 million for 2014 and \$1.85 million for 2015, or a total of \$5.43 million.

Jumping ahead seven years, the entire company was sold on November 15, 2021, for \$1 billion cash, which was allocated among the shareholders. Each of the trusts received about \$153 million.

Issues. Three issues were in contention: (1) Would the defined value formula gifts, using the approach approved in *Wandry*, be respected? (2) What is the appropriate fair market value of the shares on the dates of the 2014 gift and the 2015 sale? (3) Are penalties appropriate or should they be waived for reasonable cause?

IRS Arguments: First, Relinquishment of Dominion and Control. The IRS argued that the donors had relinquished dominion and control of 9,385 shares on December 31, 2014, pointing to a number of facts that it viewed as supportive. The company reported that each trust owned 9,385 shares on its stock ledgers and on income tax returns. The trusts received pro rata distributions based on ownership of 9,385 shares. The trusts never agreed to transfer shares based on the defined value formula and did not countersign the stock powers, which described the transfers as defined value formula transfers. And the trusts transferred 9,385 shares each to the third-party purchaser, who paid the trusts for those shares.

The IRS’s Pretrial Memorandum includes this analogy to a defined value gift of cows (emphasis added, citations omitted):

Consider that if a farmer agrees to transfer his son [sic] several **cows worth \$1,000 as finally determined for federal gift tax purposes**, and the farmer’s appraiser determines that five cows equal that value, then the transfer is for five cows. The son is now the owner of five cows. Years pass. The son breeds the cows and opens a barbeque stand. If a later gift tax examination finds that each cow was actually worth more, and that two extra cows had been included in the transfer, **nothing in the agreement would allow the farmer to take the two cows back. They were sold as barbeque.** The parties might be held to their agreement – a transfer of the number of cows as finally determined to equal \$1,000 coupled with the possibility of the farmer getting something (barbeque?) in the event of a

redetermination of value. But whatever it is, it won't be the cows transferred. And it might be nothing; the farmer may not pursue his claim, and if he does, he is now just a general creditor who must stand in line with all the other unsecured creditors of the barbecue operation.

The farmer's use of a transfer clause that contemplates subsequent events does not change the fact that the transfer of the five cows was complete on the execution of the documents. This is the case even though the number of cows was indefinite until the initial appraisal was completed. The transfer was of five cows, regardless of whether the transfer is structured as a gift or a sale.

Under the farmer's transfer document, however, a redetermination of the value of a cow might give rise to a right of recovery against the son. But **a right that is dependent upon the occurrence of an event beyond the donor's control**, such as a later redetermination of value by federal authorities or the courts, **does not alter the fact that the transfer is complete for gift tax purposes upon the execution of the documents.** The possibility that the farmer might get something back does not change the fact that he transferred five cows upon the execution of the documents, regardless of whether the transfer is structured as a gift or a sale.

The IRS reportedly often uses this folksy analogy in audits involving *Wandry* transfers. The Fifth Circuit in *Nelson v. Commissioner*, 17 F.4th 556 (5th Cir. Nov. 3, 2021), *aff'g*, T.C. Memo. 2020-81, referred to this analogy presented by the IRS in that case. The emphasis on not being able to adjust the transfer of cows because they have been turned into barbecue ignores that we are in a society with a monetary system and can make appropriate adjustments to determine that the proper value is transferred.

Second, a Procter Argument. The IRS also argued that the language in the stock power attempting to "adjust" the number of shares transferred is a condition subsequent and violates public policy, based on *Commissioner v. Procter*, 142 F.2d 824 (4th Cir. 1944), because that language purports to preclude the IRS from enforcing the gift or making efforts to collect gift tax and purports to preclude enforcing valuation misstatement penalties.

The taxpayers reside in Florida, so the case would be appealable to the Court of Appeals for the Eleventh Circuit. The IRS cited an Eleventh Circuit case that referred to *Procter, TOT Property Holdings, LLC v. Commissioner*, 1 F.4th 1354 (11th Cir. 2021), which held that language in a conservation easement deed purporting to bring the easement into compliance with regulations was an unenforceable savings clause that presented "the same sort of catch-22 situation that leads to the trifling with the judicial process" as in *Procter*.

The IRS distinguished formula allocation clauses in which the transferor clearly transferred all of a specific block of shares or interests, and the formula clause allocates the block between two recipients (and the transfer to one of those recipients would not result in a taxable gift). Those types of clauses have been approved in *McCord v. Commissioner*, 461 F.3d 614 (5th Cir. 2006), *rev'g and rem'g* 120 T.C. 358 (2003) (reviewed by the Court); *Estate of Petter v. Commissioner*, T.C. Memo. 2009-280, *aff'd*, 653 F.3d 1012 (9th Cir. 2011); and *Hendrix v. Commissioner*, T.C. Memo. 2011-133.

Third, Wandry Was Wrongly Decided. The *Wandry* decision had reasoned (referring to *Petter*) that a savings clause is void because it creates a donor that tries to "take property back," but the transfer document in question reflected the intent to transfer "a predefined ... percentage interest expressed through a formula" to each donee, and the transfer document does not allow taxpayers to "take property back" but only to correct the allocations. The IRS suggested several reasons why it viewed that analysis as faulty: The formula transfer created a condition subsequent that could not change the fact the gift was complete as of the date the donors gave up control of LLC units. The adjustment to capital accounts to reflect the values as finally determined for gift tax purposes was not merely an internal accounting adjustment as discussed in *Wandry* but affected each member's economics in the LLC. *Wandry* referred to competing interests, but unlike a situation involving a transfer to a third party, there are no real competing interests where the donor is gifting property to a spouse and/or children and both the donor and donee want to maximize the number of units transferred. The *Wandry* approach subverts congressional intent regarding valuation misstatement penalties in gift tax matters. And the court would not be deciding the amount of gift tax on property transferred but would just be determining the property that should be returned to the donor. In that scenario, there could never be a valuation misstatement penalty.

