Estate Planning Tax Update—Highlights of Current Developments

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

1. Trending in 2024 [EP1-4]

a. Basic estate planning and coordination

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

c. Ownership planning in 2025 to facilitate gifts in 2026

d. Planning for flexibility with grantor trust status; Strategies for mitigating the "burn" of grantor trust status (outstanding article by Kristen Curatolo & Jennifer Smith, 48 BLOOMBERG TAX MGMT. ESTS., GIFTS & TRUSTS J. No. 3 (May 11, 2023))

e. Corporate Transparency Act

f. Decanting; trust modification

g. Trust flexibility; directed trusts

2. Legislative Proposals

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

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

(2) The Harris presidential campaign has not discussed her tax plans in detail, but her campaign aides say she endorses all the proposed tax increases in the FY 2025 Greenbook, including the promise not to increase taxes for households making under $400,000. *See* Rubin, *Kamala Harris's Tax Increases and Cuts Take Shape*, WALL STREET J. (updated 08 27 24).

(3) Income Tax for High-Income Taxpayers – Increased top rates (44.6%, up from 23.8% on capital gains, 29.6% on some business income, and over 39% on wages); "Billionaires Income Tax" (taxing unrealized capital gains of people with net worth exceeding $100 million) [EP5, WU24-28]

(4) Treat transfers of appreciated property by gift or on death as realization events; gain on unrealized appreciation would also be recognized by certain non-corporate entities about every 90 years [EP5]

(5) Estate, Gift, and GST Tax bold proposals including GRATs, grantor trusts, defined value clauses, valuation, GST exemption time limit, no zeroed-out or shark-fin CLATs [EP6-8, WU29-46]

(6) S. 3988, the "Getting Rid of Abusive Trusts Act (the "GRATs Act") introduced on March 20, 2024, would implement the items regarding GRATs, sales between deemed owners and grantor trusts, and the grantor's payment of income tax on grantor trust income. [EP6]

b. There are reports that the Harris presidential campaign has endorsed transfer tax provisions in the American Housing and Economic Mobility Act of 2024, introduced in the Senate by Senator Warren (D-MA) (S. 4824, July 29, 2024) and in the House by Representatives by Representative Cleaver (D-MO) (H.R. 9245, August 2, 2024) (similar to legislation that has been proposed in prior years). *See* Erskine, *Kamala Harris Endorses American Housing and Economic Mobility Act Tax Proposals*, FORBES (Aug. 22, 2024) ("In a significant development, the Kamala Harris presidential campaign has announced its endorsement of the estate tax reforms outlined in the American Housing and Economic Mobility Act of 2024"). The proposal would be paid for entirely by very significant transfer tax changes. [EP12]

- Increased estate and gift tax rates (55% up to $13 million, 60% between $13 million and $93 million, 65% over $93 million, and additional 10% surtax over $1 billion)
- Estate and gift exclusion reduced to $3.5 million (reverting to the 2009 amount, without inflation adjustments)GRATs would have a minimum 10-year term (with no decrease in the annuity during the first 10 years) and a remainder interest equal to at least 10% of the value transferred to the GRAT
- Grantor trust assets are (i) subject to gift tax to the extent distributed during the grantor's life or to the extent grantor trust status terminates during the grantor's life and (ii) otherwise included in the grantor's gross estate for estate tax purposes (adding §2901)
- GST exemption would only cover transfers to grandchildren or others assigned to their generation (not more remote beneficiaries) and to beneficiaries born before the creation of the trust
- Gift tax annual exclusion "simplified" by eliminating the present interest requirement and replacing it with a per-donor annual limit of twice the per-donee limit (indexed, now $36,000) on the total of transfers (i) in trust (including trusts with "Crummey powers," with no exception for "vested" single-beneficiary trusts), (ii) of interests in passthrough entities, (iii) of interests subject to a prohibition on sale, and (iv) of property that "cannot immediately be liquidated by the donee" (ignoring withdrawal, put, or other such rights)
- No basis step-up for assets in grantor trusts that are not in the transferor's gross estate
- Valuation discount limitations for interests in entities controlled by the transferor, the transferee, or their families or for non-business assets
- Income tax surcharge on high income estates and trusts (5% of modified AGI over $200,000 and an additional 3% for modified AGI over $500,000); "modified AGI" is AGI reduced by investment interest that is not deducted in determining AGI and by amounts paid or set aside for charity under §642(c)
- Increased potential special use valuation adjustment under §2032A from $750,000 (indexed, now $1,390,000) to $3 million (inflation adjusted going forward)
- Increased limit on exclusion of the value of conservation easements under §2301(c) from $500,000 to $2 million

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

d. Likelihood of Further Tax Legislation; Exclusion Amount in 2026 – remember that big increases in exclusions and portability of the exclusion were passed in 2010 (when **Democrats** controlled the

Presidency, Senate, and House) as a result of **negotiation**, but there is at least a significant chance the exclusion amount will be reduced in 2026 (which will lead to a very busy time for estate planners in the fall of 2025) [EP11-12]

Negotiations in 2025 about the 2017 Tax Act cuts (scheduled to expire January 1, 2026) will include discussion of the estate and gift tax rates and exclusions. The Congressional Budget Office estimates that extending the 2017 tax cuts for ten years would add $4.6 trillion to the deficit. [EP12]

3. Miscellaneous IRS Guidance; Proposed Regulations

a. Inflation Adjusted Amounts, (based on information each year through August 31), Rev. Proc. 2023-34 gives the 2024 amounts) [EP25]

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

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

b. Final regulations with new procedures for extensions regarding GST exemption allocations or elections, Reg. §26.2642-7 [EP19-22]

(1) Extensions requests regarding GST exemption allocations or elections made on or after May 6, 2024, must use the new procedures and 9100 relief is no longer available

(2) Additional proposed regulations will be forthcoming to address the practical effect of a grant of an extension of time for making elections and the interplay between affirmative and automatic allocations. They will include examples applicable to this new final regulation and the newly proposed regulations.

(3) Relief from certain affirmative elections is permitted under the final regulations (electing out of automatic allocation for lifetime direct skips, electing out of lifetime allocations to "GST trusts," and treating a trust as a GST trust as to transfers to the trust made by such individual)

(4) The final regulations narrow the list of persons who must provide affidavits (for example, not including advisors who were consulted about "any aspect of the transfer [or] the trust")

(5) The (i) good faith and (ii) no prejudice to the interests of the government (mainly not using hindsight to the taxpayer's advantage) tests are applied a little more rigorously.

c. Some pending proposed regulations

(1) Section 2053 (PV administration expenses paid more than three years after death; *Graegin* loans) [EP27-30, WU65-67]

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

Particularly problematic factors [EP29, WU66-67]

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

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

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

(2) Anti-abuse exception to the anti-clawback regulation [EP26-27, WU56-63]

(3) Proposed regulations regarding qualified domestic trusts merely update various outdated references; no substantive changes are included. [EP19]

(4) Keep in mind current legal effect of proposed regulations: "carry no more weight than a position advanced on a brief" [EP26]

d. Rev. Rul. 2023-2 Guidance regarding availability of §1014 basis adjustment at the death of the owner of a grantor trust when the trust assets are not included in the owner's gross estate [EP15-19, WU73-76]

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

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

4. Final Regulations Under SECURE Act, Required Minimum Distribution Rules for Retirement Plans and IRAs; Proposed Regulations Under SECURE 2.0 [EP69-73]

a. Long-awaited final regulations for distributions from retirement plans and IRAs, including implementation of changes made by the SECURE Act (and some changes by the SECURE 2.0 Act) were released July 18, 2024, and published in the Federal Register on July 19, 2024.

b. The final regulations largely follow the 2022 proposed regulations but include various clarifications and some significant changes. The regulations generally are effective for distributions beginning in 2025. Some of the changes reflected in the final regulations are briefly summarized.

c. Retention of requirement that annual payments must be made during the 10-year period for making distributions to designated beneficiaries (DBs) if the owner dies on or after the required beginning date (RBD). Reg. §1.401(a)(9)-5(d)(1). If the beneficiary is not an "eligible designated beneficiary" (EDB), under the SECURE Act, the entire distribution must be made by December 31 of the tenth year after the owner's death. Reg. §1.401(a)(9)-5(e)(2). If the beneficiary is an EDB, the annual payments would continue until the beneficiary no longer qualifies as an EDB, and the final distribution generally must be made within 10 years afterward. IRS Notices have stated that no excise taxes are imposed for failure to take such required annual distributions in 2021-2024, and the final regulations do not require that make-up distributions be made in 2025 for any such annual distributions that were not made in 2021-2024.

d. The increased ages that were enacted in SECURE 2.0 for the RBD of an owner (age 73 for those reaching age 72 after 2022 and age 74 for those reaching age 74 after 2032) are reflected in Reg. §1.401(a)(9)-2(b)(2).

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

f. A charity may be the remainder beneficiary of a "type II applicable multi-beneficiary trust" for a disabled person (typically drafted to include special needs trust provisions). The is added in SECURE 2.0, and the final regulations reflect that change.

g. If a trust has multiple minor beneficiaries (i.e., who have not reached age 21), the plan can be treated as having an EDB, and the final required distribution would not be until ten years after the *youngest* minor beneficiary reaches age 21 (changed from *oldest* minor child in the proposed regulations). Reg. §1.401(a)(9)-5(f)(2)(ii)(C).

h. An important change in the final regulations is to apply the separate account rule to plan interests passing to a *trust* if the terms of that trust provide that it is to be "immediately divided" upon the death of the owner into separate trusts for one or more trust beneficiaries. "Immediately divided" is defined to mean that the trust must terminate, the trustee can have no discretion as to how the plan interests are allocated to separate trusts, and administrative delays are permitted only if plan benefits ultimately are allocated as if the trust had been divided on the date of the owner's death. The separate account rule is important; otherwise, all plan beneficiaries are generally counted for purposes of determining if the plan had a DB, and the oldest DB's life expectancy is used to determine the minimum annual distributions to all beneficiaries. Previously, the separate account rule applied only if the plan *beneficiary designation* left the plan interests to separate individuals or separate see-through trusts. Under the final regulation, the plan beneficiary could be a revocable trust, for example, which would be split at the owner's death into separate trusts for separate beneficiaries. (Under the final regulation, the trust must be divided into separate see-through trusts, and none of the interests could be allocated outright to certain individuals.) Reg. §1.401(a)(9)-8(a)(iii)(B-C).