The IRS's Pretrial Memorandum summarized its criticism of *Wandry*:

The *Wandry* opinion improperly focused on the donors' intent rather than the donors' relinquishment of dominion and control over gifted property, as required by the statutes and regulations thereunder. Therefore, to the extent necessary to resolve this issue, this Court should find *Wandry* was wrongly decided, and petitioners owe additional gift tax to the extent that the value of 9,385 nonvoting shares of FRG [Firehouse Restaurant Group] exceeds petitioner's annual exclusions and lifetime exemption equivalents.

Fourth, the Facts Are Distinguishable from *Wandry*. In *Wandry*, the court noted that the number of LLC units initially transferred was unclear from the record before the court. In this case, the IRS argued, specific shares were gifted and the benefits attributable to those shares were shifted. Furthermore, unlike the donors in *Wandry*, the Sorensen donors failed to follow their own transfer clauses. Based on the appraised value, \$5.0 million worth of shares would have been 9,384.56 shares, but (contrary to their attorney's advice) the donors for administrative simplicity rounded that to 9,385 shares, which resulted in transferring shares worth \$5,000,234.15 (\$234.15 more, oh my!). Thus, the facts align more with *Knight v. Commissioner*, 115 T.C. 515-16 (2000) (in which the donors did not report the transfer as a formula transfer on the gift tax return) than with *Wandry*. Moreover, a transfer of shares in an S corporation (by the Sorensens) is different from the transfer of units in an LLC in *Wandry* (where there is broader flexibility to determine the economic rights of members).

The IRS also argued that the shares transferred could not be adjusted because of the sale of all shares to a third party and because the taxpayers had stipulated that each brother had gifted 9,385 shares.

Valuation. The parties obviously had substantial differences in their valuations of the nonvoting shares. The experts used similar valuation approaches but applied significantly different risk adjustments and comparables. Also, the IRS disputed the use of "tax affecting" for valuing S corporation shares. Interestingly, the IRS Pretrial Memorandum cited several cases that rejected tax-affecting but did not cite the more recent case of *Estate of Jones v. Commissioner*, T.C. Memo. 2019-101, that accepted a tax-affecting analysis under the facts of that case.

Penalties. The taxpayers argued that penalties should not apply because the three-prong test of *Neonatology Associates v. Commissioner*, 115 T.C. 43, 99 (2000), *aff'd*, (3rd Cir. 2002), for the reasonable cause exception was satisfied: (1) the adviser was a professional with expertise to justify reliance, (2) the taxpayer provided accurate and necessary information to the adviser, and (3) the taxpayer actually relied on the adviser's judgment in good faith.

The IRS maintained that the valuation understatements were attributable to negligence and disregard of rules and regulations. As to the 2014 gifts, the brothers knew they gifted 9,385 shares as shown by their reporting on 2015-2020 income tax returns, stock ledgers, and their gift tax returns, as well as the receipt by each of the trusts of about \$153 million from the sale of the company. Also, they knew the 9,385 shares were worth far more than \$5.0 million because of the company's "prior five years of distributions, revenue, and operating income growth, and store expansion." As to the 2015 sales, the brothers "failed to report a transaction in which they transferred stock ... for far less than its value." Also, they relied on an appraisal with a December 31, 2014, valuation date to determine the value of shares transferred on March 31, 2015.

Settlement. A Stipulation of Settled Issues reached the following conclusions:

- A defined value formula clause does not apply to or control the donor's transfer of nonvoting shares on December 31, 2014.
- Each brother gave 9,385 shares on December 31, 2014.
- Each gifted nonvoting share was valued at \$1,640, for a total gift from each brother of \$15,391,400 (a difference of \$10,391,400 from the reported value of \$5,000,000, which had resulted in a gift tax of zero).
- No penalties applied as a result of the 2014 gifts.
- Each brother sold 5,365 shares on March 31, 2015.
- Each such sold nonvoting share was valued at \$1,722, for a total transferred value of \$9,238,530, less the \$2,858,418 consideration received, resulting in a gift by each brother of \$6,380,112.
- The 10 percent accuracy related penalty under section 6662(a) applies to the 2015 transfer.

A Decision for the 2015 transaction reported a gift tax deficiency of \$2,516,045 and a penalty under section 6662(a) of \$251,605. The Stipulation regarding the 2014 gift of \$15,391,400 would have resulted in a gift tax of a little over \$4.0 million (assuming no substantial taxable gifts had been made previously). Therefore, the total gift tax deficiency for each brother for 2014 and 2015 was \$4,000,000+ plus \$2,516,045, or a total of \$6,516,045+. The total penalty was \$251,605.

Takeaways. The values resulting from the settlement (\$1,640 per share for the gift and \$1,722 per share for the sale) were much closer to the IRS's position that the shares were worth about \$2,000 per share than they were to the donors' appraised value of about \$500 per share. Some of that added value may have been attributable to not allowing tax affecting of the S corporation shares.

The IRS supported its *Procter* argument in part by distinguishing this case, and *Wandry* upon which the Sorensens relied, from *McCord*, *Petter*, and *Hendrix* (in which the quantity transferred was fixed, and only the allocation of that quantity between noncharitable and charitable recipients was dependent on the fair market value). Is the IRS suggesting that it is more likely to respect those types of defined value approaches?