i. A required distribution in the year of the owner's death (if the owner had reached the RBD by that time) may be made to "any" beneficiary (rather than having to be left proportionately to all beneficiaries). Reg. §1.401(a)(9)-5(d)(1).

j. If the beneficiary is younger than the deceased owner and if the owner dies after the RDB, distributions can be made in annual payments over the DB's lifetime (subject to the 10-year rule if the beneficiary is not an EDB). A provision in the proposed regulations (Prop. Reg. §1.401(a)(9)-5(e)(5)) requiring that the plan be distributed entirely by the end the *owner's* life expectancy (determined at the owner's death) was deleted in the final regulations.

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

5. Buy Sell Agreement Value Does Not Fix the Estate Tax Value; Life Insurance Proceeds Payable to Corporation Under Corporate Redemption Arrangement Included in Estate Tax Value and Not Offset by Redemption Obligation, *Connelly v. United States*, 602 U.S. __ (June 6, 2024) (Justice Thomas, unanimous), *aff'g* 131 AFTR 2d 2023-1902 (8th Cir. 2023), *aff'g* 128 AFTR 2d 2021-5955 (E.D. Mo. 2021) [EP134-139]

a. Buy-sell agreement did not fix estate tax value. District court reasoned that it did not satisfy the device test or comparability test under the §2703(b) safe harbor and did not meet case law requirements (no determinable price, not binding on estate, and was a substitute for a testamentary

disposition for less than full consideration). Eighth Circuit reasoned that neither of the two pricing mechanisms in the agreement were followed and they did not constitute a "fixed or determinable price for valuation purposes." (Those two pricing mechanisms are often found in buy-sell agreements – [1] annual agreement, and [2] appraisal process.) A determinable price is "arrived at" by "formula," "a fair, objective measure," or "calculation." This issue was not addressed by the Supreme Court.

b. Was $3 million of life insurance proceeds includable in determining value of decedent's stock? Almost 20 years ago, the Eleventh Circuit said no, reasoning that proceeds were offset by an obligation to use the proceeds to buy stock. *Estate of Blount v. Commissioner*, 428 F.3d 1338 (11th Cir. 2005). The district court and Eighth Circuit disagreed with *Blount* reasoning and considered insurance proceeds as a corporate asset in determining stock value. Eighth Circuit: "In sum, the brothers' arrangement had nothing to do with corporate liabilities. The proceeds were simply an asset that increased the shareholders' equity."

c. U.S. Supreme Court affirmed June 7, 2024, in a unanimous opinion written by Justice Thomas. At oral argument, one Justice said he found the issues in the case "extremely difficult." The Court viewed the issue differently from *Blount*; instead of deciding whether the life insurance is included as a corporate asset in valuing the decedent's shares, the Court said that "all agree that life-insurance proceeds payable to a corporation are an asset that increases the corporation's fair market value." Instead, the issue was whether the corporation's contractual obligation to purchase the decedent's shares "offsets the value of life-insurance proceeds committed to funding that redemption." The Court's analysis is briefly summarized.

   (1) A redemption of shares at fair market value does not affect any shareholder's economic interest. For example, if a $1,000 corporation with 1,000 shares (worth $1 per share) has an 80% and 20% shareholder, assume the 20% shareholder is redeemed for $200. The corporation's value is reduced to $800, but the remaining shareholder's 800 shares are still worth $1 per share.

   (2) No willing buyer purchasing the decedent's shares would have treated the corporation's obligation to redeem the shares at fair market value as a factor that reduced the value of those shares.

   (3) Offsetting value by the amount of redemption obligation values the corporation on a post-redemption basis, but "for calculating the estate tax, the whole point is to assess how much Michael's shares were worth at the time that he died—before Crown spent $3 million on the redemption payment."

   (4) Treating the redemption obligation as a liability cannot be reconciled with the basic mechanics of a stock redemption. The estate argued that the corporation was worth only $3.86 million before the redemption and was worth $3.86 million after the redemption. That "cannot be reconciled with an elementary understanding of a stock redemption."

   (5) The estate argued "that affirming the decision below will make succession planning more difficult" because a corporation would need policies with far more death benefits to have sufficient insurance proceeds to redeem a decedent's shares at fair market value. (Several of the amicus briefs made this same point.) "True enough, but that is simply a consequence of [using a redemption agreement]." Other planning options are available; there are advantages and disadvantages of each of the options, but one result of the redemption arrangement is that insurance proceeds paid to the corporation that are used to fund the purchase will increase the value of the shares.

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

(1) Entity purchase – the parties may feel more comfortable with the entity taking steps to fund the purchase agreement rather than relying on other owners to accumulate funds (or purchase life insurance) to fund a purchase obligation, but the funding in the entity (such as life insurance) may increase the value of the entity (as in *Connelly*); for a corporation, tax considerations include whether the redemption of stock by the corporation will be given sale or exchange vs. dividend treatment.

(2) Cross purchase – the parties must rely on the remaining owners to purchase their interests at death, funding will be outside the entity, not increasing the entity's value at the death of an owner, and a basis step up for the units purchased will be permitted; these advantages are quite significant; if an entity has multiple owners, one approach is to have the owners form a separate partnership to own a life insurance policy on each owner's life rather than having each owner purchase a life insurance policy on each other owner's life. *See* Private Letter Ruling 200747002 (LLC owned life insurance for funding of cross-purchase buy-sell agreement of S corporation, with all shareholders of the S corporation as members of the LLC).

(3) Changing course – for corporations that have already purchased life insurance to fund an entity purchase, the parties may want to restructure the agreement in light of *Connelly* but will face the problem of how to move the policies out of the corporation (distributions will generally be treated as generating dividends). There are no easy answers.

6. Option Agreement Not Recognized for Gift Tax Purposes Under §2703, *Huffman v. Commissioner*, T.C. Memo. 2024-12 (Jan. 31, 2024) [EP112-116]

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

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

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

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

7. Challenges to Validity of Tax Regulations, Supreme Court Rejection of 40-Year Old *Chevron* Doctrine, *Loper Bright Enterprises v. Raimondo*, 603 U.S. __ (June 28, 2024) [EP139-153]

a. The Supreme Court, in a major shift of approach in analyzing the validity of actions of federal agencies (including regulations), overruled a 40-year rule announced in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Six justices joined in the majority opinion (written by Chief Justice Roberts).

b. *Chevron* announced a two-step approach: (1) first, determine if a particular statutory provision is ambiguous ("the statute is silent or ambiguous with respect to the specific issue"), and if so; (2) second, the regulation would be upheld if it is a "permissible" construction of the statute, even if a court would have reached a different interpretation. The Court held that approach is inconsistent with the Administrative Procedure Act (APA), which requires "the reviewing court" to "decide *all* relevant questions of law" and "interpret statutory provisions." (emphasis added, as quoted by the Court).

c. If a statute explicitly authorizes an agency to interpret or provide details about implementation of a statutory provision, courts will consider if the delegation was within constitutional limits and whether the agency acted within the scope of the delegation.

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

e. A dissenting opinion by Justice Kagan, joined by Justices Sotomayor and Jackson (this case actually involved two separate cases and Justice Jackson participated only in the second case) gives various reasons why *Chevron* deference is appropriate and criticizes overruling this 40-year doctrine.

f. Tax regulations have been subject to the *Chevron* analysis (*Mayo Foundation v. U.S.*, 562 U.S. 44 (2011)), and the overruling of *Chevron* may lead to more challenges on the validity of various tax regulations.

g. The Supreme Court followed *Loper Bright* with an opinion several days later saying that the six-year statute of limitations under the Administrative Procedure Act for challenging administration actions would not bar attacks on even very old regulations; the statute does not begin to run until a plaintiff is injured by agency action. *Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, 603 U.S. __, 2024 WL 3237691 (July 1, 2024) (J. Barrett writing for majority; Dissent by J. Jackson, joined by J. Sotomayor and J. Kagan).

h. An example of a case rejecting a tax regulation under the *Chevron* analysis is *Walton v. Commissioner*, 115 T.C. 589 (2000), reasoning that the infamous "Example 5" in the original GRAT regulations was not a reasonable interpretation of the statute.

i. The *Loper Bright* Court did not make clear what standard of review would be applied going forward. The *Skidmore* case (323 U.S. 134 (1944)) before *Chevron* said courts would consider the viewpoint of an agency in light of its thoroughness, reasoning, consistency, and power to persuade. More detail about that standard for reviewing a tax regulation was provided in *National Muffler* (440 U.S. 472 (1979) (factors include whether the regulation carries out the language, origin, and purpose of the statute; if it is a substantially contemporaneous construction; manner in which it evolved; length of time it has been in effect; reliance placed on it; consistency of the Commissioner's interpretation; and degree of Congressional scrutiny of the regulation during subsequent re-enactments of the statute).

j. Possible future implications regarding tax regulations include: (i) more challenges of regulations, (ii) the need for careful attention to procedural details for challenges; (iii) effect of regulations previously found to be valid; (iv) possibly less changing of agency interpretations in regulations; (v) possibly more emphasis on revenue rulings than on regulations; (vi) less declaring victory by regulation (e.g., the "anti-Hubert" regulations); (vii) impact on IRS's approach in administrative proceedings and position regarding settlement; (viii) taxpayer's approach on the relevant tax return, in the tax examination proceeding, and in litigation; and (ix) Congress's approach in crafting details of tax legislation, providing more legislative history, and giving careful attention to any express delegation of regulatory authority.

k. *Loper Bright* will have a transformative impact on administrative law. "The impact of *Loper Bright* on federal courts and agencies, Congress, and parties challenging agency action cannot be underestimated. The opinion will surely give rise to an increase in legal challenges to agency regulations and administrative actions and in forum shopping by litigants wishing to get those cases before their desired judges and circuit courts. Federal agencies will lose the significant advantage in those cases that *Chevron* deference afforded them and they will likely take additional steps in issuing guidance and rulemaking to shore up the foundation and persuasiveness of their regulatory actions." Summary by Miller & Chevalier law firm (Washington D.C.).