Some of the other IRS arguments in *Sorensen* suggest some precautions to consider in designing *Wandry*-style transfers:

- Include a footnoted explanation on the stock ledger and tax returns regarding the possibility of a future adjustment of the number of shares transferred. Using "uncertificated shares" may facilitate this.
- Document in company records that distributions are based on the initially determined amount of shares, which could be adjusted based on finally determined gift tax values, and that the parties will make appropriate adjustments between themselves if the shares are changed.
- Have the donees (the trusts in this case) countersign the stock powers to specifically acknowledge the conditions under which they are receiving the stock transfers.
- When subsequently selling the company, have the buyer acknowledge that the ownership of shares is based on the defined value formula transfers, but that the donees and donors agree that collectively they own the 9,385 shares and transfer them to the buyer, and, if adjustments are made in the ownership of the shares, the donors and donees will adjust the sales proceeds appropriately but acknowledge that the buyer can pay the purchase price attributable to the 9,385 shares to the respective donees (again, the trusts in this case).

Because of the huge appreciation reflected in the sale in 2021, the Sorensen brothers were probably highly motivated and relieved to be treated as having transferred 9,385 shares in 2014, and not have some of those shares treated as having been owned by the donors. Applying the defined value formula, based on the stipulated value of \$1,640 per share, would have resulted in each trust receiving only about \$87 million from the sale in 2021 rather than about \$153 million. Perhaps a sobering reminder of what it might look like in some cases for a defined value clause to "work."

But by any measure, these transactions were wildly successful from a transfer planning standpoint. For a gift tax of about \$6.5 million, as of seven years later each brother had transferred \$153 million, minus the note for roughly \$2.9 million from the 2015 sale, or \$150.1 million – reflecting an effective tax rate of less than 5 percent.

Number Three: IRS Funding in the "Inflation Reduction Act": Public and Political Perceptions

Highlights. "Eighty Billion Dollars" of controversial long-term IRS funding should be the occasion for serious reflection about the IRS, its role, its performance, and its importance.

The "Inflation Reduction Act of 2022." It started in September 2021 with the House Ways and Means Committee's approval of the "Build Back Better Act" (H.R. 5376), including accelerated sunset of the doubled basic exclusion amount from the 2017 Tax Act, closer "alignment" of the grantor trust and transfer tax rules, realization of gains on sales between a deemed owned trust and its deemed owner (nullifying Rev. Rul. 85-13, 1985-1 C.B. 184), and estate and gift tax valuation of certain nonbusiness assets owned by entities as if they were owned directly. None of those provisions remained in the bill the House passed in November 2021.

After several months of suspense, with occasional bursts of reported negotiation, the Senate passed a very different version on August 7, 2022, by a vote of 51-50 (with Vice President Harris voting to break the 50-50 party-line tie vote). The Senate called it the “Inflation Reduction Act of 2022” (not its formal name in the statute, but, like 2017’s “Tax Cuts and Jobs Act,” a name that has survived in popular usage). The House approved the compromise amendment in a party-line 220-207 vote on August 12, 2022. President Biden signed it into law as Public Law 117-169 on August 16, 2022.

The principal focuses of the Inflation Reduction Act were energy, the environment, and health care. It included only two tax increases – a 15 percent alternative corporate minimum tax on “adjusted financial statement income” of corporations with “average annual adjusted financial statement income” over \$1 billion in three consecutive years, and a “buyback tax” of 1 percent of the fair market value of tradeable stock repurchased in a redemption or similar transaction.

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

- \$3,181,500,000 for **taxpayer services**, “including pre-filing assistance and education, filing and account services, [and] taxpayer advocacy services”;
- \$45,637,400,000 for **enforcement**, including “necessary expenses for tax enforcement activities of the Internal Revenue Service to determine and collect owed taxes, to provide legal and litigation support, to conduct criminal investigations (including investigative technology), to provide digital asset monitoring and compliance activities, to enforce criminal statutes related to violations of internal revenue laws and other financial crimes, [and] to purchase and hire passenger motor vehicles”;
- \$25,326,400,000 for **operations support**, “including rent payments; facilities services; printing; postage; physical security; headquarters and other IRS-wide administration activities; research and statistics of income; telecommunications; information technology development, enhancement, operations, maintenance, and security; the hire of passenger motor vehicles; ... [and] the operations of the Internal Revenue Service Oversight Board”;
- \$4,750,700,000 for **business services modernization**, “including development of callback technology and other technology to provide a more personalized customer service”;
- \$403,000,000 for the Treasury Inspector General for Tax Administration;
- \$104,533,803 for the Treasury Office of Tax Policy;
- \$153,000,000 for the United States Tax Court; and
- \$50,000,000 for “oversight and implementation support” by the Treasury Department.
- Total: \$79,606,533,803.

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

For necessary expenses of the Internal Revenue Service to deliver to Congress, within nine months following the date of the enactment of this Act, a report on (I) the cost (including options for differential coverage based on taxpayer adjusted gross income and return complexity) of developing and running a free direct efile tax return system, including costs to build and administer each release, with a focus on multi-lingual and mobile-friendly features and safeguards for taxpayer data; (II) taxpayer opinions, expectations, and level of trust, based on surveys, for such a free direct efile system; and (III) the opinions of an independent third-party on the overall feasibility, approach, schedule, cost, organizational design, and Internal Revenue Service capacity to deliver such a direct efile tax return system.

The Treasury Secretary’s Response. A month after the Act became law, on September 15, 2022, Secretary of the Treasury Yellen laid out priorities for allocation of the increased budget in a visit to an IRS facility:

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

In addition, the IRS will dedicate increased budget resources to enforcement. Secretary Yellen stated:

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

To address this, Treasury will focus its enforcement priorities. She added: "Importantly, I've directed that enforcement resources will not be used to raise audit rates for households making under \$400,000 a year relative to historical levels." She had included that direction in an August 10, 2022, letter to IRS Commissioner Rettig. In a follow-up memo to Commissioner Rettig on August 17, 2022, she noted that the Inflation Reduction Act had once required the IRS to produce an operational plan within six months, detailing how these additional resources would be deployed over the next decade, but that provision had been dropped from the Act to meet the requirements of the Senate parliamentary procedure rules that apply to budget reconciliation. Reviving that idea, she herself directed that such an operational plan be delivered to her within six months – that is, by February 17, 2023.