8. Administrative Procedure Act; Tax Court Reverses Course and Invalidates Conservation Easement Regulation Under APA, *Valley Park Ranch, LLC et al. v. Commissioner,* 162 T.C. No. 6 (March 28, 2024) [EP118-120]

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

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

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

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

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

9. QTIP Trust Planning, *Anenberg v. Commissioner,* 162 T.C. No. 9 (May 20, 2024) [EP122-132]

a. Background—A "ticking time bomb"; at the spouse's death all assets will be subject to estate tax.

(1) Distributions to spouse followed by freezing transactions

(2) IRS might argue it should ignore unauthorized distributions

- *Estate of Lillian Halpern v. Commissioner*, T.C. Memo. 1995-352 (distributions from general power of appointment marital trust to descendants; spouse consented but the distributions were not authorized; court recognized the distributions that were made when the spouse was competent but did not recognize distributions made after the spouse had become incompetent because a guardian could have set aside the distributions, so those distributions were included in the spouse's estate under §2041)
- *Estate of Hurford v. Commissioner*, T.C. Memo. 2008-278 (beneficiary-trustee made distribution to self, contrary to standards in trust, and sold those assets for private annuity; trust assets included in decedent's gross estate under §2036 and the distributed assets were not excluded from the decedent's gross estate merely because of ascertainable standards in the trust)
- *Estate of Hartzell v. Commissioner*, T.C. Memo. 1994-576 (court rejected IRS argument that assets distributed from marital trust to decedent during her lifetime and given to family were includable in her gross estate because the distributions were improper transfers from the trust; Ohio court would have approved the transfers because distribution standard of "comfort, maintenance, support, and general well being" would include distributions to assist her desire to continue giving gifts to family members to ensure family control of family businesses)
- *Estate of Council v. Commissioner*, 65 T.C. 594 (1975) (IRS argued that trustee did not have the authority to distribute trust assets to spouse for gifting purposes; court stated that the issue was not whether a state court would have approved the distributions beforehand but whether a state court would rescind the distributions after made; conclusion that trustees acted within the bounds of reasonable judgment)
- *United Food & Commercial Workers Unions v. Magruder Holdings, Inc.*, Case No. GJH-16-2903 (S.D. Md. March 27, 2019) (failure to comply with fiduciary constraints regarding trust distributions caused a trust to be treated as a grantor trust for non-tax purposes)
- *SEC v. Wyly,* 2014 WL 4792229 (S.D.N.Y. September 25, 2014) (SEC recoupment case; court reasoned that a failure to comply with fiduciary constraints regarding trust distributions caused a trust to be treated as a grantor trust for non-tax purposes)

(3) Section 2519 addresses the manner in which a transfer tax is applied to QTIP assets when there is a disposition during life rather than at death. For gift and estate tax purposes, §2519 treats a disposition of any of the spouse's income interest as if the surviving spouse transferred 100% of the remainder interests in the QTIP.

(4) *Kite v. Commissioner*, T.C. Memo. 2013-43 (*Kite I*) held that the distribution of QTIP assets to the wife-beneficiary in connection with a sale of the assets by her in return for a deferred private annuity (that was equal in value to the assets that were sold) triggered §2519 resulting in a deemed transfer of the value of the QTIP remainder interest. *Kite II* was an unpublished order on Oct. 25, 2013, finding that the deemed transfer under §2519 could not be offset by assets received by the spouse (i.e., by the value of the deferred private annuity). In fact, the spouse died before receiving any annuity payments.

b. *Anenberg v. Commissioner* was a unanimous reviewed opinion issued just three months after hearing on motions for partial summary judgment

c. Facts. QTIP trusts judicially terminated and distributed to surviving wife (with consent of sons as remaindermen). Five months later, wife gave a small portion to trusts for sons and six months later wife sold all remaining stock of Company to trusts for sons and grandchildren.

d. Opinion emphasized "QTIP regime," purpose to defer transfer tax until spouse dies or makes gift; creates "a legal fiction under which the surviving spouse is treated as receiving all the QTIP"

e. HELD: Termination and distribution to wife did not result in taxable gift of remainder under §2519; whether or not that is a disposition of a qualifying income interest for life that triggers §2519, no taxable gift results because the wife received all QTIP assets and there is no "transfer of property by gift" for the imposition of gift tax under §2501

f. HELD: No deemed transfer of the remainder interest under §2519 applied upon the sale of the assets because following the termination of the QTIP trusts, the qualifying income interest for life terminated, and there could be no disposition of something that did not exist

g. Appears to be a repudiation of *Kite II* (which said the deemed transfer of the remainder interest under §2519 could not be offset by amounts received by the spouse)

h. Whether the sons made a gift by consenting to wife receiving all assets was not addressed

i. Does not apply to commutations, in which the spouse merely receives the value of the income interest; that likely would result in a taxable gift under §2519 of the value of the remainder interest

j. IRS did not make a step transaction claim to treat the termination and sale as an integrated transaction

k. Dividing a single QTIP trust into separate QTIP trusts may minimize the §2519 risk; transfers to the spouse to allow transfer planning by the spouse could be made from just one of the trusts, not risking the application of §2519 to the assets of the other trust. Many PLRs have allowed taxpayers to sever QTIP trusts in anticipation of this type of planning. *E.g.*, Ltr. Rul. 202146001.

l. Planning with large QTIP trusts is difficult. *See* Joy Miyasaki & Read Moore, *Estate Planning Strategies for QTIP Trusts: Do Good Things Come to Those Who Defer?*, AMERICAN COLLEGE OF TRUST & ESTATE COUNSEL 2023 ANNUAL MEETING (March 2023); Read Moore, Neil Kawashima & Joy Miyasaki, *Estate Planning for QTIP Trust Assets*, 44th U. MIAMI HECKERLING INST. ON EST. PLAN. ch. 12 1202.3 (2010).