More about the Treasury Secretary's remarks and the statistics she cited is available at https://home.treasury.gov/news/press-releases/jy0952#_ftnref10.

Sequel. The "omnibus" Consolidated Appropriations Act, 2023 that President Biden signed on December 29, 2022, included only \$12.3 billion for the IRS for fiscal year 2023 (which ends September 30, 2023). This is lower than the \$12.6 billion appropriated for fiscal year 2022 and lower than the \$14.1 billion President Biden had requested for fiscal year 2023. A Summary of the Financial Services and General Government provisions of the act (available at https://www.appropriations.senate.gov/imo/media/doc/FSGG_FY_23.pdf) published by the Senate Appropriations Committee on December 19, 2022, commented on the reduction from the prior year by stating that "[f]unds have not been provided for business systems modernization since funds are available for that activity from unobligated balances in the American Rescue Plan."

Takeaways. The funding of the IRS has become a very partisan issue. We have all heard of the "Eighty Billion Dollars" for "87,000 new agents" who are coming after wage earners and nonprofit organizations. That is at best an exaggeration, as the allocations and timing in the Inflation Reduction Act and the elaborations of

Secretary Yellen cited above show. But it is hard to un-hear once it's been said. Meanwhile, as the December 19, 2022, Summary noted, "[t]he IRS budget has decreased by about 15 percent in real terms since fiscal year 2010 [and] [s]taffing levels have declined and now are close to 1974 levels." It is true that some of those budget cuts have been rationalized with reference to shortcomings, or at least perceived shortcomings, of the IRS, but without much thought for whether many of those shortcomings could actually be addressed with more reliable funding. The IRS is uniquely a profit center after all; it does take in more than it spends.

It has not always been so tense. Some of us, for example, can remember when the IRS was so highly regarded that it was chosen, over other agencies, to administer initiatives not even related to revenue, such as tax credits, some of them refundable, for low-income families (a choice that was reprised in recent Covid-relief legislation). Ironically, it is exactly such well-intended programs that have sometimes become the occasion for awkward and seemingly insensitive correspondence audits, partly because such programs have also attracted abuse and fraud from opportunists, including some describing themselves as "tax return preparers." Then practices like those audits have in turn fostered the image of "87,000 agents" coming after low-income families, which obscures what otherwise seem like commendable and long-overdue priorities in the Inflation Reduction Act and in Secretary Yellen's vision for addressing those priorities.

It is hard to know what to say about the current state of affairs. It is unrealistic to expect taxpayers to love the tax collector, or – being more precise – welcome an IRS audit. It is true that in an audit the IRS is necessarily an adversary. Even so, we should welcome measures that make it more likely that audits will start more promptly and move more efficiently, with examiners who are more knowledgeable, more prepared, and thus less dependent, for example, on "throwing issues at the wall to see what sticks."

The IRS is not perfect and won't be perfect. But even so, some things could materially improve if long-needed strategic modernization, technology upgrades, contracting, hiring, and training can be freed from year-to-year funding anxiety. I know from decades of audit, appeals, and ruling request experience that the typical IRS employee is hard-working, sincere, and professional, and willing to partner with taxpayers' representatives to find solutions to problems and resolutions of disagreements. This was confirmed to me by my opportunity to observe many levels of the IRS first-hand in the three years (2014-2016) I served on the IRS Advisory Council. But I have also been frustrated by the departure of knowledgeable IRS professionals and the apparent reduction in resources and opportunities for training their replacements. All aggravated by the Covid pandemic and perhaps by the political climate.

My hope and recommendation is that somehow tax professionals will reflect on the current challenges and opportunities and will find ways to be supportive of the IRS, as I am, as it seeks to respond to those challenges and seize those opportunities.

Number Two: Clarification of SECURE Act RMD Rules (Prop. Reg. §1.401(a)(9)-4, Notice 2022-53)

Highlights. The experience with changes to retirement plan rules, particularly for required minimum distributions (RMDs) from retirement plans and IRAs, has been at times exasperating and at times more reassuring.

The SECURE Act. Also in the tradition of late-year "omnibus" spending legislation, on December 20, 2019, President Trump signed into law the Further Consolidated Appropriations Act, 2020 (Public Law No. 116-94), including the Setting Every Community Up for Retirement Enhancement (SECURE) Act. It included two dozen or so provisions intended to expand and simplify the access to various retirement benefits, including the repeal of the age limit on making contributions and the postponement of the age for required minimum distributions. These were paid for largely by limiting "stretch IRAs" to 10 years. Except in the case of a spouse or minor child of the participant, a disabled or chronically ill individual, or any individual not more than 10 years younger than the participant, a participant's entire interest in a defined contribution retirement plan or IRA generally must be distributed within 10 years after the participant's death.

It may be argued that the 10-year payout requirement simply and appropriately refocuses the tax benefits of retirement plans on retirement, not on leaving an inheritance. On the other hand, it seems to raise fairness concerns about employees and other plan participants who have voluntarily set money aside in part in reliance on the required minimum distribution rules that the SECURE Act dramatically changed. But one of the biggest

mysteries about that provision in the SECURE Act was its revenue estimate. For all those reasons – the expansions, the pay-for, and the revenue estimate – the SECURE Act was Number One in the 2019 Top Ten. Here is how the 2019 Top Ten concluded by analyzing the revenue estimate:

[T]he Joint Committee on Taxation has estimated that this provision would raise revenue by about \$15.7 billion in Fiscal Years 2020-2029. That is almost enough to offset the revenue losses from all the other provisions of SECURE, estimated to be about \$16.3 billion. ...