10. QTIP Trust Planning; Do Remainder Beneficiaries Make a Gift By Consenting to Spouse Receiving All QTIP Assets?, *McDougall v. Commissioner,* Tax Ct. Docket Nos. 2458-22, 2459-22, and 2460-22 (petitions filed February 18, 2022, Judge Halpern) [EP132-134]

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

b. *Anenberg* will significantly impact the §2519 issues in *McDougall*

11. Trust Modification to Add Discretionary Reimbursement Power Results in Gifts by Beneficiaries Who Consent, CCA 202352018 [EP30-34, WU85-92]

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

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

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

d. Changed position from Letter Ruling 201647001

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

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

12. Corporate Transparency Act, Final Regulations, FinCEN Updates, Constitutionality [EP34-42]

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

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

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

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

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

b. Final Regulations regarding beneficial ownership reporting were released September 29, 2022, with an effective date of January 1, 2024. FinCEN posts on its website *Beneficial Ownership Information Frequently Asked Questions* to provide more detail regarding implementation of reporting requirements under those regulations. Recently updated FAQs in 2024 have addressed the reporting requirements for dissolved entities (dissolved entities generally must be reported unless they were completely dissolved before 2024, C.13-14) and have clarified that a single member LLC that is a "disregarded entity" for tax purposes will not be required to obtain its own EIN but can report the Tax ID number of the single member (F.13).

c. Filing Due Dates. Existing companies, 1 year after final regulations effective date (i.e., by January 1, 2025); New companies, 30 days after formation of the entity (this is extended to 90 days for 2024 only [RIN 1506-AB62]); Various legislative proposals introduced in 2023 (H.R. 4035 and H.R. 5119) and in 2024 (H.R. 9278) would extend the due date for reports.

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

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

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

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

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

At least four other cases have been filed in federal courts challenging the constitutionality of the CTA. *Boyle v. Yellen*, No. 24-00081 (D. Maine March 15, 2024) (business owner seeking injunctive relief from CTA for himself); *Small Business Association of Michigan et al v. Yellen et al*, No. 1:24-cv-00314 (W.D. Mich. Mar. 26, 2024); *Gargasz v. Yellen*, No. 23-cv-02468 (N.D. Ohio) (arguing invalidity of CTA and its regulations under the Constitution, the Paperwork Reduction Act, and the Administrative

Procedure Act and seeking nationwide injunction); *Taylor v. Yellen*, No. 2:24-cv-00527 (D.C. Utah July 29, 2024) (Fourth Amendment, Due Process, Congress exceeded authority; right to associate).

g. The AICPA, joined by all state CPA societies, sent a letter to Treasury Secretary Yellen and the FinCEN Director on April 2, 2024, asking that all enforcement of BOI reporting be suspended until one year after "all court cases related to NSBA v. Yellen" are resolved.

h. Legislation to repeal the CTA (S. 4297), the Repealing Big Brother Overreach Act), was introduced on May 9, 2024, by Sen. Tuberville (R-AL), with eleven cosponsors. A companion bill has been introduced in the House by Rep. Davidson (R-OH). The bill has been endorsed by over 100 trade organizations. Rep. Zach Nunn (R-IA) filed a bipartisan bill (H.R. 9278) on August 2, 2024, to delay the reporting deadline by one year.

Filings have been slow so far. At a hearing before the House Financial Services Committee on July 9, 2024, Secretary Yellen said that about 2.7 million businesses had filed to date (of the 32.6 million that are required to file by the end of 2024).

i. **Residential Real Estate Non-Financed Transfers [EP40-42].** Real estate "all-cash" sales in certain geographic areas must currently be reported under the existing Real Estate Geographic Targeting Order program (GTO) under the Bank Secrecy Act. Regulated lenders are excluded because banks already have anti-money laundering (AML) programs and requirements of filing suspicious activity reports (SARs) under the Bank Secrecy Act.

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

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

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

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

(3) **Attorneys as Reporting Persons.** Some commenters believed that attorneys should not be required to report primarily due to concerns about attorney-client privilege and confidentiality requirements. The final rules continue to include attorneys are possible reporting persons. FinCEN does not believe that including attorneys would cause them to violate their professional

ethical obligations because the ABA Model Rules on Professional Conduct allow revealing information "to comply with other law or a court order" and annotations to the Model Rules elaborate that "[t]he required-by-law exception may be triggered by statutes, administrative agency actions, or court rules." If an attorney believes that filing a report would violate the attorney-client privilege, the attorney might allow other parties in the reporting cascade to file the report. FinCEN expects to provide further guidance about situations in which an attorney is concerned about disclosing privileged information or violating the attorney-client privilege.

(4) **Residential Real Estate.** Residential real estate for this purpose would include "single-family homes, townhouses, condominiums, and cooperatives, including condominiums and cooperatives in large buildings containing many such units, as well as entire apartment buildings, designed for one to four families" that are located in the United States. Preamble to Final Rule. Residential real estate also includes "land located in the United States on which the transferee intends to build a structure designed principally for occupancy by one to four families."

(5) **Transferee Trusts; Beneficial Owners of Trusts.** Most types of trusts, domestic or foreign, would be included, because FinCEN believes that transfers to trusts present a high risk for money laundering. The proposed rules specifically referred to revocable trusts. However, as discussed below, the final rules add an exception for gift transfers to certain trusts.

The definition of beneficial owners of trusts is similar to the beneficial ownership rules under the CTA.

(6) **Exceptions (Including Gift Transfers to Certain Trusts).** Various exceptions were included in the proposed rules including certain transfers involving an easement, transfers that occur as the result of the death of the property's owner, transfers that are the result of a divorce, and transfers that are made to a bankruptcy estate. The final rules retain those exceptions, with clarifications, and adds some additional exceptions.

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

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

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

In response to various comments requesting exceptions for estate planning transfers, FinCEN refused to grant a broad estate planning transfer exception (for example, specifically refusing to except transfers where beneficial ownership does not change or where the transfer is an intra family one) because an overly broad exception would be open to significant abuse. Illicit actors are known to use estate planning techniques.

Instead, an exception is provided for (i) gift transfers (ii) by an individual (or an individual and his or her spouse) (iii) to a trust of which the same individual(s) are the settlor or grantor. The preamble explains that this will cover many common transfers for estate planning purposes. Such transfers are a lower risk for money laundering because the true owner is not obscured when the property is transferred.

Sales to trusts would not be excepted from the reporting requirements.

13. Gift Tax Adequate Disclosure, *Schlapfer v. Commissioner,* T.C. Memo. 2023-65 (May 22, 2023) [EP60-67]

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

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

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

d. Statute: "in a manner adequate to apprise the Secretary of the nature of the item" §6501(c)(9) (Taxpayer Relief Act of 1997)

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

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

g. Substantial compliance analysis applies

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

i. This Tax Court case was not appealed.

14. Personal Liability for Unpaid Estate Tax by Successor Trustees and Beneficiaries of Decedent's Funded Revocable Trust, *United States v. Paulson,* 131 AFTR 2d 2023-1743 (9th Cir. May 17, 2023), *cert. denied* (U.S. March 4, 2024) (No. 23-436) [EP98-112]

a. Background regarding personal liability for estate taxes

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

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

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

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

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

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

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

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

f. Practical Planning Tips: (1) Successor trustees should be careful of possible personal liability beyond value of trust before accepting office; (2) Trust distributions may impact beneficiaries' status with creditors and beneficiaries may have to show potential liability on financial statements; (3) Personal liability exposure could last about 25 years after date of death for estate that elects to defer tax under §6166; (4) If estate taxes are unpaid, consider deferring making distributions to trust beneficiaries until after liability exposure period has ended; (5) the IRS may proceed against any beneficiary or trustee (and presumably would pursue ones with deep pockets) [EP107-108]

15. Tax Affecting; Differing Marketability Discounts for Different Block Sizes of Stock, Zero Weight Given to Asset Value in Valuing Ongoing Business, *Estate of Cecil v. Commissioner*, T.C. Memo. 2023-24 (Feb. 28, 2023) [EP83-88]

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

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

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

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

e. Taxpayer's Brief:

> With interest through the trial date, the total demand exceeded $30 million. Respondent left this 84 and 87 year-old couple living with that Sword of Damocles swinging over their heads for nearly two years. [The donors both died before trial.]

> Despite knowing his Notice lacked any rational basis, Respondent stubbornly refused to concede "economic substance" in his Answer, his informal responses, his formal discovery responses, and various motions. For the first time 30 days prior to trial, he tendered an appraisal proving his Notices overstated the tax by at least $22,989,798. Even though he adopted that valuation in his trial memorandum, he never amended his pleadings or admitted he overstated his claims by 90 percent. To this day, he will not concede the words "economic substance" in writing.