But wait. The new rule that requires distribution “within 10 years after the death” of the participant says nothing about spreading payments over that 10-year period, as in the case of required minimum distributions computed with reference to life expectancies. Thus, with respect to the earliest application of SECURE, to participants who die in 2020, the tenth anniversary of their deaths is in 2030, the end of that calendar year (see Reg. §1.401(a)(9)-3, A-2) is December 31, 2030, and income tax returns are due in April 2031. If the participant has a spouse, the 10-year period may not start until both of them have died. And this legislation is estimated to raise \$15.7 billion **by September 30, 2029**? Of course revenue estimates take account of all kinds of projected behaviors, but assuming \$15.7 billion of income tax for a year or two before anyone technically has to pay it is really ambitious. Indeed, it appears that limiting the use of the “stretch” IRA that requires distributions **annually** over the life of the beneficiary may actually tend to **reduce** tax revenues in the first 10 years. Does SECURE really mean “Significantly Erroneous Congressional Use of Revenue Estimates”? What are we missing?

Learning what we are missing may be a contender for inclusion in next year’s Top Ten!

Well, “next year” was 2020. Maybe the third year instead.

Proposed Regulations. In a revised version of Publication 590-B, dated May 13, 2021, the IRS seemed to confirm that potential for revenue loss, stating:

The 10-year rule requires the IRA beneficiaries who are not taking life expectancy payments to withdraw the entire balance of the IRA by December 31 of the year containing the 10th anniversary of the owner’s death. For example, if the owner died in 2020, the beneficiary would have to fully distribute the plan by December 31, 2030. The beneficiary is allowed, but not required, to take distributions prior to that date.

But then a clue to a contrary interpretation seemed to come in February 2022 in Proposed Reg. §1.401(a)(9)-4, REG-105954-20, 87 FED. REG. 10504 (Feb. 24, 2022). The proposed regulations surprisingly provided that life expectancy payments must still be made during the 10-year period for making distributions to designated beneficiaries if the participant dies on or after the required beginning date. The IRS reasoned that the SECURE Act did not repeal section 401(a)(9)(B)(i), which requires that distributions be made “at least as rapidly as under the method of distributions being used” as of the date of death. Thus, there are two distribution rules: Annual distributions are required (based on the life expectancy of the beneficiary or, if longer, the life expectancy of the owner prior to death); and an outer limit of 10 years applies to whatever has not been distributed by then. But because these proposed regulations were published in February 2022 and there obviously was no longer any opportunity to take a 2021 RMD, and because of the position taken by the IRS in the May 13, 2021, version of Publication 590-B, there was still considerable uncertainty about 2021 RMDs.

Notice 2022-53. Some relief came with Notice 2022-53, 2022-45 I.R.B. 437 (Oct. 7, 2022), which stated that the IRS intends “to issue final regulations related to required minimum distributions (RMDs) under section 401(a)(9) of the Internal Revenue Code (Code) that will apply no earlier than the 2023 distribution calendar year.” Notice 2022-53 also observed that commenters had noted the uncertainty about 2021 and 2022 and clarified that a plan will not be treated as having failed to make distributions required under section 401(a)(9) merely because it failed to make distributions in 2021 or 2022. Also, although the Notice does not imply that the required 2021 and 2022 distributions will no longer be treated as RMDs (for example, for purposes of rollovers, which are not allowed for RMDs), the IRS will not impose an excise tax under section 4974 because of the failure to make RMDs in 2021 or 2022, and if the taxpayer has already paid an excise tax for a missed distribution in 2021, the taxpayer may request a refund.

Takeaways. Because neither the proposed regulations nor Notice 2022-53 provide for an acceleration or increase in RMDs during the 10-year period after the participant’s death, they still do not answer the question of how this 10-year rule can raise any revenue at all, and certainly not \$15.7 billion, in fiscal years 2020-2029. Partly because the mystery remains unsolved, but mostly because Notice 2022-53 represents a significant and quite timely common-sense acknowledgment of some beneficiaries’ obvious dilemmas, the SECURE Act and its fallout return as Number 2 in 2022.

SECURE 2.0. Then the Consolidated Appropriations Act, 2023 that President Biden signed on December 29, 2022, included a set of provisions titled (formally titled, not just popularly referred to) the SECURE 2.0 Act of 2022. It changes the RMD rules again, by providing that the age used to compute the required beginning date will be 73 for those who turn 72 after December 31, 2022. In other words, someone who turns 72 in 2023 and therefore was **expecting to take an RMD for 2023** (no later than April 1, 2024, under Reg. §1.401(a)(9)-5, Q&A 1(b), and Proposed Reg. §1.401(a)(9)-5(a)(2)(iii)) will now **not have an RMD until 2024** (to be taken no later than April 1, 2025). And if the plan was to start taking that RMD in January 2023, then, well, there were still two days left in 2022 in which to change the plan! (The applicable age is changed to 75 for someone who turns 74 in 2033 or later, but they will have a little more time to plan. The Act makes a number of other changes too, including, in certain cases, reducing the penalties for failing to take RMDs and permitting a qualified charitable distribution from an IRA to a charitable remainder trust or a charitable gift annuity.)

Number One: Estate Tax Deductions: Present Value Concepts (Prop. Regs.)

Highlights. An almost-20-year-old guidance project has finally produced proposed regulations, REG-130975-08, 87 FED. REG. 38331 (June 28, 2022), to apply to the estates of decedents dying on or after the date the final regulations are published in the Federal Register. In the short term, it has attracted interest and controversy. In the long term, it portends significant changes in the way estates that are required to file federal estate tax returns are administered.

Background. This particular regulation project first appeared in the 2008-2009 Treasury-IRS Priority Guidance Plan, as an outgrowth of the project begun in 2003 that led to the amendments of the section 2053 regulations proposed in April 2007 and finalized in October 2009. The significance of present value concepts is elaborated in this paragraph in the preamble to the 2009 final regulations (T.D. 9468, 74 FED. REG. 53652 (Oct. 20, 2009)) (emphasis added):

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

Present Value Discounting. Specifically addressing that issue, Proposed Reg. §20.2053-1(d)(6) would require, except for unpaid principal of mortgages and other indebtedness deductible under Reg. §20.2053-7, a present-value discounting of claims and expenses not paid or expected to be paid within a “grace period” ending three years after the decedent’s death. Under Proposed Reg. §20.2053-1(d)(6)(i)(B), the discount rate to be used would be the applicable federal rate determined under section 1274(d) for the month in which the decedent died, compounded annually. Whether that is the mid-term rate (3-9 years) or long-term rate (over 9 years) would be determined by the length of time from the date of the decedent’s death to the date of payment or expected date of payment. Proposed Reg. §20.2053-1(d)(6)(vi) provides that any such discounted deduction is “subject to adjustment” to reflect any change in the amount or timing of the payment while the statute of limitations on assessment of estate tax has not run or a claim for refund is pending – basically an application of the existing rule in Reg. §20.2053-1(d)(2).

The preamble to the proposed regulations offers the following explanation and justification of the three-year grace period:

The Treasury Department and the IRS propose to amend the regulations under section 2053 to incorporate present-value principles in determining the amount deductible under section 2053 for claims and expenses (excluding unpaid mortgages and indebtedness deductible under §20.2053-7). The Treasury Department and the IRS recognize, however, that estates often cannot pay every deductible claim and expense within a short time after the decedent’s death and that sound tax administration should balance the benefit of more accurately determining the amounts not passing to the beneficiaries of an estate garnered from applying present-value principles with the administrative

burden of applying those principles to deductible claims and expenses that occur during a reasonable period of administration of the estate. The Treasury Department and the IRS understand that a significant percentage of estates pay most, if not all, of their ordinary estate administration expenses during the three-year period following the decedent's date of death. This three-year period takes into account a reasonable time for administering and closing the estate. The Treasury Department and the IRS note that a reasonably short period of time between the decedent's death and the payment of a claim prevents the lack of a present-value discount from significantly distorting the value of the net (distributable) estate. Applying present-value principles in computing the deductible amount of those claims and expenses paid more than three years after the decedent's death strikes an appropriate balance between benefits and burdens.

Many estates are closed, or, as the preamble puts it "pay most, if not all, of their ordinary estate administration expenses," within three years after the decedent's date of death. But that is not necessarily true of estates required to file a federal estate tax return. Often such an estate, being typically a larger and more complex estate, requires steps that can be quite involved, including

- marshaling and valuing assets (which could be of several kinds, spread among several jurisdictions, domestic and foreign);
- liquidating assets (marketing, negotiating and documenting the sale, and collecting the sales price, sometimes over time);
- managing assets (which could be operating businesses facing transitions, successions, and more negotiations or renegotiations as a result of the decedent's death);
- determining the appropriate allocations of assets among beneficiaries (including special tangible assets, which sometimes require discussion and in effect a type of "negotiation");
- making distributions (including documenting, receipting, and sometimes packing, shipping, and insuring);
- obtaining court approvals;
- preparing accountings, reports to beneficiaries, and of course tax returns; and
- dealing with any will contest or other litigation.

But perhaps the biggest (and most "reasonable") cause for being conservative and not rushing the closing of the estate is to make sure that liabilities are identified and provided for, including the federal estate tax itself. Even if the federal estate tax return is filed without an extension, the normal three-year statute of limitations on assessment of additional tax will not run until three years and nine months after the date of the decedent's death – necessarily beyond the three-year grace period. Of course, many of these related administration expenses, as well as claims, can still be actually paid within three years, not deferred, and the deferral of distributions themselves, which might be the most common consequence of conservative administration, will ordinarily not directly implicate the three-year grace period. Moreover, if there is an estate tax audit, the resolution of the audit can often be the occasion for claiming more deductions.

Overall, though, while extending the administration of an estate beyond three years can certainly be "reasonable" under the circumstances, it is easy to understand Treasury's desire to find "an appropriate balance between benefits and burdens." Some comments have suggested a longer grace period, typically five years, and five years has the appeal of allowing 15 months to file an estate tax return (on extension), three years for the estate tax statute of limitations to run, and nine months more for the executor to address the issues in the bullet points above and to make appropriate payments. (In that case, the provision in Proposed Reg. §20.2053-1(d)(6)(vi), cited above, that a discounted deduction is "subject to adjustment" to reflect any change in the amount or timing of the payment while the statute of limitations on assessment of estate tax has not run or a claim for refund is pending would have less impact.)

Three years in the proposed regulations is a "cliff," meaning that a payment expected to be made 36 months after death would not be discounted at all, but a payment expected to be made 37 months after death would be discounted for the whole 37 months. And that would likely be the case for any longer period the final regulations might adopt. But that may be an unavoidable consequence of striking a fair and administrable balance.

Can They Do This? At least one public comment on the proposed regulations made the interesting suggestion that Treasury has no authority to require the discounting of expenses or claims because section 2053(a) provides that “the **value** of the taxable estate shall be determined by deducting from the **value** of the gross estate such **amounts**” (emphasis added) of expenses and claims. In other words, deductions are not “valued” as are the components of the gross estate.