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

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

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

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

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

k. Other recent tax affecting cases [EP86]: *Estate of Michael Jackson*, T.C. Memo. 2021-48 (rejected tax affecting because taxpayer's experts had not persuaded the court that the buyers would be C corporations); *Estate of Jones*, T.C. Memo. 2019-101 (allowed tax affecting; "we do not have a fight between valuation experts but a fight between lawyers"); *Kress v. United States*, 123 AFTR 2d 2019-1224 (E.D. Wis. March 26, 2019) (taxpayer's and IRS's appraisers both tax affected earnings; court accepted most of taxpayer's expert's conclusions, including regarding tax affecting)

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

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

n. Other cases that have given no or minimal weight to liquidation value include *Estate of Jones v. Commissioner*, T.C. Memo. 2019-101 (timber valued under income method); *Estate of Giustina v. Commissioner*, 586 F. App'x 417, 418 (9th Cir. 2014) (timber partnership, no weight given to liquidation value); *Estate of Watts v. Commissioner*, 823 F.2d 483 (11th Cir. 1987) (15% interest in general partnership with timberland that could not force liquidation was valued based on its going concern value, not its liquidation value; conclusion based on absence of right to force liquidation, not on the remaining partners' intent to continue the partnership). [EP54, 84-86]

16. *Wandry* Clause Gift Tax Case Settled, *Sorensen v. Commissioner*, T.C. Docket 24797-18, 24798-18, 20284-19, 20285-19 (Decision Entered Aug. 22, 2022) [EP47-53]

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

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

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

d. Planning Observations [EP52-53]

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

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

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

(4) Reporting consistency (stock ledger, distributions, donee acknowledgment of stock power, third parties)

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

(6) Use a grantor trust

17. Assignment of Income and Availability of Charitable Deduction, *Estate of Hoensheid v. Commissioner*, T.C. Memo. 2023-34 (March 15, 2023); *Keefer v. U.S.*, 130 AFTR 2d 2022-5405 (N.D. Tx. August 10, 2022) (denying motion for reconsideration of Order), 130 AFTR 2d 2022-5002 (July 6, 2022) [EP88-98]

a. *Estate of Hoensheid v. Commissioner* [EP88-97]

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

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

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

b. *Keefer v. United States* [EP97-98]

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

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

18. Recognition of Decanting for Tax Purposes, *Estate of Horvitz v. Commissioner*, Dkt. No. 20409-19 (Petition filed Nov. 15, 2019; Order dated Feb. 7, 2023, Judge Gustafson) [EP81-83]

a. QTIP trusts, funded when the predeceased spouse died in 1992, were decanted in 2013 to trusts that expanded the appointees under the surviving spouse's power of appointment to include charities. The surviving spouse died in 2015, having exercised the power to leave $21 million to charities.

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

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

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

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

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

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

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

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

19. Valuation of Life Insurance Policies, *M. Joseph DeMatteo v. Commissioner*, Tax Court Docket No. 3634-21 (Stipulated Decision Feb. 22, 2024) [EP116-117]

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

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

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

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

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

20. Reverse Split Dollar Life Insurance, *Cinader v. Commissioner*, Tax Court Docket No. 13491-22 to 13496-22 & 5245-22 (Stipulated Decision Jan. 3, 2024) [EP117]

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

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

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

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

e. A stipulated decision was entered January 3, 2024, reporting agreed gift tax deficiencies of $3,327,230 for 2002, $99,213 for 2003, $1,424,814 for 2012, $8,433,707 for 2013, $1,527,836 for 2015 (total gift tax efficiencies of $14,812,800) and an estate tax deficiency of $14,298,629.

21. Treatment of Advances to Son as Legitimate Loans vs. Gifts, *Estate of Bolles v. Commissioner*, 133 AFTR 2d 2024-1235 (9th Cir. April 1, 2024) (unpublished opinion), *aff'g per curiam*, T.C. Memo. 2020-71 [EP120-121]

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

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

22. "Patagonia Trusts"; Section 501(c)(4) Organizations [EP73-79]

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

b. Advantages.

(1) No private foundation rules

(2) No public support tests

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

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

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

(6) Tax-exempt entity

(7) Privacy

c. Disadvantages

(1) No income tax charitable deduction

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

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

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

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

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

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

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

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

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

b. *Estate of Michael Jackson*, T.C. Memo. 2021-48 (valuation of publicity rights; undervaluation penalties; tax-affecting not appropriate because taxpayer's experts had not persuaded the court that the buyers would be C corporations) [EP85]

c. *Nelson*, T.C. Memo. 2020-81, *aff'd*, 17 F.4th 556 (5th Cir. 2021) (appeal: assignments were not defined value transfers based on finally determined values) [EP47]

d. *Estate of Moore*, T.C. Memo. 2020-40, *aff'd* 124 AFTR 2d 2021-6604 (9th Cir. 2021) (transfer to FLP included under §2036; discussion of §2043; charitable formula transfer not recognized by Tax Court; affirmed, but on narrow grounds) [EP56]

e. *Estate of Warne*, T.C. Memo. 2021-17 (valuation of majority interests in LLCs owning real estate [4% LOC & 5% LOM discounts]; charitable deduction based on values passing to each separate charity) [EP58-59]

f. *Estate of Levine*, 158 T.C. No. 2 (2022) (intergenerational split dollar life insurance in trust; mother advanced $6.5 million for premiums; unrelated business associate controlled insurance for ILIT and he alone (not in conjunction with decedent) could terminate the split dollar arrangement early; Sections 2036, 2038 not applicable because of fiduciary duties and mere ability to amend contract was not "in conjunction with" under §§2036(a)(2) and 2038); Section 2703 not applicable) [EP57]

g. *Estate of Morrissette*, T.C. Memo. 2021-60 (no §2036, 2038 or 2703; valued reimbursement rights with very little discount; undervaluation penalties applied despite reputable appraisals) [EP57, 60, 114-]

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