The calculation of the estate tax is just that – a calculation. The “gross estate” is not a “thing,” or a set of assets, like an “estate” might be. Of course, we find it convenient to speak, or even write, about an asset being “included in the gross estate,” even though that is technically wrong. But, to the point, that casualness is reflected in the language of the Code itself. For example, sections 303 and 537 refer to “stock ... included in the gross estate,” and section 1040 refers to “a trust (any portion of which is included in the gross estate of the decedent).” While those provisions were not necessarily drafted by estate tax specialists, there are also references to “property,” “interest in property,” “assets,” “trusts,” “portion” of a “trust,” or “items” being “included,” “includible,” or “comprised” in a “gross estate” in sections 2523(f)(5)(B), 2624(b), 2632(c)(3)(B)(iv), 2642(c)(2)(B), 2801(e)(2)(B), 6035(a)(1), 6048(a)(3)(A)(iii)(II), 6501(e)(2), and 7269.

The inference is that the Code uses “value” and the things being valued interchangeably, and the observation in the comment must be applied with respect for that context. For example, sections 2501(a)(1) and 2502(a) impose the gift tax on “taxable gifts,” which section 2503(a) states “means the total amount of gifts made during the calendar year, less [deductions],” but there is no question that those gifts must be valued, despite being described as an “amount.” More analogous to these proposed regulations, the estate tax charitable deduction is defined in section 2055(a) as “the amount” of certain qualified “bequests, legacies, devises, or transfers,” but there is no question that the subject of such a charitable transfer must also be valued, as in *Estate of Warne v. Commissioner*, T.C. Memo. 2021-17, where two transfers at death to two charities of all the interests of an LLC had to be valued for purposes of the charitable deduction as two separate transfers – that is, discounted. Cash included (technically, cash the value of which is included!) in the gross estate is not ordinarily valued or discounted, of course, but if the asset is the right to receive cash at some time (such as more than three years) in the future, it no doubt would be valued at a present-value discount on the estate tax return. In the context of statutory and practical usage described above, it seems reasonable to infer that the obligation to pay cash after some prescribed time in the future could also be discounted, and it is within Treasury’s authority to describe how.

Deduction of Interest on Taxes. A new Proposed Reg. §20.2053-3(d) (with the current paragraphs (d) and (e) redesignated paragraphs (e) and (f)) addresses the deduction of interest as an estate administration expense. Proposed Reg. §20.2053-3(d)(1)(i) affirms the nondeductibility of interest on federal estate tax deferred under section 6166, in accordance with section 2053(d)(1)(D), which was added to the Code in 1997.

Proposed Reg. §20.2053-3(d)(1)(ii) and (iii) affirm and amplify the requirement of Reg. §20.2053-3(a) that to be deductible the payment of interest must be “actually and necessarily incurred in the administration of the decedent’s estate.” Proposed Reg. §20.2053-3(d)(1)(ii) states that “[w]hen non-section 6166 interest accrues on unpaid federal estate tax deferred under section 6161 or 6163, the interest expense is actually and necessarily incurred in the administration of the estate ... because the extension was based on a demonstrated need to defer payment,” while other interest on unpaid federal tax or interest payable under state or local law “generally” meets that requirement. But Proposed Reg. §20.2053-3(d)(1)(iii) provides that interest does not meet that requirement “to the extent the interest expense is attributable to an executor’s negligence, disregard of applicable rules or regulations (including careless, reckless, or intentional disregard of rules or regulations) as defined in [Reg. §1.6662-3(b)(2)], or fraud with intent to evade tax.” Because the proposed regulation confirms that interest on federal tax is “generally” deductible, it should be presumed (hoped?) that this exception would be applied with moderation and balance.

The preamble repeats the language of the proposed regulations, and also offers some context and explanation, as follows (emphasis added):

Non-section 6166 interest may accrue on and after the date of a decedent’s death on unpaid tax and penalties in connection with an underpayment of tax or a deficiency (as that term is defined in section 6211). In many cases, such interest and the underlying underpayment of tax or deficiency is attributable to the reasonable exercise of an

executor's fiduciary duties in administering the estate, as may occur in cases involving **legitimate disagreements** with the IRS, **inadvertent errors**, or **reasonable reliance** on a qualified professional. The Treasury Department and the IRS have determined that, **generally**, such interest **is actually and necessarily incurred** in the administration of the estate. However, the Treasury Department and the IRS are concerned that there are some circumstances in which such interest expense would not satisfy the "actually and necessarily incurred" requirement in §20.2053-3(a). For instance, when non-section 6166 interest accrues on unpaid tax and penalties in connection with an underpayment of tax or deficiency and the underlying underpayment or deficiency is attributable to an executor's negligence, disregard of the rules or regulations (including careless, reckless, or intentional disregard of rules or regulations) as defined in §1.6662-3(b)(2), or fraud with intent to evade tax, the interest expense is not an expense actually and necessarily incurred in the administration of the estate. Accordingly, the Treasury Department and the IRS have determined that, when interest accrues on any unpaid tax or penalty and the interest expense is attributable to an executor's **negligence, disregard of the rules or regulations, or fraud with intent to evade tax**, the interest expense is neither actually and necessarily incurred in the administration of the estate nor essential to the proper settlement of the estate. Further, the Treasury Department and the IRS have determined that the rationale underlying this determination applies to all non-section 6166 interest, whether the interest accrues in connection with a **deferral, underpayment, or deficiency**.

The reference to "deferral" appears to refer to (or at least include) "interest ... on unpaid federal estate tax deferred under section 6161 or 6163." The proposed regulations themselves (quoted above) say such interest "**is** actually and necessarily incurred in the administration of the estate" (emphasis added), while the preamble seems to contemplate that such interest also will be subject to the "negligence, disregard of the rules or regulations, or fraud" test.

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

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

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

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

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

It is understandable that the IRS and Treasury would be concerned about structures that might try to convert distributions to beneficiaries in their capacities as beneficiaries into interest payments that are deductible in computing the estate tax. Or concerned about borrowing from a family-owned entity that might own enough liquid assets to have accommodated the funding of the estate's tax and other obligations with a simple distribution, as analyzed in *Estate of Koons v. Commissioner*, 686 Fed. Appx. 779, 119 AFTR 2d 2017-1609 (11th Cir. 2017), *aff'g* T.C. Memo. 2013-94, and cases cited therein. But it is also the experience of many estate planners that the option of borrowing from a family-owned entity, including an operating business, may be not only the most convenient but also the most protective of the viability of that entity or business whose owners are faced with tax liabilities that shareholders of public corporations, for example, could satisfy simply by sales of stock that do not affect the company. In several cases courts have refused to "second guess" the business judgment of executors in deciding to borrow to pay expenses rather than demanding a distribution from a family entity. *See, e.g., Estate of Murphy, Jr. v. U.S.*, 104 AFTR 2d 2009-7703 (W.D. Ark. 2009). The proposed regulations would not necessarily prohibit the deduction of interest in such cases; they simply offer "factors" to be weighed. Again, estate planners would welcome some assurance in the final regulations that such weighing would be appropriately balanced.

Graegin Loans. *Graegin* loans (see *Estate of Graegin v. Commissioner*, T.C. Memo. 1988-477), which prohibit prepayment of either principal or interest and therefore have been held to allow a full undiscounted estate tax deduction for the payment of interest that might be deferred for, say, 15 years, would lose that element of their effectiveness. The interest would be discounted under Proposed Reg. §20.2053-1(d)(6). Moreover, if the new regulations provoke more IRS scrutiny of such loans under the "bona fide" and "actually and necessarily incurred" tests, deductibility might be disallowed altogether. (In this regard, the facts of the *Graegin* case itself were quite strong.)

"Appraisal Documents." Reg. §20.2053-4(b) and (c), part of the 2009 amendments of the regulations, incorporated the "qualified appraisal" and "qualified appraiser" concepts from the context of valuing charitable gifts for income tax purposes into the context of valuing claims against the estate for estate tax purposes. The preamble to the current proposed regulations acknowledges that those concepts are an awkward fit, and proposed amendments to those regulations would replace them with a list of requirements for an "appraisal document" that is more focused on the section 2053 context. One of those requirements, in Proposed Reg. §20.2053-4(b)(1)(iv)(F) and (c)(i)(iv)(F), is the unprecedented requirement that the appraisal document be "signed under penalties of perjury."

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

Takeaways. It is hard to miss the implication that if these proposed regulations are finalized, the administration of estates required to file federal estate tax returns will be made significantly more complicated, expensive, and stressful, perhaps particularly (as noted above in the discussion of interest on loans) in the case of family-owned and -operated businesses.

The initial and most obvious impact is that executors required to file an estate tax return will inevitably feel obliged to reconsider their approach to the timing of the payment of administration expenses, particularly expenses like executors' commissions and attorneys' fees. Often it is concern for the best interests of the beneficiaries (or at least concern for the beneficiaries' perceptions) that cause those payments to be deferred until uncertainties about the estate administration have been resolved (or, in more practical terms, until

distributions to beneficiaries have been made or are soon to be made). The choice between prudently postponing payment of those expenses and artificially timing those payments to secure a full deduction could create greater anxiety and frustration for fiduciaries and beneficiaries alike.

In any event, the greater significance of forecasting the timing of the payment of expenses, as well as their ultimate amounts, will inevitably require more attention, extra work, and thus greater expense. Such forecasts very often do not turn out to be precisely correct, even though they are made in good faith and with care.

The concerns expressed in both of the preceding paragraphs are likely to be mitigated, although not completely removed, if the “grace period” is changed from three to five years.

Whenever an estate has the need to borrow funds to satisfy estate expenses, there will be increased anxiety about the deductibility of interest on the loan. A primary effect of the regulations may be to bolster IRS arguments in future cases in which the IRS seeks to deny an estate tax deduction for interest payments.

And, for deductions for claims that require “appraisal documents” under Proposed Reg. §20.2053-4(b) or (c), the concern about extra work and greater expense is aggravated. The amount and timing of payment of many such claims, especially those related to litigation, are best estimated by lawyers involved in or at least familiar with the litigation, and Treasury should repudiate the implication in the proposed regulations that a professional appraiser is needed to prepare an “appraisal document.” Even so, the requirement that such a document be “signed under penalties of perjury” would create even greater difficulty in engaging any professional to provide such an estimate, and therefore add to the time, trouble, and expense of administering the estate. This is aggravated further by the requirement in Proposed Reg. §20.2053-4(b)(1)(iv)(F) and (c)(i)(iv)(F) that the “appraisal document” be prepared by someone who “is not a family member of the decedent, a related entity, or a beneficiary of the decedent’s estate or revocable trust” and therefore is not necessarily in a position to know first-hand the accuracy of the facts behind the “appraisal document.”

This review of 2022 developments has discussed the tax treatment of estate planning actions and tools like intergenerational split-dollar life insurance (Number Ten), “sprinkling” CRUTs (Number Nine), and syndicated conservation easements (Number Seven) that many clients have not used and will not use, and even GRATs (Number Five) that may be used by more clients but not by everyone. It has discussed certain gifts to use the doubled exclusion amount (Number Eight) that only a relatively few people will have made, and only until the “sunset” at the end of 2025. It has discussed interest-rate-sensitive and mortality-sensitive techniques and the use of defined value clauses (Number Four) that, again, not everyone uses. Even the drama over required distributions from retirement plans and IRAs (Number Two) will probably last only until the transition years have passed and we have gotten familiar with whatever the new rules turn out to be.

But the “present value,” “deductibility of interest,” and related proposals in these proposed regulations are likely to have a permanent complicating impact on the administration of almost all estates for which a federal estate tax return is required. Descriptions of that impact with words like “permanent” and “all” are what make the proposed regulations Number One in 2022.